COMMENT

THE BANKRUPTCY OF THE ZHU KUAN GROUP:
A CASE STUDY OF CROSS-BORDER
INSOLVENCY LITIGATION AGAINST
A CHINESE STATE-OWNED ENTERPRISE

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1. INTRODUCTION

The collapse of Zhu Kuan Development Company Limited ("ZKG") was the second largest bankruptcy in the history of the People's Republic of China ("PRC"). The face-off between Zhuhai Municipal Government's ("ZMG") collapsed window company ZKG and its creditors began nearly five years after the People's Republic of China ("PRC") initiated its efforts to clean up state-
owned window companies plagued by mismanagement, poor corporate disclosure, corruption, and other illegal activities followed.

4 See Associated Press, supra note 2 (discussing corporate malpractice and ill-advised investments in China); Jane Moir, Zhuhai Unit Faces Collapse, Creditor Banks Are Threatening to Liquidate Zhu Kuan Group After Getting an 'Insulting' Debt Restructuring Offer, S. CHINA MORNING POST, July 19, 2003, at 1, available at 2003 WLNR 5863317 (describing mismanagement of investments and reckless investments in China); see also Matt Miller, Macau Bid to Unravel Zhu Kuan Debt Tangle, THE STANDARD, May 6, 2004, available at 2004 WLNR 9989539 (asserting that many Chinese local government conglomerates were run very poorly).

5 See Jianbo Lou, China's Bank Non-Performing Loan Problem: Seriousness and Causes, 34 INT'L LAW. 1147, 1173 n.167 (2000) (noting that generally poor disclosure practices in the PRC, including at State Owned Enterprises ("SOEs"), make it difficult for creditors to determine when to initiate bankruptcy proceedings SOEs); Mark E. Monfort, Reform of the State-Owned Enterprise and the Bankruptcy Law in the People's Republic of China, 22 OKLA. CITY U. L. REV. 1067, 1106-07 (1997) (underscoring the failure of corporate disclosure practice in SOEs by noting the lack of reliable information); Xian Chu Zhang, The Old Problems, the New Law, and the Developing Market – A Preliminary Examination of the First Securities Law of the People's Republic of China, 33 INT'L LAW. 983, 989 n.57 (1999) (describing the PRC corporate environment as conducive to SOE failures to disclose and—even more strikingly—blatant fraud, and describing a case in which a company failed to disclose significant interests over two years).


7 See Associated Press, supra note 2 (discussing illegal lending and corporate malpractice by Chinese companies listed on domestic exchanges); Executions, Crime Reported in China, BBC MONITORING INT'L RTS., Sept. 13, 2002, at 1, 1-3, (discussing punishment meted out for various corrupt practices, illegal issuance of bonds, and related activities); Tom Mitchell, Vice-Governor May Find Ghosts Not His Only Problem, S. CHINA MORNING POST, Apr. 10, 2001, at 6, available at 2001
Following Guandong International Trade and Investment Corporation's ("GITIC") $4.7 billion bankruptcy in 1999, the largest ever in the PRC. Despite these red flags (sometimes apparent, sometimes not), window companies had little trouble obtaining loans, thanks to the assumption by large international banks that they had one of the best kinds of insurance you could get: state backing. Despite the central government's warnings that these assumptions were invalid, local state actors readily encouraged them.

During the mid-1990s, many local governments in the PRC had to put their prized infrastructural projects on hold while funding was scant. The only places to obtain funds were from domestic banks charging high interest rates or from cumbersome equity in-

WLNR 3759361 (noting illegal deposit taking, illegal lending, and financial irregularities); Nhu-Nguyen Ngo, The Chinese Cycle: Between Overheating and Overcapacities, CONJONCTURE, May-April, 2004, at 22, available at http://economicresearch.bnpparibas.com/applis/www/RechEco.nsf/ConjonctureDateEN/1730DCC9555CDF2DC1256E8A0046D0E6/$File/C0404_A2.pdf?OpenElement (last visited Apr. 1, 2006) (noting the incumbent advantages and abuses of the Chinese quasi-state-owned banking system). See also Michele Lee, Note and Comment, Franchising in China: Legal Challenges When First Entering the Chinese Market, 19 AM. U. INT'L L. REV. 949, 985 (noting that rules go unenforced at the regional level because local officials gain financially from the furtherance of illegal activity); Leahy, supra note 1 (implying that ITICs are "examples of Asia's corporate miscreants."); Benjamin L. Liebman, Watchdog or Demagogue? The Media in the Chinese Legal System, 105 COLUM. L. REV. 1, 30-31 (2005) (noting that most cases of illegal activities are among those with connections to officials, just like the connections between Zhu Kuan Development Company Limited ("ZKG") and Zhuhai Municipal Government ("ZMG"); id. at 73 n.133 (discussing the illegal activities of construction enterprises).


9 See Associated Press, supra note 2 (noting that Guandong International Trade and Investment Corporation's ("GITIC") bankruptcy was the largest in China).

10 See Miller, supra note 4, at 1 ("[M]any local government conglomerates . . . were able to entice international investors to pour millions of dollars into them.").

11 See Associated Press, supra note 2, at 1 ("GITIC's failure highlighted the risks of investments in government-backed ventures that lenders had assumed would be guaranteed by the state but in fact were not."); Moir, supra note 8, at 16 (discussing the legacy of the collapse of government-owned window companies).

12 See Sophie Roell, Zhuhai Deal May Soften State Stance on Financing, FIN. TIMES, Aug. 2, 1996, at 24 ("Under central government guidelines, foreign borrowing for infrastructure should be on the basis of the economic viability of projects, rather than the support of the state.").

13 I will use "local" to refer to any governmental subdivision smaller than the PRC central government.
vestments from central government backed financial institutions. The PRC had traditionally allowed little flexibility in procuring financing from abroad, worried about its own potential foreign debt obligations should it have to foot the bill and also about uncreditworthy entities driving up the costs of borrowing. The PRC, looking to ease the infrastructure financing crunch and relieve the burden of the PRC’s floundering banking industry, gradually became more flexible, allowing more and more companies to seek funding abroad despite the potentially higher costs. Presented with this opportunity, local governments, in addition to issuing securities abroad, also sought loans from international banks.

In the 1990s these banks were eager to “pave the way” for market entry into the PRC, regarded by many as the world’s biggest market, by developing strong guanxi in the PRC with whoever they could. This led to what, in retrospect, can be called reckless lending to state-owned window companies of questionable financial status, ZKG included. The repeated collapses of such state-owned window companies during the late 1990s left many banks that had lent to these SOEs—both international and domestic—burnt.

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15 Leahy, supra note 1, at 18.
16 Roell, supra note 12, at 24.
17 Gesteland, supra note 14.
18 Moir, supra note 8.
20 Moir, supra note 3; Moir, supra note 8.
21 Moir, supra note 8, at 16. See also Miller, supra note 4 ("[ZKG’s liquidation] could be the closing chapter for one of the last of China’s many debt-plagued in-
This comment will seek to tell the story of the Zhu Kuan case and draw out the lessons learned by creditors from the case by fitting it into the larger picture of PRC cross-border insolvency. It will begin with a comprehensive review of the Zhu Kuan case. First, I will discuss ZKG’s development in the context of aggressive development policies by ZMG. I will begin the look at ZKG’s financial difficulties through three cases involving ZKG subsidiaries: the ZHC’s bonds, ZKD’s stock, and the Glencore debt scandal involving ZKT. After looking at these specific cases, I will take a broader look at the reasons for ZKG’s financial difficulties. From there I will discuss the dispute between ZKG and its creditors, starting with pre-liquidation negotiations in 2000 through its termination in 2005. I will then analyze the most prominent legal problems reflected in the case and finally conclude with some of the apparent practical lessons.

2. FACTS

2.1. ZKG’s Development

2.1.1. ZMG’s developmental planning

Zhuhai City, with a population of over 1.2 million,22 is in Guangdong Province adjacent to Macau and just across the Pearl River Delta from Hong Kong. In 1979, the central government designated Zhuhai one of the first four special economic zones and trading companies that lured foreign investors to their ruin in the mid-1990s.”); Moir, supra note 3, at 1 (“[M]ost banks in the region are familiar [with debtors’ bankruptcies] as several international trust and investment corporations—or ITICs—across the mainland have faltered to various degrees following the onset of the Asian financial crisis.”). GITIC was placed into bankruptcy in 1999 by PRC authorities with US$4.7 billion in debt. Guangdong Enterprises (Holding) staved off bankruptcy with “a tortuous workout” that saw HKD 3.5 billion in debt restructured after their 1998 collapse. Moir, supra note 8. There is also suspicion that this pattern may be starting in the private sector. See Moir, supra note 8, at 16 (“[T]he fear is that similar problems are emerging with many mainland private enterprises. Standard Chartered, for example, was one of several lenders involved in a syndicated loan to Far East Pharmaceutical Holdings, whose chairman vanished across the border. A large hole was subsequently discovered in Far East’s accounts.”).

Zhu Kuan Group Bankruptcy

Zhu Kuan Group Bankruptcy ("SEZs"). Zhuhai succeeded in getting this designation due to its proximity to Macau in an effort to exploit the potential of bringing investment to the PRC from or via Macau. SEZs, Zhuhai included, enact their own unique regimes of local regulations and thus have economic systems and policies that differ from those the central government applies to the rest of the PRC. While there is a strong argument to be made that the SEZs were extremely successful, Beijing's divestment of power undoubtedly left the SEZs large leeway to create their own successes or failures.

Zhuhai's plan was ambitious. Liang, Zhuhai's mayor from 1983 to 1998 and concurrently Zhuhai Communist Party Secretary, had aggressive goals to transform Zhuhai through massive infrastructure projects funded from wherever funding was to be had. Much of ZKG's debt financed these projects of this "Mayor of Roads and Bridges," as Liang came to be known. Liang, who

23 Concerning the Establishment of Special Economic Zone in Guangdong Province, (promulgated by the Standing Comm. Nat'l People's Congress, effective August 26, 1980) available at ISONOLAW 503-131795. See John Zhengdong Huang, An Introduction to Foreign Investment Law in the People's Republic of China, 28 J. Marshall L. Rev. 471, 471-72 (1995) (explaining that, in SEZs, investors benefit from tax breaks, a reduction in administrative hurdles, duty-free imports of equipment needed to set up factories, as well as other various benefits). See also The Rise and Rise of an SEZ, Hong Kong Imail Emerging Markets Datafile, Jan. 23, 2002, available at LEXIS 200201233920.m20 (noting that the other four 1979 SEZs were Shantou [in eastern Guangdong], Shenzhen [adjacent to Hong Kong], and Xiamen [adjacent to Taiwan]).

24 In explaining the choice, Deng Xiaoping said, "[w]hen we decided to establish the four special economic zones in 1979, we chose them mainly on the basis of their geographical advantages. Shenzhen is adjacent to Hong Kong, and Zhuhai is close to Macao. We chose Shantou because there are many natives of nearby Chaozhou living in Southeast Asian countries. Xiamen became a special economic zone because many natives of southern Fujian have emigrated to other countries and gone into trade." Deng Xiaoping, Remarks Made During an Inspection Tour of Shanghai (Jan. 28-Feb. 18, 1991), available at http://english.peopledaily.com.cn/dengxp/vol3/text/d1180.html (last visited Apr. 1, 2006).


26 See id. at 131-32 ("[M]any observers attribute much of the success of China's economic reform and its exciting economic development to the achievements of the SEZs and the coastal cities."). See also Daniel J. Brink and Xiao Lin Li, A Legal and Practical Overview of Direct Investment and Joint Ventures in the "New" China, 28 J. Marshall L. Rev. 567, 571 (1995) ("Provinces [with SEZs] have experienced tremendous changes and stunning economic development.").

27 Miller & Clifford, supra note 3 (explaining that Liang's namesake derived from the infrastructural building spree that took place in Zhuhai under Liang's
stepped down in 1998, had begun a trend that resulted in US$13 billion being throttled into infrastructure, including some of the PRC’s most well-known white elephants. Nevertheless, Liang was largely successful in transforming Zhuhai, which now has a GDP of US$5 billion and is the PRC home of the operations of an array of multi-national corporations. However, by the time he stepped down, it had become clear that Zhuhai “was in serious financial trouble and Liang’s recklessness was part of the cause.”

Zhuhai has not yet shed any of their grand ambitions despite the financial difficulties. In 2002, ZMG proclaimed that Zhuhai would become the “Riviera of China” in a plan that would cost RMB 10 billion. While the soppy marketing scheme still lingers on the Internet, the investment plan itself and others fizzled out as ZMG’s financial difficulties gradually came to light. ZMG’s current development plan consists of a long list of Party-approved platitudes that manages to be vague and grand in one stroke.

28 Miller and Clifford note that:

Liang’s reach eventually exceeded his grasp. He built a high-performance motor speedway, but the Formula One event he lobbied for never arrived. He constructed an [US]$800 million international airport, but never received Beijing’s permission to land overseas flights there. Today, the little-used facility is one of China’s most notorious white elephants, serving fewer passengers in a year than Hong Kong does in a week. Under Liang, Zhuhai even started construction on a 30-kilometer bridge and causeway complex to span the mouth of the Pearl River and connect Zhuhai to Hong Kong. In the end, the bridge stopped at an island just 3 km from Zhuhai.

29 Id.

30 Id. (quoting Joseph Cheng, Chair Professor of Political Science, City University of Hong Kong).

31 Moir, supra note 3.

32 See, e.g., At East by the Sea – A Zhuhai Idyll, SHANGHAI STAR, May 24, 2003, available at http://www.china.org.cn/english/travel/65366.htm (list visited Apr. 1, 2006) (“The romance of Zhuhai can be seen at first glance from the flowers blooming everywhere but especially when you notice that the name of the street you’re walking down means ‘Lover’ in Chinese.”).

33 Moir, supra note 3.

34 The “Basic Development Concept and Target” of the ZMPC and the ZMG consists of:

[Pl]ushing forward the new-style industrialization, optimizing economic
However, various past investment plans have turned out to be miserable failures or were not even able to be completed. With this record of failures belying a precarious financial state, any progress towards lofty goals is questionable.

2.1.2. ZKG's history and business

According to suspiciously legend-like reports in PRC state-owned media, ZKG began humbly as a mere teahouse in 1980 with only HKD 2,000 in capital.35 ZMG began to mold ZKG into its current form when the PRC began urging local governments to set up their own foreign trade representative offices to deal directly with foreigners in the mid-1980s.36 With this imprimatur from Beijing, on February 13, 1988, ZMG incorporated ZKG in Macau for the sole purpose of financing investment in Zhuhai from Macau,37 and, four years later on May 19, 1992, ZMG incorporated ZKG subsidiary ZKHK in Hong Kong to play the same role in relation to Hong Kong.38 In an August 19, 1995 letter of undertaking to SCB, ZMG described ZKG and ZKHK as "economic and trading entities rep-
resenting [ZMG]" but in actuality they behaved as investment holding companies, conducting business primarily through subsidiaries in an array of industries. Especially prominent was ZKG's key role in financing a wide array of infrastructure projects in Zhuhai. Nevertheless, ZKG had no business that generated a substantial cash flow. Its core asset was land from its real estate activities, worth nearly RMB11 billion, of which 73% was in Zhuhai, 23% in Macau, and the remainder in Hong Kong.

Over the years, ZKG's activities spanned a broad range of business activities. Its principal businesses were its real estate activities in Zhuhai, Hong Kong and Macau; trading operations, mainly in Zhuhai and Macau; tourism ventures in Zhuhai and Macau, such as water parks, theme parks, and hotels; and civil engineering, primarily in Macau. Other business activities included automobile services; light industry, including manufac-

40 Id. para. 9.
41 For the array of industries, see infra figure 1.
42 Miller & Clifford, supra note 3.
43 Moir, supra note 3.
44 Moir, supra note 3.
46 Moir, supra note 3; RSM, supra note 37, para. 8.1.
49 Moir, supra note 3.
51 Jane Moir, $4b Loan to Zhuhai Uncovered; Accounts of the Government's Window Company Zhu Kuan Group Show that $7b is Owed to Banks, S. CHINA MORNING POST, Aug. 2, 2004, at 1, available at 2004 WLNR 6014562; RSM, supra note 37, para. 8.3.
53 Debbie Chu, Tax Drives Down Orders for Mercedes, S. CHINA MORNING POST,
turing, manufacturing, building materials, and electronics; infrastructure, such as water plants, waste treatment plants, bridges, highways, and telecommunications; and air, water, and land transportation.

2.1.3. Structure of the ZKG conglomerate

ZKG was set up as an investment holding company and conducted business only through subsidiaries, encompassing some fifty companies in Zhuhai, Macau, and Hong Kong, seventeen of which were in Hong Kong. ZKG itself was incorporated in Macau in 1988 and is 100% owned by ZMG. ZKG's most significant subsidiary, ZKHK, is involved...
in thirty businesses, with more than a dozen in Hong Kong.\textsuperscript{70} Tourism subsidiary ZKD (renamed JZD in November 2004)\textsuperscript{71} was listed in Hong Kong in 1998.\textsuperscript{72} The following is a summary of the structure of the major companies relevant to ZKG's bankruptcy.

**Figure 1: Structure of Selected ZMG-Owned Companies**\textsuperscript{73}

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\textsuperscript{72} Associated Press, supra note 2.

2.1.4. ZMG's explicit backing of ZKG and subsidiaries

Generally, government backing of window companies was implicit.\textsuperscript{74} While the assumed implicit backing was certainly at play here, ZMG was nonetheless more than willing to make it explicit when it suited its purposes. ZKD was "given full support by the Zhuhai Municipal Government in its development, acknowledging its status as the only conglomerate supported by the Zhuhai government to be listed on the Stock Exchange of Hong Kong."\textsuperscript{75} In defending ZKD's record-low issue price, Cai reiterated that "the company had the support of the Zhuhai government to become its only diversified listed arm abroad."\textsuperscript{76} After the ZKG subsidiary ZKT's Glencore debt scandal,\textsuperscript{77} Yu said, "I think the share price will not come under pressure [from the scandal] because our company has quality assets and is supported by the Zhuhai government."\textsuperscript{78} Yu naturally failed to point out that both ZKG and ZKT had had the backing of ZMG. Nevertheless, strongly pushing ZMG "support" as an asset, and despite never clearly explaining what that support comprised, ZKD was able to raise huge amounts of money.\textsuperscript{79} There were even numerous cases of explicit backing that involved what were in effect guaranties from ZMG. From 1994 to 1999, ZMG issued letters to creditors that again stated ZMG's support for ZKG's development but went further, stating that ZMG would cover any loss suffered by the creditors in certain instances.\textsuperscript{80} This would have accounted for some HKD 2.2 billion of the debt.\textsuperscript{81} ZMG ultimately reneged on this, infusing cash enough only to cover about $1 billion beyond the debt that ZKG had previ-

\textsuperscript{74} Adam Luck, Western Banks Hit by Pounds 500m Corporate Collapse in China,\textit{ The Sunday Times} (U.K.), June 6, 2004, at 11, 2004 WLNR 5387985; Miller & Clifford, supra note 3.

\textsuperscript{75} David Evans, Zhu Kuan Distances Itself from Debt Case,\textit{ Hong Kong Standard}, May 26, 1988, available at LEXIS News & Business, Country & Region (excluding U.S.), Asia/Pacific Rim Archive News. See also Lana Wong, Mystery Note Claiming Dishonoured Debts Targets Zhu Kuan Debut,\textit{ S. China Morning Post}, May 26, 1998, at 3, available at 1998 WLNR 3261776 (noting the company's comment that it was supported by the Zhuhai government).

\textsuperscript{76} Id.

\textsuperscript{77} See infra section 2.2.3.

\textsuperscript{78} Id. supra note 75 (emphasis added).

\textsuperscript{79} Evans, supra note 75 (emphasis added).

\textsuperscript{80} Wong, supra note 75; see also infra section 2.2.3.

\textsuperscript{81} RSM, supra note 37, para. 61.1.
ously offered to pay off.\textsuperscript{82}

### 2.1.5. Incestuous relationship between ZMG and ZKD leadership

As the owner of ZKG, ZMG had the ultimate decision-making power when it so desired. ZMG took advantage of this power over ZKG and other fully owned enterprises, such as LSG, to run the show from backstage during ZKG’s bankruptcy.\textsuperscript{83} This was made even easier by the ambiguous separation between ZMG and ZKG. ZMG officials with no positions whatsoever in ZKG were often involved in ZKG decision making processes, such as debt restructuring negotiations with Wang.\textsuperscript{84} muddying up the waters of where the line between ZMG and ZKG should be drawn. To further cloud the waters, officials of ZMG often served as the executives in ZKG and its subsidiaries.\textsuperscript{85} Cai, for example, was both the chairman of ZKD and a vice-mayor in ZMG.\textsuperscript{86} Finally, cementing ZMG’s interest in ZKG, ZMG officials held various pecuniary interests in ZKG companies.\textsuperscript{87}

\textsuperscript{82} See infra sections 3.1.4, 3.2 and 3.3.
\textsuperscript{83} RSM, supra note 37, para. 60.
\textsuperscript{84} See Moir, supra note 4 (“There is also a concern that the company has said it will pay off creditors by pledging some of its assets in Zhuhai owned by the government to local banks.”).
\textsuperscript{85} Jane Moir, Zhuhai Government Tries to Grab Big Slice of Zhu Kuan, S. CHINA MORNING POST, Sept. 9, 2003, at 1, available at 2003 WLNR 5913333.
\textsuperscript{86} Lana Wong, Zhuhai Government’s Hotel Arm Sees Profit Jump 35pc, S. CHINA MORNING POST, Sept. 23, 1998, at 2, available at 1998 WLNR 3257433. Other directors in ZKG who had previously held positions in ZMG included He Weilong (Chief-in-Charge, Vice Office Director and Office Director of ZMG), Leong Hok Peng (Town Master and Deputy Party Secretary of Qianshan Town of Xiangzhou, Zhuhai, and Vice Office Director of Foreign Trade and Economic Cooperation Committee in Xiangzhou, Zhuhai), Liang Caijia (Chief-in-Charge of the Department of Corporate Finance Administration of the Financial Bureau of Zhuhai and Chief-in-Charge of the Department for Finance Administration of Government Backed Business of the Financial Bureau of Zhuhai), and Ouyang Guoliang (General Secretary of ZMG and Vice Office Director of the Management Commission of Zhuhai SEZ). RSM, supra note 37, para. 62.
\textsuperscript{87} See Interim Report 2003, Zhu Kuan Development Company Limited (Jan. 14, 2004), at 34, http://www.hkex.com.hk/listedco/listconews/sehk/20040121/00908/EWF101.pdf (listing directors, most of whom hold or have held positions in ZMG, other ZKG entities, or both, that have exercised the largest share options).
2.2. Three Cases Studies

2.2.1. ZHC bonds

ZKG tapped into international debt markets with the first PRC overseas junk bond,88 issued by ZHC in the United States to institutional investors in 1996.89 The bonds were issued despite the lack of any relevant PRC law to protect creditors' interest, and thus relied heavily on ad-hoc contract-made "law."90 Nevertheless, the bonds were three times oversubscribed,91 raising $200 million92 in two tranches, a $85 million 9.125% ten-year senior tranche rated Baa3-BBB and a $115 million 11.5% twelve-year subordinated tranche rated Ba1-BB.93 The bond was a non-recourse loan, meaning no government backing, secured by vehicle registration fees and road tolls in Zhuhai.94 All government entities, ZMG included, steered clear from any direct guarantees. ZKG, however, pledged support should there be an interruption in the revenue stream or if the company had difficulties in finding foreign currency to service its obligations.95 ZKG's promise, in light of the blurry lines between themselves and ZMG, seemed to imply ZMG support despite ZMG not making any explicit guarantee.

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88 Miller, supra note 4.
91 Morag Forrester, China is the Silver Lining, GLOBAL FINANCE, Aug. 1997, at 34. available at http://www.findarticles.com/p/articles/mi_qa3715/is_199708/ai_n8761526 (last visited Apr. 1, 2006).
95 Roell, supra note 12.
Four years later, S&P had lowered the rating to junk bond status following the Asian financial crisis and a period of slower growth,96 and after ZKG's defaults against banks97 and the Glencore scandal98 had shaken creditor confidence. Nevertheless, some analysts were still looking at ZHC's bonds as a good investment. DebtTraders Inc., a Hong Kong based financial services firm wrote:

We believe [ZHC's] senior notes offer an attractive investment opportunity for investors in distressed securities seeking exposure to the toll-road sector in China. . . . The terms of the senior notes offer solid protection in case of a default. Even under our worst-case scenario, there will be more than sufficient funds available from underlying toll revenues to fully repay holders of senior notes.99

Analysts such as this one seemed to have had a predisposition to ignore the emerging problems of such government-related investments by still recommending a buy.

Investors who bit this line would ultimately find themselves hurting. ZHC had relied on optimistic predictions of future revenues based on an "extraordinary" revenue expansion in the mid-1990s when issuing the bond,100 but an economic slowdown resulted in lower vehicle registrations and lower traffic volume than predicted.101 ZMG aggravated the situation further by refusing to implement indenture-mandated annual increases in vehicle registration fees102 due to political pressures and a deflationary environment.103 ZMG even further aggravated the situation by misappropriating for its own use a portion of tolls collected rather than

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96 Gesteland, supra note 14.
97 See infra section 2.3.
98 See infra section 2.2.3.
99 Gesteland, supra note 14.
102 Id.
103 Id. Had ZMG implemented the increases, it would have had fees higher than surrounding municipalities. Id.
place it into the indenture-mandated trust fund.\textsuperscript{104} ZMG said shortfalls would be made up with subsidies and it was unclear whether this ever happened as of 2001.\textsuperscript{105} Given ZMG's financial state as seen through ZKG, and despite past subsidies,\textsuperscript{106} it is extremely doubtful that ZMG had sufficient funds to allocate to a subsidy. Regardless, the financial situation of ZHC would force bond maintenance to be subject to the willingness of ZMG to issue subsidies,\textsuperscript{107} hardly reliable given ZMG's various financial problems. Nor did funding from ZKG materialize, despite ZKG's contractual obligation.\textsuperscript{108} In fact, the threat of a cross-default from ZKG's debts loomed large.\textsuperscript{109}

In July 2000, ZHC defaulted on the subordinated bonds and soon defaulted on the senior bonds as well.\textsuperscript{110} By 2001, both tranches of ZHC bonds had been downgraded to S&P's lowest possible rating, effectively declaring the firm to be in default.\textsuperscript{111} Bondholders soon began putting further pressure on ZKG and ZMG finances. In April 2001, bondholders, pursuant to the indenture, issued a notice of acceleration to ZMG for immediate payment of the principal and all interest accrued. Trustee CMB distributed to bondholders US$25.6 million held in its accounts as per the notice of acceleration.\textsuperscript{112}

Expectedly, the acceleration payment was not received.\textsuperscript{113} Talk also arose of lawsuits,\textsuperscript{114} but to date none have come to fruition. Ultimately, bond holders felt compelled to sell off their holdings as part of workouts structured by companies specializing in distressed debt.\textsuperscript{115}

\textsuperscript{104} Id.
\textsuperscript{105} Gesteland, supra note 14.
\textsuperscript{106} Highway Rtgs, supra note 100.
\textsuperscript{107} Id.
\textsuperscript{108} S&P Lowers Rating, supra note 101.
\textsuperscript{109} Highway Rtgs, supra note 100.
\textsuperscript{110} S&P Lowers Rating, supra note 101.
\textsuperscript{111} Gesteland, supra note 14. The rating of D is S&P's lowest possible rating.
\textsuperscript{112} S&P Lowers Rating, supra note 101.
\textsuperscript{113} Id.
\textsuperscript{114} Highway Rtgs, supra note 100; S&P Lowers Rating, supra note 101.
\textsuperscript{115} Angela Mackay, Asia's Crisis Has Meant Big Returns on Distressed Debt, FIN. TIMES, Apr. 7, 2003, at 23.
2.2.2. ZKD stock

ZKG tapped into international equity markets with a public listing of ZKG subsidiary ZKD in Hong Kong in 1998.\textsuperscript{116} Two years after ZHC's bond issue, the market tore into this stock issue with fervor: ZKD raised about HKD 142.38 million by selling 126 million shares at HKD 1.13 each\textsuperscript{117} to strategic and professional institutional investors and forty-two million shares\textsuperscript{118} in an IPO that was 10.13 times oversubscribed.\textsuperscript{119} As ZKG's financial difficulties came to light and ZKD's bottom line suffered (see table below), ZKD's stock took a dive and now hovers at nearly one-third of the initial price.\textsuperscript{120}

Table 1: ZKD (JZD) Performance Statistics

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit (HKD million)</th>
<th>Sales (HKD million)</th>
<th>Operating Profit (HKD million)</th>
<th>Earnings per Share (HK$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Six Months to October</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004\textsuperscript{121}</td>
<td>12.1</td>
<td>114.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003\textsuperscript{122}</td>
<td>1.7</td>
<td>93.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002\textsuperscript{123}</td>
<td>4.808</td>
<td>111.191</td>
<td>0.533</td>
<td>0.0060</td>
</tr>
<tr>
<td>2001\textsuperscript{124}</td>
<td>23.952</td>
<td>147.469</td>
<td>23.952</td>
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\textsuperscript{117} Wong, supra note 75.

\textsuperscript{118} Wong, supra note 73.


\textsuperscript{120} JZD, as ZKD had been renamed, traded around HKD 0.43 in March of 2005. Main Board and Trading Only Stocks Daily Quotations, The Stock Exchange of Hong Kong Limited, Mar. 15, 2005, at http://www.hkex.com.hk/markdata/quot/d050315e.htm (last visited Apr. 1, 2006).
As provisional liquidator, RSM was seeking to stake out a claim over the 71.7% of ZKD shares owned by ZKHK and PIV and negative media reports prompted ZKD to suspend trading in its shares. ZKD proposed a general mandate to buy back up to 10% of its shares and issue or allot up to 20% in new stock, all


122 Id.


124 Id.


127 Id.

128 Id.


130 Id.


without telling the 29.3% of non-ZKG shareholders that PIV was subject to a winding-up petition. While not explicitly stated, the purpose of the new stock moves seems to have been to either raise money to pay off debts or to dilute RSM’s potential stake in ZKD. Given the weakened price of ZKD’s stock and the wording of the proposal, the latter seems the more likely of the two. Moreover, this proposed new issuing was despite a HKD 6.4 million loss during 2002-2003 following a HKD 20.2 million profit during 2001-2002.139 ZKD sought approval at its general meeting on September 26. It seems the plan would be to attempt to buy back 10% from ZKHK, for whom RSM has not yet perfected its claim, and issue new stocks to those under ZMG’s control but not part of the ZKG bankruptcy. Assuming the full percentages requested were used, and depending on which was done first, ZMG could have potentially reduced RSM’s share from a maximum 71.7% to either 57.1% or 55.3%.

Although media reports regarding the liquidation proceedings were abundant, ZKD only came to reveal the full extent of the issue in a warning to investors after ZKG had been declared bankrupt in Hong Kong, stating:

sehk/20030828/00908/EWF104.pdf (last visited Apr. 1, 2006).

135 Id. at 6.
136 Moir, supra note 85.
137 Before suspension, ZKD’s stock was last traded at HKD 0.294. HK’s Zhu Kuan Development Suspended Pending Clarification of Press Reports, AFX - ASIA, Aug. 15, 2003, available at LEXIS News & Business, Country & Region (excluding U.S.), Asia/Pacific Rim News, Current. See also Audrey Parwani, We Will Pay Our Debt, Says Zhu Kuan, S. CHINA MORNING POST, May 27, 1998, at 1, available at 1998 WLNR 3242827 (stating that ZKD’s stock was issued at HKD 1.13 and reached a high of HKD 1.42).
138 The proposal grants directors a variety of options regarding new shares “subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements” and allows them to direct these “to officers and/or employees of the Company and/or any of its subsidiaries and/or any eligible grantees pursuant to the scheme of shares or rights to acquire shares of the Company,” providing ample leverage to exclude any shares controlled by RSM in future plans regarding the issuing of new stock and thereby diluting the stake controlled by the creditors. Notice of Annual General Meeting, supra note 134, at 5–6.
140 Moir, supra note 85.
Though the winding up of Zhu Kuan Group and Zhu Kuan (Hong Kong) does not automatically render the above share charges to be varied or void, there arises additional uncertainty in such matter . . . . If there is a change in the registered holder of the Pioneer charged shares or in the beneficial owner and/or registered holder of the shares held by Zhuhai Industrial and charged to Bank of China, there may be a change in the composition of the board of directors of the company and/or change in the business of the group.

Nevertheless, ZKD had no intention of letting RSM take control of the shares if they still had the means to prevent it. In September 2003, RSM, having already laid claim to a 42.2% stake from PIV, attempted to appoint three new directors to the board of ZKD at ZKD's annual general meeting. To RSM's shock, ZKD directors barred them from voting on PIV's behalf because, according to ZMG and based on advice from Chiu & Partners' Grace Chan, LSG held the stakes' voting rights as the holder of the mortgaged shares. ZKD, apparently fearing that the meeting would turn acrimonious, had both security guards and video cameras keeping an eye on the proceeding. The issue of stock ownership appears to never have been resolved independent of the final settlement.

2.2.3. The Glencore debt scandal

A dramatic early sign of ZKG defaulting on debts, and a portender of how ZKG would behave when facing debt for which they were unwilling or unable to pay, came just before ZKD's IPO. An anonymous letter was faxed to the press claiming that ZKG had failed to honor a US$2.5 million debt to Switzerland-based Glencore International, one of the world's biggest zinc traders, for zinc sales contracts fulfilled in 1997 while Glencore was positioned long

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142 Bei Hu & Jane Moir, Zhu Kuan Liquidators Denied Vote, S. CHINA MORNING POST, Sept. 26, 2003, at 3, available at 2003 WLNR 5954134. ZKHK owned this 42.2% stake of 337 million shares that was pledged to LSG but subject to litigation. ZKG owned an additional 29.5% stake of 235.2 million shares that was pledged to BOC. HK-Listed Zhu Kuan, supra note 69.
143 Hu & Moir, supra note 142.
of the market and "certain unnamed mainland traders" were severely short.\textsuperscript{145} The letter read:

Zhu Kuan Trading refused to make payment to Glencore and has since closed its office and disconnected its phone line.... Glencore has begun legal proceedings before the ICC (International Chamber of Commerce) in London to collect the sum.... The stock offering prospectus describes the Zhu Kuan Group as having an "excellent reputation" and being "highly reputable." However, Glencore claims its attempts to have the group honour its debts of its trading arm been rebuffed.\textsuperscript{146}

Yu noted that ZKG was investigating and seeking to clarify the matter.\textsuperscript{147} Cai could not, or perhaps would not, confirm that Glencore was among ZKG's "many import and export clients."\textsuperscript{148} Yu further noted that ZKG had not received any claims for unpaid debts.\textsuperscript{149} Nevertheless, ZKG dismissed the allegations.\textsuperscript{150} Yu questioned the motives behind the letter, a valid suspicion given the nature of the letter and that it specifically said the Glencore scandal would "cloud the prospects for the shares of another Zhu Kuan company scheduled to begin trading on the Hong Kong stock exchange."\textsuperscript{151} Cai then went further, decrying the letter, sent on May 25, 1998,\textsuperscript{152} as an attempt to sabotage ZKD's IPO on the following day and even threatened legal action "to defend its reputation and to claim for damages for all defamatory acts against the group."\textsuperscript{153} Unsurprisingly, no such legal action ever appears to have materialized.

ZKD disingenuously sidestepped the underlying implication

\textsuperscript{145} Evans, \textit{supra} note 75.


\textsuperscript{147} Parwani, \textit{supra} note 137; see also Wong, \textit{supra} note 75 (noting that Yu dismissed the allegations saying "the parent company was seeking to clarify the matter").

\textsuperscript{148} Parwani, \textit{supra} note 137.

\textsuperscript{149} Id.

\textsuperscript{150} Wong, \textit{supra} note 75.

\textsuperscript{151} Id.

\textsuperscript{152} Parwani, \textit{supra} note 137.

\textsuperscript{153} Id.; Wong, \textit{supra} note 75.
that ZKG would not pay any future ZKD debts by simply moving to distance itself from ZKT. Yu said, "[t]here is no relationship between [ZKD] and [ZKT] other than we both belong to the same conglomerate [ZKG]." That, of course, was exactly the problem the letter was trying to point out. Cai said, "[t]he subject matter of the allegations does not relate to [ZKD] and its subsidiaries and hence does not have any impact on the group." Yu expanded on this, emphasizing that the scandal would not affect the listed company as ZKD was "only a tourism-related company," that ZKD's "only interests are a theme park and hotels," and that ZKD had not engaged in any raw material trading and did not itself owe any money to Glencore. ZKD further emphasized that it always honors its debts. ZKD directors seemed oblivious to the fact that business operations had little to do with the fact that ZKT and the parent it shared with ZKD clearly had some difficulties in always honoring their debts. Nevertheless, the scandal appears to have been resolved quietly since it disappeared off the radar as quickly as it had appeared, even though ZKG's other debt issues would soon become a major problem once again.

2.3. ZKG's Financial Difficulties

ZKG was among the leading mainland window companies during the 1990s. A pattern emerged in ZKG bonds, stocks, and banks loans in which analysts would give a thumbs-up and major institutional investors would pony up massive sums of money, assuming government backing and eager to tap the PRC market. These are the international institutions that would feel the pinch when ZKG's problems finally caught up with it.

ZKG's financial difficulties first began to emerge at the beginning of the Asian Financial Crisis in 1997 when it became unable to obtain additional financing. ZKG's problems were only exac-
eribated by the intense credit crunch faced by SOEs, red chips, and companies based in Guangdong in the wake of Guangdong International Trust and Investment Corporation's (''GITIC'') 1998 collapse.\footnote{Vincent A. Pace, Guangdong International Trust and Investment Corporation's Collapse and Its Implications for a China in Transition, 1 THE PHOENIX 43, 49-50 (2002). Red chips are PRC-controlled, Hong Kong-listed companies, and often SOEs. Red Chip, INVESTOPEDIA.COM, http://www.investopedia.com/terms/r/redchip.asp (last visited Apr. 1, 2006).} ZKG now found itself burdened with a very high debt-asset ratio and numerous bad investments that had been hoisted upon it by ZMG. It began defaulting on loan payments to the banks in November of the following year.\footnote{Miller & Clifford, supra note 3.}

By 1999, both ZKG and ZKHK had defaulted on nearly all of their obligations from debt owed to their international bank creditors.\footnote{RSM, supra note 37, para. 29.} By the following year, 41\% of ZKG's land assets were pledged against bank loans,\footnote{Moir, supra note 45. Red chips are listed PRC SOEs. Notice of the State Council Concerning Further Strengthening Administration of Issuing and Listing Shares Overseas (promulgated by the State Council, June 20, 1997, effective June 20, 1997) ISINOLAw 229-134357 (last visited Apr. 1, 2006) (P.R.C.).} as were 235.2 million shares in ZKD owed by ZKG\footnote{Christine Chan & Jane Moir, BOCHK Among Largest of Zhu Kuan's Creditor Banks, S. CHINA MORNING POST, July 23, 2003, at 1, available at 2003 WLNR 5930321.} to Chinese banks owed HKD 406 million.\footnote{BOC Hong Kong Among Zhu Kuan Group's Biggest Creditors - Report, AFX - ASIA, July 23, 2003, available at LEXIS News & Business, Country & Region (excluding U.S.), Asia/Pacific, News.} Also in 2000, ZKG stopped making payments on its principal.\footnote{Luck, supra note 74.} Finally, in October 2004, after years of floundering and failed negotiations, ZKG earned the ignominious distinction of being the first major overseas investment company of a mainland government to be put into liquidation by a Hong Kong court\footnote{Moir, supra note 3.} with HKD 7.8 billion in debt\footnote{Id.; see also Moir, supra note 48 (noting that creditors of ZKG were "owed about $8 billion").} and only about HKD 4 billion in assets.\footnote{Miller & Clifford, supra note 3; see also Interactive Currency Table, IE.COM, at http://www.xe.com/ict (last visited Apr. 1, 2006) (stating that the US$1 was worth HKD 7.7659611244 as of December 1, 2003).} It had already
faced similar results in both Macau and the British Virgin Islands ("BVI").

2.3.1. Signs of mismanagement

Most of ZKG's debts were incurred from numerous infrastructure projects in Zhuhai, an ultimately unprofitable priority for ZMG—largely forced onto ZKG. Moreover, "[a] substantial majority of the funds raised by [ZKG] in Hong Kong and Macau were advanced to and invested in assets and projects owned, controlled or promoted by ZMG." Accordingly, the pattern of ZKG mismanagement followed the greater pattern of ZMG mismanagement; an optimistic prediction would be made for a speculative investment, and major losses would result. Just as it is difficult to draw the line between ZMG and ZKG, it is also difficult to delineate between ZMG's poor policy and ZKG's mismanagement. ZMG's various white elephants figure prominently in ZKG's financial difficulties. ZKG was usually directly involved in ZMG's various projects, but even when not directly involved, ZKG had a large indirect risk as ZMG's primary financier.

The list of botched plans is long. Assuming Beijing would approve the landing of international flights in Zhuhai, ZMG built the RMB 6.9 billion Zhuhai "International" Airport that never got approval for international flights and now operates at only 5% capacity with fewer passengers in a year than Hong Kong has in a week. Assuming funding to complete the thirty-kilometer Lingdingyang Bridge to Hong Kong, ZMG ended up building a

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173 See infra section 2.6.4. (discussing insolvency and the process of winding up of companies in Hong Kong courts).
174 Moir, supra note 3.
175 RSM, supra note 37, para. 61.2.
176 Moir, supra note 63.
177 Sunil Jain, Hotel California, China, Bus. STANDARD, Aug. 23, 2004, available at 2004 WLNR 4759747. Hong Kong's airport, within a two-hour drive from Zhuhai, has exacerbated Zhuhai International Airport's problems by moving aggressively to compete with the nearby Guangzhou airport, offering ferries direct to PRC cities and even considering a check-in center in the Pearl River Delta. Id. It seems likely Beijing denial was a result of Guangzhou out maneuvering Zhuhai; Guangzhou itself recently opened its own white elephant airport that already has to compete with Hong Kong and surely did not want additional competition from nearby Zhuhai.
178 Luck, supra note 74.
179 See Moir, supra note 63 ("In the mid-1990s the government started work on
RMB 17 billion bridge that has no roads connecting to either side of it and ends at the minuscule Qi’ao Island just three kilometers from Zhuhai. Assuming Formula One would hold races at Zhuhai, ZMG built a state of the art racetrack but never succeeded in drawing Formula One to the city. Assuming a continuing boom in the real estate market, ZMG directed massive investment into real property, only to now be met by a glut. Assuming good visitor turnout, Zhuhai now has a range of under-visited tourist attractions and hotels with low occupancy rates. Assuming continuing steep rises in profits, ZMG approved ZHC’s bond issuance and ZKG backed it, but the profits failed to materialize. Given this pattern, it even seems likely that ZMG assumed it would get the properties over which it is now involved in litigation with ABC.

ZMG also seemed to have assumed that it would be able to raise further capital on the SEHK, only to have this too foiled by Beijing. At the time of ZKD’s listing in 1998, it was well known that ZMG had long planned to group and list its infrastructure assets separately of ZKD. However, the State Council issued regu-

the Lingdingyang bridge, which was intended to stretch from the Pearl River to Hong Kong. It stopped short at Qi’ao Island.”); Moir, supra note 3 (“[A] 17 billion yuan bridge to Hong Kong now juts out as an abandoned stump.”).

180 Leahy, supra note 1.
181 Miller & Clifford, supra note 3.
182 Id.
183 Moir, supra note 63. As a visit to any major PRC city can tell you, the rush to develop real estate is widespread in the PRC, and seems to reach all the way to the top:

[O]ne-sixth of the luxury residential real estate is vacant in Shanghai, a quarter in Beijing, and a third in Shenzhen. And with banks lending money for construction at government-mandated rates, which are much lower than the inflation rate, the real estate bubble is only getting bigger with each passing day. Experts predict the supply of office space will rise 50 per cent over the next couple of years, and the residential space even faster.

Jain, supra note 177.

184 Moir, supra note 63.
185 See supra section 2.2.1.
186 See infra section 2.3.2.
187 Wong, supra note 73; see also Wong, supra note 47 (“It is understood that the Zhuhai government plans to group its infrastructure business for a separate listing.”).
lations regarding red-chip listings in June 1997 in an attempt to reign them in.\textsuperscript{188} ZMG's plans ultimately fell afoul of Beijing's tightening control of listings;\textsuperscript{189} as of this writing, they have not been able to list another red chip on the SEHK, increasing the pressure on ZMG's finances.

When ZKG hired Price Waterhouse Coopers ("PwC") to help with restructuring in 2001, PwC calculated that ZKG would have a US$2 million operating loss in 2002 even without making a single payment to service any of its debt.\textsuperscript{190} By September 2003, most of ZKG's investments and trading businesses had terminated, curtailed, or postponed activities,\textsuperscript{191} including the closing of a number of ZKG subsidiaries in Hong Kong.\textsuperscript{192} To rub salt in a wound, the still-running tourism operations, like those of ZKD for example, received a sharp blow due to the SARS outbreak,\textsuperscript{193} although the decline started well before the outbreak began.\textsuperscript{194} By this point, there

\textsuperscript{188} Lai, supra note 59.
\textsuperscript{190} Miller & Clifford, supra note 3.
\textsuperscript{192} Moir, supra note 3.
\textsuperscript{193} See Tam, supra note 50.

[ZKD] warned . . . that the outbreak of SARS may hurt their sales and profits. . .

Zhu Kuan Development, which runs amusement parks and ferries in Hong Kong and China, said its marine passengers, hotel occupancy rate and visitors to its theme parks had plunged about 50 per cent since mid-March.

The company said the outbreak in Hong Kong and on the mainland would have a negative impact on its financial position. It added that action had been taken to control spending, such as reshuffling employees' schedules.

was no question that ZKG has suffered an utter and complete financial collapse.

2.3.2. Signs of involvement in illegal activities

While there is no smoking gun, various signs point to a tendency in ZKG to engage in certain illegal activities. ZKG was caught at least once for breaking PRC regulations. During a PRC crackdown on foreign currency flight, 195 three ZKD subsidiaries were fined a total of RMB 7.75 million for breaking PRC foreign exchange regulations. 196 ZKG also faced the same allegation several other times. ZMG rejected allegations that ZMG’s Zhuhai Highway Company (“ZHC”) US$200 million bond issue had breached State Planning Commission (“SPC”) regulations for overseas fund raising, countering that the State Administration for Exchange Control (“SAEC”) approved the issue, that SPC was notified, and that SPC had denied the allegations. 197

There were also allegations of ZKG involvement in a tariff-evading smuggling operation. A report tied ZKG to a Fuji film and photographic paper smuggling operation worth nearly RMB10 billion through a number of former employees and managers who manipulated their connections with ZKG for their own benefit. Because much of the smuggling was done under the nose of ZMG via customs in Zhuhai, it is not farfetched to posit that ZMG at the very least turned a blind eye to the operation, although the report

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197 Ma, supra note 89.
At least one company sought to take ZKG to court for fraudulent misrepresentation. ABC claimed in a suit in Hong Kong's High Court that ZKG has failed to carry out real estate development projects with money it had invested. ABC sought HKD 50 million in "damages for deceit or fraudulent misrepresentation," that untrue contractual statements were made which induced the bank's Zhuhai branch to invest. ABC said one project was never completed, one property was purchased for just HKD 5 million, and a third property was never owned by ZKG and thus could not be developed.

2.3.3. ZKG's creditors

ZKG owed a total of HKD 7.8 billion to forty-two international creditor banks. The largest creditor was believed to be BOC, owed an estimated HKD 2 billion. BOCM was owed HKD 1.6 billion, making it the second largest creditor, and DBL was owed HKD 536 million, making it the third largest creditor. ZKG owed SCB HKD 181 million. Other creditors included ABN AMRO, Australia and New Zealand Banking Group, Bank of America, BOCHK, Crédit Agricole Indosuez, ICBC (Asia),


*Id.*

*Moir, supra note 3; Moir, supra note 48.*


*Moir, supra note 48.*

*Id.*

*Moir, supra note 8.*

*Jain, supra note 177.*

*Wong, supra note 73.*

*Moir, supra note 38.*

*Chan & Moir, supra note 167.*

*Adam Luck, Madam Ding's Amazing Takeaway: China Is Not a Place for the*
Lehman Brothers, Morgan Stanley, Société Générale, and the well-connected Macau-based Tai Fung Bank.

These international investors found themselves pitted against not only each other as creditors, but more formidably against well-connected Chinese banks, as well as other creditors. All Chinese banks were able to obtain secured debt, meaning higher priority amongst creditors in case of bankruptcy, while foreign banks were left with the unsecured debt. BOC, for example, was able to secure their position by receiving a pledge from ZKHK for a 29.5% share of ZKD stock. Each time a new creditor was able to secure its position, the remaining unsecured creditors were forced to fight over a smaller and smaller pie. Moreover, the banks were not the only ZKG creditors. There were several disputed liabilities between ZKG and ZMG itself as well as between ZKG and ZMG-controlled enterprises. ZHC bondholders at the time continued to hold debt from the bond issuance. ABC had a pending HKD 50 million claim. If you extend the economic analysis of ZKG to include ZMG, ZMG holds further debts to a large number of institutions in the PRC, making ZKG payment that much more complicated.

2.4. Pre-Liquidation Negotiations

2.4.1. ZMG’s 2002 offer

ZMG, represented by Xian, began talks with creditors in approximately September 2000. These talks culminated in an offer

Unwary Businessman, as an Electrifying Court Case in Hong Kong Shows, THE SUNDAY TELEGRAPH (LONDON), Apr. 4, 2004, at 1, available at 2004 WLNR 4128432.
that would have given creditors from 40%\textsuperscript{221} to 61%, depending on
the class of their loans,\textsuperscript{222} through payments including a RMB 1.5
billion cash commitment from ZMG\textsuperscript{223} and the proceeds of the
later-disputed Hengqin and Tangjia land plots.\textsuperscript{224} Creditors, hav-
ing a good sense of just how big a hole ZKG now found itself in,
readily accepted this offer in June 2002.\textsuperscript{225}

By January 2003, ZMG was seeking more time, allegedly in or-
der to obtain funds.\textsuperscript{226} Creditors response to this was to up the
ante and demand 45% for unsecured creditors.\textsuperscript{227} In April 2003,
creditors gave ZKG legal notice demanding their money after
ZMG failed to implement restructuring as per their offer.\textsuperscript{228} A far
cry from 45%, ZMG ultimately completely reneged on the 2002 of-
fer, saying only that it “didn’t make sense financially” for ZKG.\textsuperscript{229}

2.4.2. ZMG’s 2003 offers

In June 2003, ZKG made a new offer\textsuperscript{230} that would have given
unsecured creditors a return of just 18%.\textsuperscript{231} This was unanimously
rejected\textsuperscript{232} and criticized as “derisory.”\textsuperscript{233} After a month of no pro-
gress, SCB served a statutory demand on ZKG in Hong Kong for
repayment on the loans due to SCB in preparation for litigation.\textsuperscript{234}
The payment never came. In August, after obtaining a new loan
from a mainland commercial bank with ZMG’s assistance, ZKG
made a revised offer of 21% but most creditors rejected this as
well.\textsuperscript{235} Creditors questioned whether ZKG could afford even this

\textsuperscript{221} Moir, supra note 191.
\textsuperscript{222} Moir, supra note 48.
\textsuperscript{223} Moir, supra note 3.
\textsuperscript{224} Miller & Clifford, supra note 3.
\textsuperscript{225} Moir, supra note 3.
\textsuperscript{226} Id.
\textsuperscript{227} Chan & Moir, supra note 167.
\textsuperscript{228} Miller & Clifford, supra note 3.
\textsuperscript{229} Id.
\textsuperscript{230} Re ZKG 2004, supra note 39, para. 6.
\textsuperscript{231} Moir, supra note 48; Moir, supra note 3.
\textsuperscript{232} Moir, supra note 48.
\textsuperscript{233} Id.
\textsuperscript{234} Re ZKG 2004, supra note 39, para. 6.
\textsuperscript{235} Moir, supra note 191.
offer\textsuperscript{236} while at the same time questioning whether there was more to be had. As one source close to the creditors said, "[t]here’s nothing to prove to us that 21 cents is the best offer. The bottom line is I don’t think we trust them."\textsuperscript{237} With no acceptable explanation of the drastic reduction in offer price ever given, creditors had little choice but to assume the worst.

2.4.3. ZMG’s attempt at pressure tactics

After creditors had rejected the second 2003 offer, ZMG attempted to use pressure tactics to convince creditors to accept the 21\% settlement. They began softly, with statements such as, "[t]he present bailout proposal is the best we can offer to creditors. We hope they all will accept it . . . . Creditors should approach the issue calmly and intelligently."\textsuperscript{238} But then ZMG adopted an ultimatum, informing creditors that it would withdraw all support from ZKG unless creditors accepted a restructuring offer by October 8, 2003.\textsuperscript{239} It said that 21\% "reflected the maximum support the Zhuhai municipal government can afford" and Wang, in a letter to SCB, said, "should [this] final offer not be accepted, the Zhuhai municipal government would have to withdraw all support to the companies and accept that they will be liquidated."\textsuperscript{240} Finally, ZKG became more blunt: "The Zhu Kuan Group maintains that its most recent offer . . . should be accepted by creditors because it would provide a better return than liquidation."\textsuperscript{241} About 20\% of ZKG’s creditors accepted this offer, including secured creditor BOCHK, while only 5\% of ZKHK’s creditors accepted it,\textsuperscript{242} possibly reflecting a belief by ZKHK’s creditors’ that they would have fewer difficulties in getting a higher return from Hong Kong-based assets. In any case, those that called ZMG’s bluff would ultimately be rewarded down the line.

\textsuperscript{236} Miller & Clifford, supra note 3.
\textsuperscript{238} Id.
\textsuperscript{239} Moir, supra note 191.
\textsuperscript{240} Id.
\textsuperscript{241} Miller & Clifford, supra note 3.
\textsuperscript{242} Moir, supra note 191.
2.4.4. Creditors' changing strategy

Creditors had initially negotiated one-on-one with ZKG and banded together only after this proved utterly ineffective.\textsuperscript{243} Creditors had begun negotiations with the hope that a massive government bail out was in line for ZKG.\textsuperscript{244} As this hope proved to be unfounded, they turned their hope to a settlement, under the assumption that ZMG wanted to avoid the pending public fight which was sure to be bitter, and would cast a negative light on ZMG,\textsuperscript{245} to damage their future borrowing potential, and to possibly expose ZKG directors to potential criminal liability. There was also a broad assumption that, without a settlement involving assistance from ZMG, the creditors would ultimately fare even worse than otherwise.\textsuperscript{246}

Creditors sought to have Beijing and Guangdong bear down on ZMG,\textsuperscript{247} and there is little doubt that ZMG had thought about these areas already. Although Beijing essentially told Guangdong and Zhuhai to resolve things on their own,\textsuperscript{248} the ultimate result seems to have been that higher-ups avoided the dispute altogether, at least in public.

Creditors viewed liquidation as the unavoidable final resort after these protracted talks,\textsuperscript{249} but nevertheless hoped that litigation would push ZMG and ZKG back to the negotiating table.\textsuperscript{250} Creditors also expressed the desire to know what would happen to the funds in the event of liquidation.\textsuperscript{251} However, the bottom line remained getting back as much money as possible and a settlement was held throughout to be the best way to do this.

\textsuperscript{243} Re ZKG 2004, \textit{supra} note 39, para. 4.
\textsuperscript{244} Moir, \textit{supra} note 3.
\textsuperscript{245} \textit{Id}.
\textsuperscript{246} Wong, \textit{supra} note 73.
\textsuperscript{247} See Moir, \textit{supra} note 45 ("The provisional liquidators will seek assistance from officials in Beijing.").
\textsuperscript{248} Interview with Hubert Lam, Senior Manager, RSM Nelson Wheeler Corporate Advisory Services Limited, Neil E. McDonald, Partner, White and Case LLP, and Kelly Naphtali, Associate, White and Case LLP, in Hong Kong, China (Jan. 11, 2005) (notes on file with author) [hereinafter Interview].
\textsuperscript{249} Moir, \textit{supra} note 3.
\textsuperscript{250} Miller, \textit{supra} note 4.
\textsuperscript{251} Miller & Clifford, \textit{supra} note 3.
2.5. Dissipation of ZKG's Assets

It was only after ZKG was declared bankrupt in Hong Kong that RSM discovered that the vast majority of ZKG assets were from land interests in Zhuhai and accounts receivable from entities in Zhuhai, nearly half received from ZMG. Much of the land interests had been transferred to ZKG from ZMG in an effort to bolster ZKG's balance sheet, a common and legal practice among PRC municipalities and their SOEs. By 2001, more than 90% of ZKG's assets were property-related and more than half of that was undeveloped land in Zhuhai for which ZKG held commercial or industrial use rights. From the start of negotiations, creditors feared that "there could have been a transfer of assets by the group to the detriment of the creditors." These fears proved all too correct. According to creditors, "[ZMG] want[ed] to take the prime assets," engaged in systematic asset-stripping, and was "always three steps ahead" of creditors' actions to protect ZKG's assets. ZMG seemed prone to use underhanded means, prompting Borrelli to say, "[t]his sort of behavior for anywhere in the world is just disgraceful, but to have a government also participating in that kind of behavior is just unreal." For their part, ZMG categorically denied asset-stripping. Liu said, "[o]utside parties have questioned whether there is now a plan to strip Zhu Kuan assets .... This is an accusation completely without merit and is also irresponsible." Overall, ZKG and ZMG's excuses for the asset transfer cannot be justified in light of the given facts.

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252 Jane Moir, Receivers Find $10b Zhu Kuan Assets; Recovery of the Money from the Companies Controlled by the Zhuhai Government is Unclear as it is Tied Up in Land, S. CHINA MORNING POST, Oct. 15, 2003, at 3, available at 2003 WLNR 5993101.

253 Miller & Clifford, supra note 3. In 1998, after financial difficulties had begun, ZMG transferred $423 million in real estate assets to ZKG and later an additional $89.5 million. Id.

254 Id.

255 Re ZKG 2004, supra note 39, para. 5.

256 Moir, supra note 4.

257 Moir, supra note 51.


259 Miller, supra note 4.

260 Moir, supra note 3.

261 Moir, supra note 51.

262 Miller & Clifford, supra note 3.
2.5.1. ZMG's debt to ZKG

RSM discovered that HKD 4 billion of HKD 7.8 billion debt went directly to ZMG\(^{263}\) for unspecified purposes,\(^{264}\) all of which was still owed to ZKD.\(^{265}\) These loans were used for development and on property nominally owned by the window company, but a sizeable portion of the cash also went right to ZMG for its own projects,\(^{266}\) including an array of ZMG-affiliated entities such as the Library of Zhuhai Municipality, Labor Union of Zhuhai Municipality, and Zhuhai Television Station.\(^{267}\) RSM found no debts whatsoever that ZKG owed to ZMG, despite ZMG alleging such debts without actually providing any evidence of their existence.\(^{268}\) One example of such debts was an alleged liability to ZMG of HKD 741 million that was suspiciously "overlooked" and suddenly brought to light at a later point. According to sources close to the creditors, ZKG transferred land-use rights to ZKD in order to raise extra funds but neither the asset nor the liability were entered into ZKD's accounts, leaving HKD 741 million due to the government. Unsurprisingly, creditors demanded documents relating to the transfer and an explanation as to why it was "overlooked."\(^{269}\) It ultimately appears that no explanation was ever given and this issue remained unresolved until the final settlement rendered it moot.

2.5.2. ZKG's forfeiture of land-use rights to ZMG

Under PRC law, all land is owned by the state and those using the land are merely granted land-use rights by the state.\(^{270}\) LAL provides broad leeway for state requisition of land.\(^{271}\) ZKHK's

\(^{263}\) Moir, supra note 48.

\(^{264}\) Miller & Clifford, supra note 3.

\(^{265}\) Moir, supra note 52.

\(^{266}\) Moir, supra note 51.

\(^{267}\) RSM, supra note 37, para. 188.

\(^{268}\) Moir, supra note 51.

\(^{269}\) Chan & Moir, supra note 167.


\(^{271}\) Id., at art. 2, para. 4 ("The State may, in the interest of the public, lawfully
ownership of land in the PRC would have been recognized with the provision of the necessary paperwork, including the land use right certificates.\textsuperscript{272} However, from the beginning, creditors were wary of using ZKG’s land-use rights due to ZMG’s ultimate ownership of the land as the relevant state actor.\textsuperscript{273}

Creditors’ reservations would ultimately prove to have been well founded. During restructuring negotiations in 2002, both ZKG and ZMG repeatedly assured creditors that, as per an agreement between the parties, mortgages for the benefit of the creditors would be taken out on several properties. These, however, were never executed.\textsuperscript{274} In July 2003, just one day before Xian met with creditors to explain why the 2002 offer had been withdrawn, ZMG took advantage of the law to take from ZKG the land-use rights on two plots of land in Zhuhai\textsuperscript{275} that were considered some of ZKG’s prime land assets.\textsuperscript{276} They asserted that these transfers were within their rights and simply “a matter of zoning regulation,”\textsuperscript{277} “a routine city-planning exercise,”\textsuperscript{278} or “part of legitimate change in Zhuhai planning policy.”\textsuperscript{279} The plots, totaling more than 100 hectares,\textsuperscript{280} included a Hengqin site worth RMB 320 million—the proposed site of one end of the Hong Kong-Zhuhai-Macau bridge.\textsuperscript{281}

\begin{footnotesize}
\begin{enumerate}
\item See L.A.L, supra note 270, at art. 11 (requiring the government to issue land use right certificates); Regulations for the Implementation of the Land Administration Law of the People’s Republic of China, Jan. 1, 1999, ISINOLAW 76613, 291-11528 (last visited Apr. 1, 2006) (P.R.C.) (describing the means by which land use right certificates are issued).
\item Moir, supra note 4.
\item RSM, supra note 37, para. 204.
\item Moir, supra note 3.
\item Miller & Clifford, supra note 3.
\item Moir, supra note 252 (internal citations omitted).
\item Miller, supra note 70.
\item Miller & Clifford, supra note 3.
\item Id.
\item Moir, supra note 52. By March 2005, the PRC had given its approval to begin construction of the bridge. However, despite ZMG promoting Hengqin, Gongbei was selected instead as the landing site for the bridge in Zhuhai. See Bridge Task Force Site for Inaugural Talks, NEWS GUANGDONG, Aug. 29, 2003, http://www.newsgd.com/specials/gdandcepa/projects/200308290018.htm (“Zhuhai Executive Vice Mayor Xian Wen said . . . that Zhuhai preferred the
\end{enumerate}
\end{footnotesize}
and a Tangjia site\textsuperscript{282} worth RMB 691.5 million.\textsuperscript{283} Despite ZKG's knowledge of the transaction\textsuperscript{284} and their meeting with creditors on the next day, neither ZKG nor ZMG informed creditors of these forfeitures,\textsuperscript{285} seemingly running afoul of LAL.\textsuperscript{286} Creditors were not informed of these transactions until a routine land search during August 2003.\textsuperscript{287} These rights originally were to be sold to meet the cash requirement of the 2002 offer and their forfeiture was a major issue as to why ZKG could not hold up its end of the bargain.\textsuperscript{288} ZMG never provided any compensation for these seizures.\textsuperscript{289}

ZKG was entitled to appeal this decision\textsuperscript{290} or to request to compensation for these forfeitures,\textsuperscript{291} but it failed to do either\textsuperscript{292} despite promises to "challenge the forfeiture . . . and to seek substantial compensation."\textsuperscript{293} ZKG subsequently informed creditors that they would "ask the Zhuhai government to change its mind," but

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{282} Moir, supra note 3.
  \item \textsuperscript{283} Re ZKG 2004, supra note 39, para. 8.
  \item \textsuperscript{284} Wong, supra note 73.
  \item \textsuperscript{285} Moir & Hu, supra note 258.
  \item \textsuperscript{286} See LAL, supra note 270, art. 46 ("[T]he requisition shall . . . be announced by people's governments . . . .").
  \item \textsuperscript{287} Moir & Hu, supra note 258.
  \item \textsuperscript{288} Moir, supra note 3.
  \item \textsuperscript{289} RSM, supra note 37, para. 206.
  \item \textsuperscript{290} See Administrative Procedure Law of the People's Republic of China, (Standing Comm. People's Cong. Beijing Mun., Oct. 10, 1990) ISINOLAW 24-131604 (last visited Apr. 1, 2006) (P.R.C.) [hereinafter APL]; see also infra note 490 (explaining why this dispute falls under administrative law within the Chinese legal system).
  \item \textsuperscript{291} See LAL, supra note 270, art. 46 ("Units and individuals that own or have the right to the use of the land under requisition shall, within the time limit fixed in the announcement, register for compensation with the land administration department of the local people's government by presenting their certificates of land ownership or land-use right.").
  \item \textsuperscript{292} Moir & Hu, supra note 258.
  \item \textsuperscript{293} Re ZKG 2004, supra note 39, para. 8.
\end{itemize}
\end{footnotesize}
predictably there was no change to the benefit of the creditors. As Hengqin ultimately was not selected as the entry point in Zhuhai of the Hong Kong-Zhuhai-Macau bridge, it seems likely that the value of its land-use rights have declined significantly. As 

"[l]and requisitioned shall be compensated for on the basis of its original purpose of use," and the potentially lucrative use for the bridge was never more than speculative, there is an argument to be made that whatever compensation ZKG would have received previously, however uncertain, has now been diminished. Thus, assuming that ZKG gets compensated at all for ZMG's land requisition, ZMG will likely benefit from their earlier requisition by having to pay a lesser compensation than would have been the case previously when Hengqin's future prospects looked more promising. While this could be chalked up to a stroke of luck, in light of ZKG's other behavior it seems at least equally as likely that this was strategic.

2.5.3. ZMG's seizure of additional properties

In addition to these forfeitures, RSM discovered a further HKD 50 million worth of properties that ZKG transferred to ZMG, which included a site in Dongguan, a 70,000 square foot complex in Zhuhai, and a number of residential sites, which collectively represented all of the remaining unencumbered real property of ZKG. These transfers were done pursuant to court orders following applications filed by the ZMG Finance Bureau, none of which were made known to the provisional liquidators until long after the transactions had taken place, despite ZKG's claim of legal title over the properties. In contrast to the long delays creditors

294 Moir & Hu, supra note 258.
295 See supra note 281 (specifically the discussion of the Hong Kong-Zhuhai-Macau bridge).
296 See LAL, supra note 270, art. 78 (suggesting that if RSM can somehow succeed in making the difficult argument that this requisition was illegal, ZKG will be entitled to compensation from ZMG, ZIC, or both).
297 See supra note 281 (arguing that the plan for the bridge was uncertain).
298 Moir, supra note 3.
299 Moir, supra note 51.
300 RSM, supra note 37, para. 202.
301 Id. para. 179.
302 Moir, supra note 52; Moir, supra note 51.
faced in the PRC, these applications were accepted just three days
after they were filed.\textsuperscript{303} ZMG even kept ZKG in the dark about the
legal action to seize the properties until after the fact.\textsuperscript{304} The
documents ZMG filed in ZIC alleged that the seizures would offset
debts that \textit{ZKG owed to ZMG},\textsuperscript{305} which appears to be a complete
fabrication.\textsuperscript{306}

\textbf{2.5.4. PIV's pledging of ZKD shares to LSG}

In 2000,\textsuperscript{307} two years after ZKG's financial troubles began and
by this point already grossly insolvent, ZKG transferred a HKD
250 million debt to BVI-registered LSG,\textsuperscript{308} a company ultimately
controlled by ZMG via JZPG but not part of ZKG,\textsuperscript{309} as part of a
deal with JZPG to share the sale proceeds of a 49% stake in Zhuhai
Ferry and of a 90% stake in ZJPPTS.\textsuperscript{310} When creditors discovered
this pledge—even before the appointment of the provisional liquidators\textsuperscript{311} — they immediately demanded information on the under-
lying debt, suspecting that the share charge was "illicitly cre-
ated."\textsuperscript{312} ZKG, however, failed to provide details regarding any
liabilities secured by this share charge or demonstrating that the
mortgage was properly created,\textsuperscript{313} defending the pledges on the
grounds that they were for a mortgage on ZKG's debt to BVI.\textsuperscript{314}

ZKG also had pledged 337 million SEHK-listed ZKD shares to
PIV. PIV had not yet been involved in the debt negotiations at the
time of the share charge.\textsuperscript{315} PIV was a wholly-owned subsidiary of
ZKG incorporated in BVI as an International Business Company on
April 6, 2000.\textsuperscript{316} The only material assets that RSM could find of

\begin{thebibliography}{9}
\bibitem{303} RSM, \textit{supra} note 37, para. 180.
\bibitem{304} Moir, \textit{supra} note 51.
\bibitem{305} \textit{Id}.
\bibitem{306} \textit{See supra} section 2.5.1.
\bibitem{307} Miller, \textit{supra} note 70.
\bibitem{308} Chan & Moir, \textit{supra} note 167.
\bibitem{309} RSM, \textit{supra} note 37, para. 7.
\bibitem{310} Chan & Moir, \textit{supra} note 167.
\bibitem{311} RSM, \textit{supra} note 37, para. 45.
\bibitem{312} Hu & Moir, \textit{supra} note 142; Moir, \textit{supra} note 85.
\bibitem{313} \textit{Id}.
\bibitem{314} Hu & Moir, \textit{supra} note 142.
\bibitem{315} \textit{Id}; Moir, \textit{supra} note 85.
\bibitem{316} RSM, \textit{supra} note 37, para. 43.
\end{thebibliography}
PIV in Hong Kong were the ZKD shares pledged to them by ZKG, who was also the only creditor of PIV that RSM could identify.\footnote{Id.}

Chart 2: PIV's pledges of ZKD shares

In turn, PIV charged these shares—a 42% stake at the time worth HKD 118 million—to LSG\footnote{Hu & Moir, supra note 142.} to help cover ZKG's HKD 250 million debt to LSG on June 9, 2000.\footnote{Chan & Moir, supra note 167.} ZKG further charged its 100% stake in PIV to LSG, with the effect of expanding the pledge to certain other assets outside of Hong Kong owned by PIV.\footnote{Re ZKG 2004, supra note 39, para. 11.} On August 27, 2003, LSG attempted to enforce the share charge without notifying RSM or PIV.\footnote{Hu & Moir, supra note 142.}

On September 3, 2003, RSM was additionally declared the provisional liquidators of PIV.\footnote{RSM, supra note 37, para. 45.} This allowed RSM to prevent enforcement of the share charge, keeping them under ZKG and acc-
cessible to creditors.\textsuperscript{325}

Given ZKG's action regarding other debts, the excuse, "Gee, we really wanted to pay back our debts" as their sole motivation for the share transfer is quite a big pill to swallow. Most likely, the operative factor for their behavior was to keep the shares under ZMG's control and/or just blatant asset-stripping. The fact that ZKD issued a plan that could have potentially been used to dilute the stocks RSM was seeking to control only further justifies this conclusion.\textsuperscript{326}

2.5.5. \textit{Transfer of proceeds from the sale of Lok Ma Chau land}

The Lok Ma Chau property had an estimated value of HKD 45,000,000 and yet the Hong Kong government paid HKD 74,659,860 when it took possession of a part of the land.\textsuperscript{327} RSM was unable to determine how this price was set.\textsuperscript{328} However, such a seemingly high price from the government should trigger skepticism given that Hong Kong legislator Lau Wong-fat was a majority shareholder in Grand Gain, which benefited significantly from the sale of the property.\textsuperscript{329}

From this sale, ZKHK received HKD 41,234,598.\textsuperscript{330} On December 4, 2002, Koo & Partners, acting on behalf of ZKG, informed creditors that 90\% of the net sale, or HKD 37,111,138, would be placed in an escrow account at SCB or at a bank designated by SCB. ZKHK would retain the remainder for operating expenses but would not use it until ZKHK and the creditors' steering committee agreed on a budget.\textsuperscript{331}

\textsuperscript{325} Hu & Moir, \textit{supra} note 142. \textit{See also} Announcement, Zhu Kuan Development Co. Ltd. (Sept. 3, 2003), \textit{available at} http://notice.singtao.com/ADMA%5C0908%5Cepdf/E_Zhu%20Kuan0409.pdf (stating that PIV has not enforced the charge without any mention of the attempt to do so or the or the reasons why it could not); Announcement, Zhu Kuan Development Co. Ltd. (Sept. 9, 2003), \textit{available at} http://notice.singtao.com/ADMA%5C0908%5Cepdf/Zhu%20Kuan%201009.pdf (responding to reports in the media revealing that RSM blocked enforcement).

\textsuperscript{326} \textit{See supra} section 2.2.2.

\textsuperscript{327} RSM, \textit{supra} note 37, paras. 117-18.

\textsuperscript{328} \textit{Id.} para. 118.

\textsuperscript{329} \textit{Id.} para. 117.

\textsuperscript{330} \textit{Id.} para. 118.

\textsuperscript{331} \textit{Id.} para. 119.
Nevertheless, the escrow account was never opened and for a time the HKD 41 million proceeds could not be accounted for at all. It ultimately was revealed that on November 11, 2003—just three days after receiving the proceeds and nearly a month before Koo & Partners spoke with creditors—ZKHK deposited the proceeds in a bank account held by a BVI-incorporated company called Wonderful Idea Limited, which shared an address with a ZKHK director and for whose bank account ZKHK Director Yu Jianhua was a signatory. On January 23, 2003, with authorization from Yu Jianhua, Wonderful Idea Limited transferred nearly the entire amount to Ka U Trading Limited, which shared the same office as ZKG in Macau. The money was ultimately transferred to Zhuhai beyond the reach of creditors.

The ostensible reason was again that this was in order to pay off a loan. This rationale was later expanded to hold that ZKHK owed ZKG and Zhu Kuan Group Holdings Company Limited. Furthermore, there was neither an explanation for the debt nor clarification as to the reasoning behind the transfer payment via Wonderful Life Limited.

2.5.6. Other questionable asset dissipation

Evidence of further questionable asset transfers were abundant. Accounting irregularities resulted in both assets and liabilities not being included in ZKD's books. Company shares and cash were stolen from Macau. With ZKG's dealings regarding Zhuhai Ferry already of a suspicious nature, ZKD further raised suspicions as the proceeds from the sale of a 51% stake in Zhuhai Ferry

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332 Id. para. 120.
333 Moir, supra note 3.
334 RSM, supra note 37, paras. 120-22.
335 Luck, supra note 74.
336 RSM, supra note 37, para. 121.
337 Id. para. 123.
338 See Moir, supra note 51 (stating that there is no record of government debt owed by the Zhu Khan group).
339 Associated Press, supra note 2.
340 Id., at pp. 56-59 (discussing ZKG's transfer a HKD 250 million debt to BVI-registered LSG, as part of a deal with JZPG to share the sale proceeds of a 49% stake in Zhuhai Ferry).
went unaccounted for.\textsuperscript{341} ZKHK allegedly transferred HKD 37 million to uninvolved entities controlled by ZMG in 2003.\textsuperscript{342} Alleged "discrepancies in accounting standards" brought an additional HKD 20 million of liabilities onto ZKG's books shortly before the first 2003 offer.\textsuperscript{343} Additionally, ZKG spent money on a railway but RSM was unable to track down the railway itself.\textsuperscript{344}

Creditors also faced asset dissipation among ZKG's subsidiaries, many of which involved Hong Kong legislator Lau Wong-fat. China Point Finances Limited, in which ZKHK held a 9\% interest,\textsuperscript{345} owed HKD 50 million to ZKHK but refused to pay.\textsuperscript{346} After receiving a statutory demand from RSM, China Point Finances Limited transferred to a 99.9\%-owned subsidiary, China Point Stockbrokers Limited, four properties in Hong Kong.\textsuperscript{347} It was only under threat of being appointed as provisional liquidators that RSM was able to gain leverage to prevent the further dissipation of assets in China Point Finances Limited.\textsuperscript{348} Top Ease Limited, 60\% owned by ZKHK and 40\% by Grand Gain, owed at least HKD 60 million to ZKHK and yet nevertheless paid HKD 5.7 million to other entities controlled by Lau Wong-fat after it had become dormant in 1997.\textsuperscript{349} In August 2003, long after financial trouble had begun, ZKHK provided HKD 1 million to invest in building rights licenses acquired by Goldwell Properties Limited, which was owned by former ZKG directors and Lau Wong-fat, but never received any return for this investment.\textsuperscript{350} Entities controlled by Simon Tam received a pledge of land from ZKHK, allegedly as security for debts owed by ZKHK to entities controlled by Simon Tam.\textsuperscript{351} These debts were settled and nevertheless RSM struggled to have this security released.\textsuperscript{352}

\textsuperscript{341} Moir, supra note 3.
\textsuperscript{342} Moir, supra note 252.
\textsuperscript{343} Moir, supra note 4.
\textsuperscript{344} Leahy, supra note 1.
\textsuperscript{345} Re ZKG 2004, supra note 39, para. 27.
\textsuperscript{346} RSM, supra note 37, paras. 128-29.
\textsuperscript{347} Id. para. 130.
\textsuperscript{348} Id. paras. 131-36.
\textsuperscript{349} Id. paras. 140-42.
\textsuperscript{350} Id. para. 144.
\textsuperscript{351} Id. para. 158.
\textsuperscript{352} Id. paras. 158-59.
2.6. Further Aggravating Actions

2.6.1. ZKG withholding information

RSM had extreme difficulties in obtaining ZKG books and accounts,\textsuperscript{353} describing the vast lack of information as "alarming."\textsuperscript{354} Repeated demands for information were ignored or fulfilled incompletely. Nearly all of ZKG's records from Hong Kong, Macau,\textsuperscript{355} and presumably BVI were "temporarily removed for accounting purposes" to Zhuhai by ZMG.\textsuperscript{356} In Macau, especially, this was exhaustive; when the Macanese liquidator went to ZKG's offices which occupied two entire floors of the Zhu Kuan Building, not a single book, record or computer hard disk remained.\textsuperscript{357} None were produced until two ZKG directors were arrested in Macau, and these were nevertheless insufficient.\textsuperscript{358} There was also a complete dearth of data regarding PIV in Hong Kong,\textsuperscript{359} suggesting ZMG had purposefully removed those as well. Similar problems were found in other subsidiaries.\textsuperscript{360}

When RSM went to ZKHK's registered office in Hong Kong, three employees of ZKHK were found, the most senior of which left immediately for Zhuhai. On the same day, and seemingly instigated by RSM's visit to ZKHK's office, other ZKG companies denied access to books and records located in Hong Kong and in

\textsuperscript{353} Associated Press, supra note 2; Moir, supra note 48.


\textsuperscript{355} Leahy, supra note 1.

\textsuperscript{356} Miller & Clifford, supra note 3, at 49.

\textsuperscript{357} RSM, supra note 37, para. 67.

\textsuperscript{358} Id. para. 70.

\textsuperscript{359} Moir, supra note 85.

\textsuperscript{360} ABC claimed an interest in land that might have been Lok Ma Chau, but no records of this were found in Tinson International Limited or in Ocean Time Development Limited. RSM, supra note 37, para. 127. The records of Kong Zhu Freight Piers Limited, 50% owned by ZKHK and 50% owned by Grand Gain, were nearly all allegedly destroyed. Id. paras. 151, 155. Kuan Tat, 50% owned by ZKHK and 50% by Simon Tam, sold off a property owned at Tuen Mun for HKD 6.9 million shortly after the appointment of the provisional liquidators without informing RSM. Id. para. 156.
some cases even tried to remove them from the registered offices. 361 These visits succeeded in getting only fifteen boxes of books, hardly sufficient for a company with at least twenty-five subsidiaries, not including the thirty-three subsidiaries of ZKG. 362 At ZKD, employees prevented RSM from accessing information stored there, compelling RSM to hire security guards to prevent its removal from the premises. 363 Indeed, RSM’s initial efforts to recover the books and records on ZKG showed little success as the majority of them had already been removed from Hong Kong to Zhuhai by the time provisional liquidators were declared. 364

RSM served ZKG management with legal notices to hand over books and records related to ZKG assets, but responses were slow in coming, and the few records that did come were insufficient. 365 RSM succeeded in contacting only two directors in total, even though ZKG had seven directors and ZKHK had four. 366 These directors, all located in Zhuhai, simply refused to supply anything, 367 claiming that they were unavailable because they had been removed to the ZMG Audit Department. 368 Later they claimed that the appointments in Hong Kong and Macau were not recognized in the PRC and thus they were not compelled to disclose anything. 369

ZKG’s response to creditors protesting the lack of information was to call for patience while evading questions of even whether these records would ever be turned over to creditors. 370

2.6.2. ZMG denying access to ZKG-related public information

ZMG, for its part, refused to turn over or even allow access to

361 Id. para. 65.
362 Id. para. 67.
363 Id. para. 87.
364 Id. para. 33.1.
366 RSM, supra note 37, para. 63.
367 Block Probe, supra note 365.
368 Re ZKG 2004, supra note 39, para. 10.
369 RSM, supra note 37, paras. 64, 73-79.
370 Miller & Clifford, supra note 3, at 50.
the records it controlled. ZMG’s Audit Department held and denied access to a number of companies’ accounts books. Records held by the Zhuhai Administration of Industry and Commerce and the Zhuhai Real Estate Transportation and Registry Center were also withheld.

As much of ZKG’s assets were real property in Zhuhai, RSM found one of its largest roadblocks in ZLR. RSM first sent two letters to ZLR asking it not to allow any change in the registration for any real estate owned by ZKHK and ZKG and also to notify RSM if anyone attempted to change it after August 13, 2003. ZLR did not respond and RSM resolved to visit ZLR. Upon RSM’s first visit to ZLR, officials initially said that there had been a computer breakdown preventing them from accessing the records, even though all other observable computers were working properly, before finally admitting that they had been forbidden to cooperate with RSM. This situation persisted for more than a year. Thereafter, ZLR banned and physically prevented RSM representatives from entering the premises, preventing RSM from conducting company searches and land searches on twenty-three properties in Zhuhai. ZLR also refused to reissue title documents for these twenty-three properties and would not supply any of the paperwork for the seizures of the Hengqin and Tangjia properties.

2.6.3. Third parties withholding information

RSM also had significant difficulty in obtaining information from third parties involved in the case. RSM accused PwC, a former adviser of ZKG and current advisor of ZMG holding various ZKG data, of being less than forthcoming with information, following ZMG’s explicit instructions.

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371 Block Probe, supra note 365; Miller, supra note 70.
372 Moir, supra note 52.
373 RSM, supra note 37, para. 61.6.
374 Id. para. 170.
375 Leahy, supra note 1.
376 RSM, supra note 37, para. 171.
377 Moir, supra note 3.
378 Moir, supra note 51.
379 Id.
380 RSM, supra note 37, para. 206.
381 Moir, supra note 45; RSM, supra note 37, para. 90.
In addition to PwC, RSM also had to rely on the courts to obtain additional records from Koo & Partners (who had been representing ZKG and then represented ZMG) and Chiu & Partners (who represented ZKD). Koo & Partners, at the behest of ZMG, based its lack of cooperation on two legal principles. First, it argued that the court had no jurisdiction to wind up ZKG since ZKG was a foreign company. Second, the jurisdiction of a court in the liquidation of a foreign company is limited to ancillary liquidations and thus the provisional liquidators only had power over assets in Hong Kong and information related to activities in Hong Kong. RSM asserted that Koo & Partners should have known this position was without merit.

The Zhu Kuan mess even reached a member of the Hong Kong legislature. Hong Kong Legislator Lau Wong-fat had previous dealings with ZKG through Grand Gain, a Hong Kong-incorporated company which has shareholdings in at least eleven ZKG subsidiaries, and in which Lau is a major shareholder, and some of whose books and records Lau held in a warehouse. RSM repeatedly requested that Lau hand over the information. At first, he agreed, but said it would take time to retrieve the records from the warehouse. Later, he said he would only release the information with the approval of ZKG’s directors. After Lau failed to meet a final deadline, RSM was again forced to take legal action.

2.6.4. RSM’s moves to compel disclosure

ZMG’s intransigence in providing information led RSM to take action to compel disclosure. RSM initiated various legal proceedings in the PRC, Hong Kong, Macau, and BVI. RSM was
able to meet with success outside of the PRC, but the litigational difficulties in the PRC were significant. This prompted RSM to take measures outside of the court, and they began appeals to the central authorities in Beijing. With the help of lawyers, they approached the trade offices, financial authorities, and corruption authorities. Publicly, however, Beijing remained mum on the issue.

2.6.5. Delay tactics

Creditors hold strong suspicions that at least the latter part of negotiation was nothing more than an endeavor to buy time to let ZMG cherry-pick prime assets from ZKG. After the 2002 offer, ZMG offered to inject more prime parcels of land into ZKG, convincing creditors to wait patiently even as assets continued to dissipate before presenting them with the 18% June 2003 offer. RSM also considered the battles that it had to fight repeatedly to obtain information disclosure as causing "prejudicial delays." Delays were also rampant in the ultimate court proceedings in the PRC.

2.6.6. Lack of cooperation from the directors of ZKHK and subsidiaries

When RSM was appointed as the provisional liquidator of ZKHK, it obtained the right to place two out of four directors on the board of directors of each of four different PRC-based subsi-

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393 See infra text accompanying notes 392-450 (explaining why creditors had to file winding-provisions in Hong Kong, Macau, and the British Virgin Islands ["BVI"]).

394 See id. (stating the success of the liquidation of ZKG in Hong Kong, Macau, and BVI).

395 See infra section 2.8 (discussing the Zhuhai Intermediate People’s Court favoring the government’s interests over the interests of creditors).

396 Block Probe, supra note 365.

397 Id.

398 See generally Miller & Clifford, supra note 3 (discussing the general lack of oversight of ZKG).

399 Moir, supra note 3.

400 Luck, supra note 74.

401 Moir, supra note 354.
aries of ZKHK. RSM repeatedly requested a board meeting, but the chairmen would not convene a meeting for any of the subsidiaries. Just as with the production of information, directors were not cooperative in these matters. This would ultimately lead to legal proceedings in the PRC.

2.7. Litigation in Hong Kong, Macau, and BVI

Despite the meeting on the next day, the discovery of the land forfeiture and ZKG's lack of disclosure shattered whatever remaining trust creditors had in ZKG and ZMG to negotiate in good faith, and the other various aggravating actions only served to cement that belief. As one source close to the creditors put it, "We think [their actions are] disgraceful and insulting. Where did the money go? . . . This really is an absolute joke. They're negotiating in very bad faith." ZMG, unsurprisingly, denied it was obstructing a settlement, but this was hardly enough to stop litigation from proceeding. Unfortunately for ZMG, the creditors found powerful allies in the courts outside of the PRC.

2.7.1. Hong Kong

ZKG was incorporated in Macau. Thus, it would seem logical to begin litigation there. Macanese courts claim sole jurisdiction over the liquidation of companies incorporated locally, thus legal action in Macau was inevitable as soon as the creditors decided to take the litigational route. The problem with legal action in Macau, however, was its lack of pre-liquidation asset protection. Instead, Macau relies heavily on post-liquidation claw-back measures, which would give ZKG ample time to strip assets to whatever extent possible. With books and records held by ZMG and ZKG officers, avoiding Macau claw-back measures would have been of only very limited effectiveness.

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402 RSM, supra note 37, para. 165.
403 Re ZKG 2004, supra note 39, para. 9.
404 See Moir, supra note 38 ("According to a letter prepared for banks by creditors, 'unfortunately, it has become clear that without transparency between the parties, the financial creditors can no longer trust either the management of Zhu Kuan or the Zhuhai municipal government.'").
405 Moir, supra note 4.
406 Miller & Clifford, supra note 3, at 20.
407 Kendall, supra note 65, at 41.
The most promising alternative therefore was to begin legal efforts in Hong Kong, where courts could immediately appoint a provisional liquidator to protect assets before bankruptcy was actually declared.\textsuperscript{408} On August 12, 2003, creditors, led by SCB, did just this, filing winding-up petitions against ZKG, ZKHK, and PIV in Hong Kong\textsuperscript{409} in order to seize and protect assets.\textsuperscript{410} Creditors' main argument for liquidation was that ZKG was unable to meet its obligations,\textsuperscript{411} alone a grounds for liquidation under Hong Kong law,\textsuperscript{412} but also that ZKG was negotiating in bad faith,\textsuperscript{413} appealing to the courts' powers of equitable discretion to order liquidation.\textsuperscript{414} On August 13, 2003, not even a full day later, and faced with overwhelming evidence, Hartmann declared Borrelli and Kennedy to be ZKG and ZKHK's provisional liquidators in order to protect assets and begin investigations into ZKG.\textsuperscript{415} This order, however, was subject to recognition in other jurisdictions.\textsuperscript{416} Less than a month later, on September 3, Kwan issued the same ruling with respect to PIV.\textsuperscript{417}

After being declared provisional liquidators, RSM could begin its attempts to secure and claw back the assets of these and other


\textsuperscript{409} Moir, supra note 3.

\textsuperscript{410} Moir, supra note 48; Moir, supra note 51; RSM, supra note 37, para. 32.

\textsuperscript{411} Miller, supra note 70.

\textsuperscript{412} See Companies Ordinance, Ch. 32, sec. 327(3), Feb. 13, 2004, at http://www.leisltion.gov.hk/BLIS_IND.nsf/E1BF50C09A33D3DC482564840019D2F4/2550ACB6A9B83D2648256E3C00285B4D?OpenDocument (last visited Apr. 1, 2006) [hereinafter Companies Ordinance] ("The circumstances in which an unregistered company may be wound up are as follows... (b) if the company is unable to pay its debts... "). One definition of inability to pay debts under 327(4) is failure to make payment within three weeks after a statutory demand. \textit{Id.} at sec. 327(4). Anticipating litigation, SCB had issued just such a demand. \textit{See supra} section 2.4.2.

\textsuperscript{413} Miller, supra note 70.

\textsuperscript{414} See Companies Ordinance, \textit{supra} note 412, at sec. 327(3) ("The circumstances in which an unregistered company may be wound up are as follows... (c) if the court is of opinion that it is just and equitable that the company should be wound up.").

\textsuperscript{415} Re ZKG 2004, \textit{supra} note 39, para. 10.

\textsuperscript{416} Kendall, \textit{supra} note 65, at 41.

\textsuperscript{417} Re ZKG 2004, \textit{supra} note 39, para. 11.
ZKG subsidiaries in Hong Kong as well as begin its investigations into ZKG’s records and books.\(^{418}\) As RSM worked at this, hearings related to ZKG’s liquidation continued in October 2003, November 2003, January 2004, and April 2004.\(^{419}\) In these hearings, HKHC consistently handed meaningful victories to RSM, even as RSM took advantage of its powers as provisional liquidator. RSM was able to finally compel the release of documents from PwC, Koo & Partners, Chiu & Partners, Lau Wong-Fat, and Grand Gain with the help of a court-approved s.221 application.\(^{420}\) RSM also quickly succeeded in seizing ZKG assets still remaining in Hong Kong,\(^{421}\) such as remaining land in Lok Ma Chau on Hong Kong’s border with the PRC valued at HKD 180 million, and land in Sai Kung and Yuan Long.\(^{422}\) Barma was also flexible in permitting liquidators to sell a number of assets.\(^{423}\) At the last of these hearings, the extreme difficulties RSM faced in conducting investigations, and the litigational difficulties in Zhuhai,\(^{424}\) prompted it to file for and receive a six-month adjournment from the HKHC in order to advance investigations and work on a settlement with ZMG.\(^{425}\) Reyes stressed that the adjournment was exceptional and was being granted to allow the heavily delayed litigation in Zhuhai to proceed, but he gave it to them nonetheless.\(^{426}\)

On November 17, 2003,\(^{427}\) ZKG attempted to strike creditors’ winding-up petition on jurisdictional grounds and *forum non conveniens*.\(^{428}\) Alternatively, ZKG sought to limit the liquidators’ access to Hong Kong assets on the grounds that Hong Kong courts

\(^{418}\) Moir, *supra* note 52.

\(^{419}\) RSM, *supra* note 37, para. 34.

\(^{420}\) Id. paras. 93-100; see also Companies Ordinance *supra* note 412, sec. 221 (allowing the court to require production of any information from any person regarding a company in provisional liquidation or in bankruptcy).

\(^{421}\) Moir, *supra* note 48.

\(^{422}\) Id.


\(^{424}\) See infra section 2.7.2.

\(^{425}\) Miller, *supra* note 70.

\(^{426}\) Id.

\(^{427}\) RSM, *supra* note 37, para. 36.

have no jurisdiction over assets outside of Hong Kong. Despite hearings on the application to strike having finished on December 19, 2003, Barma did not hand down his judgment until July 13, 2004. This delay—leaving unanswered the question of whether the court had jurisdiction and, by extension, whether RSM had any powers at all—significantly impeded RSM’s work during the period of the delay. In the end, however, Barma nevertheless rejected all of ZKG’s objections and dismissed their application to strike.

Finally, on October 4, 2004, after multiple hearings, six months of judicial deliberation, and the declaration of ZKG’s bankruptcy in Macau, ZKG received the ignominious distinction of becoming the first major investment arm of a mainland government to be declared bankrupt by a Hong Kong court.

2.7.2. Macau

Winding-up petitions in Hong Kong are nearly three hundred times more common than in Macau. Winding-up a company in Macau is cumbersome, inflexible, and time-consuming, leading companies to securitize their loans rather than rely on liquidation proceedings for protection. In Hong Kong, insolvency is presumed when a company cannot pay a statutory demand. In Macau, the claimant must prove insolvency by first showing a de-

429 Id.
430 RSM, supra note 37, para. 36.
431 Id. para. 37.
432 See Re ZKG 2004, supra note 39, paras. 16-69 (holding that jurisdiction is proper and declining to restrict the provisional liquidator’s powers to only assets in Hong Kong as “an undue and unnecessary limitation on the functions to be performed by a liquidator in an ancillary liquidation in Hong Kong”); Kendall, supra note 65, at 41 (discussing the jurisdiction issue).
433 RSM, supra note 37, para. 39.
434 Kendall, supra note 65, at 41.
435 Wong, supra note 117.
436 Moir, supra note 48.
437 In 2002 and 2003, there were only ten winding-up petitions filed in Macau compared to 2,853 filed in Hong Kong. Sue Kendall, Winding Up Macanese Companies in Macau—The Zhu Kuan Experience Brings Positive Development, OUT OF COURT, Autumn 2004, at 3.
438 Id.
439 Companies Ordinance, supra note 412.
fault of the company on at least one obligation and second that the company cannot pay debts as they fall due.\textsuperscript{440} Petitioners are not permitted to introduce additional information after filing except in exceptional circumstances.\textsuperscript{441} Limitations of the Macanese legal structure make the evidence-gathering process onerous; meanwhile creditors are potentially exposed to asset-stripping.\textsuperscript{442} Macanese law relies strongly on claw-back provisions to recover dissipated assets. Unfortunately, such measures are unlikely to be very useful in the case where assets have disappeared and books and records are outside of Macau's jurisdiction.\textsuperscript{443}

As Hong Kong winding-up orders are not recognized in Macau and the Macanese courts claim sole jurisdiction over the liquidation of Macanese-incorporated companies,\textsuperscript{444} creditors led by SCB had little choice but to file in a liquidation petition for ZKG Macau's Court of First Instance in March 2004.\textsuperscript{445} The delay \textit{vis-à-vis} the Hong Kong filing was due to these differences in evidentiary requirements. Despite the high up front costs, the Macanese liquidation proceeded rapidly once approved by the court, as it does generally.\textsuperscript{446} The petition for liquidation was filed on March 31, 2004. The hearings were in May; and just two weeks later,\textsuperscript{447} on

\begin{itemize}
\item \textsuperscript{440} Código de Processo Civil de Macau [Civil Procedure Law of Macau] (2004), art. 308-10, available at http://www.imprensa.maca.gov.mo/bo/i/99/40/codprcvpt/codprociv0301.asp#l3a389 (last visited Apr. 1, 2006); see also Kendall, supra note 65 (describing the effect of this law).
\item \textsuperscript{441} Kendall, supra note 437, at 4.
\item \textsuperscript{442} The petitioner must evaluate the company's known assets and liabilities. However, it is not possible to conduct a search of assets and liabilities by company name, despite the public record office having details of them. The petitioner must also establish what equity (if any) the company has in respect of its assets. This is a burdensome and time-consuming process that will often rely heavily on the information the debtor makes available to the petitioner. In the absence of pre-liquidation protection, assets remain exposed to further dissipation while evidence is being gathered. Kendall, supra note 65, at 41; see also Kendall, supra note 437 (detailing the cumbersome process of liquidation in Macau and its numerous pitfalls that leave creditors open to asset-stripping).
\item \textsuperscript{443} Kendall, supra note 437.
\item \textsuperscript{444} Id. at 5.
\item \textsuperscript{445} Miller, supra note 4.
\item \textsuperscript{446} See Kendall, supra note 437 (describing the general rapid pace of Macanese liquidation litigation once the initial and substantial hurdles have been cleared).
\item \textsuperscript{447} Id.
\end{itemize}
June 2, 2004, the court declared ZKG bankrupt. At the same time the court appointed Wu Chun Sang liquidator in Macau. Wu Chun Sang subsequently worked cooperatively with RSM to protect ZKG's assets. ZKG subsequently appealed the decision and had yet to receive an answer as of November 2004. However, a favorable decision seems unlikely in the face of consistent court rulings against ZKG and the broad mass of evidence against them. Nevertheless, thanks to the bankruptcy declaration, creditors were able to freeze ZKG's Macanese assets so they could only be disposed of by court order. Similar to RSM in Hong Kong, Wu was able to attach various properties and liquidate certain other assets.

Macanese courts also ruled in favor of creditors regarding the gathering of information. After the court found out that no information remained in ZKG's office, it issued arrest warrants for the directors of ZKG. When two of the directors entered Macau in July 2004, Macau's Immigration Department apprehended them and sent them to the court. The court ordered them to produce the books and records within two weeks from the date of their arrest. Some books were produced, but proved to be insufficient information for a company with dozens of subsidiaries.

2.7.3. BVI

In BVI, LSG petitioned the British Virgin Islands High Court of Justice ("HCJ") to recognize PIV's share charge with no more documentation than what had been provided in Hong Kong to support the validity of the charge. RSM naturally opposed this and the validity of the share charges became the focal point. LSG obtained an order from HCJ to serve notice of these proceedings to ZKG in Macau, seemingly in order to have the ZKG direc-

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448 Associated Press, supra note 2.
450 Kendall, supra note 437, at 4. Among the assets shielded were the Zhu Kuan Building and a HKD 230 million piece of real estate at Zone dos Novos Atemos do Porto Exterior. Miller, supra note 4.
451 Id. note 37, para. 105.
452 Id. para. 70.
453 Miller, supra note 70; see also supra sections 2.5.4-6.
454 RSM, supra note 37, paras. 52-59.
tors in Macau agree to a judgment in PIV's favor. LSG instead turned to delay tactics with repeated applications for extension, frustrating RSM's efforts to take over assets for the benefits of creditors and eventually garnering even the anger of HCJ.

In response to LSG's legal efforts, RSM filed a winding-up petition for PIV in the BVI HCJ on September 3, 2003. At this point, ZKG was not subject to liquidation proceedings in Macau—its place of incorporation—and in Hong Kong; the court had thus far only appointed RSM as provisional liquidators. The share charge from PIV to LSG was still being contested in Hong Kong and had been among the primary reasons for appointing provisional liquidators in Hong Kong.

LSG filed a strike-out petition against RSM's petition. HCJ's Justice Shanks was confronted with the question of whether the court would recognize a foreign liquidation outside the law of the locale of incorporation, the question, he noted, was "far from settled in English law." Shanks ultimately ruled that BVI did have discretion to recognize such liquidation and that such discretion considers whether the company under liquidation has sufficient connections to the liquidating jurisdiction, the need for order, and the principles of comity of nations. The incorporating locale's recognition or non-recognition of the foreign jurisdiction is an important but non-determinative consideration. Focusing strongly on both RSM's actions to protect all creditors worldwide and the Macanese liquidator's approval of RSM's actions, HCJ found that these outweighed the fact that the liquidation had not been recognized in Macau and that, in BVI, RSM could act on behalf of ZKG in regards to PIV. Shanks dismissed the strike-out petition.

This holding also stayed, but did not dismiss, all proceedings regarding PIV pending the determination of the validity of the

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455 Id. para. 55.
456 See id. para. 56 ("[U]nless [LSG] filed and served its Reply and Defense to Counterclaims by 4.00pm on 6 October 2004, it would be barred from filing any pleading and PIV and ZKG may enter judgment on their Counterclaims without further notice.").
457 Id. para. 46.
459 Id.
ZKD share charges. Nevertheless, the two sides came to what was essentially a gentlemen's agreement to leave BVI aside in their dispute, something possible only because ZMG did not believe it likely that its tactics would ultimately succeed.

2.8. Litigation in the PRC

In addition to lack of provisions to protect assets pending liquidation, the liquidation process in the PRC is "time-consuming, complex, and something of a lottery," ZMG has effectively been able to dictate ZIC’s decisions regarding ZKG. As McDonald elaborates:

The Zhuhai Intermediate People’s Court has permitted the Zhuhai government to seize assets which should be available for realization and distribution to all unsecured creditors. . . . It has ignored the provisional liquidators’ requests for assistance and it has actively interfered in the provisional liquidators’ attempts to obtain redress against the Zhuhai government. In simple terms, it has permitted the government’s interests to be preferred to the interests of unsecured creditors.

2.8.1. Obtaining books and records in ZMG’s possession

After ZLR barred RSM from conducting land searches on twenty-three properties in Zhuhai, RSM initiated legal action against ZLR in ZIC. PRC law mandates that "major" cases concerning foreign interests or the interests of Hong Kong and Macau should go directly to the intermediate court of the relevant jurisdiction. ZIC, however, refused to accept jurisdiction on the grounds

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460 RSM, supra note 37, para. 52.
461 Interview, supra note 248.
462 Kendall, supra note 65.
463 See Daniel Hilken, Rotten System Will Persist, Says Lawyer, THE STANDARD, Feb. 14, 2005, available at 2005 WLNR 2078432 ("The mainland's legal system has allowed domestic parties to make off with Zhu Kuan’s assets, leaving foreign banks, which are still owed around HKD 1 billion, without their rightful share.").
464 Id.
465 Moir, supra note 51.
466 Interpretation of the Supreme People’s Court on the Execution of the Administrative Procedure Law of the People’s Republic of China, art. 8 (Promulgated
that "this case does not involve any substantial Hong Kong or Macau issue."\textsuperscript{467} ZIC completely ignored the foreign interests involved in the case and narrowly interpreted "major Hong Kong or Macau issues" to exclude ZKG’s bankruptcy. This holding begs the question, if a HKD 8 billion conflict is not a major Hong Kong or Macau issue, what type of matter between private parties are? This interpretation is most likely erroneous, as the analysis of "major" focuses on both the political and economic impact of the case,\textsuperscript{468} and here the economic impact is undoubtedly very large.

ZIC transferred the case down to the district court in Xiangzhou.\textsuperscript{469} The Xiangzhou District Court ("XDC") ultimately denied RSM’s request on the grounds that the creditors "failed to give evidence confirming that it has any legal interest in the property."\textsuperscript{470} XDC completely ignored RSM’s arguments about the appropriateness of their jurisdiction over the case.\textsuperscript{471} The logic seemed to be that since the land no longer belonged to ZKG, and the creditors had no claim against ZMG or the company that ZMG subsequently transferred the land to, the creditors could not possibly have a legal interest in the property.\textsuperscript{472} On appeal, ZIC ruled that this was incorrect and remanded the case to XDC for further
In March 2004, RSM initiated separate proceedings in ZIC to obtain the data held by the directors of ZKHK and its subsidiaries in the PRC. In a relatively painless victory compared to its other tribulations in the PRC, RSM convinced ZIC to order the directors to produce such records as requested at the hearing in November 2004.

2.8.2. Obtaining the cooperation of the directors of ZKHK and subsidiaries

In the same proceeding, RSM also sought to compel the cooperation of the directors of ZKHK and its subsidiaries in the PRC. Despite the victory regarding the data, the court reserved judgment in relation to such cooperation.

2.8.3. Challenging ZKG's forfeiture of land-use rights to ZMG

RSM began legal action to reverse ZKD's forfeiture to ZMG of its rights on the Hengqin and Tangjia land plots in the fall of 2003. Problems began immediately. RSM's first step was to file an administrative review application in ZIC to appeal the decision regarding the Hengqin land plot as well as to address other disputes with ZMG. The case was initially rejected on the grounds that neither ZKG nor ZKHK had standing to complain in relation to the seizures, but was later accepted on the condition that RSM pay RMB 8.77 million in "court fees," defended on the grounds that the transaction was "a complicated case." This

473 RSM, supra note 37, para. 176.
474 Id. para. 166–67.
475 Id. paras. 166–67.
476 Moir, supra note 3.
477 Block Probe, supra note 365.
478 Miller, supra note 4; Jane Moir, Mainland Sets High Price for Legal Recourse; Liquidators Shelve Bid to Claim Disputed Land After Zhuhai Court Demands Eight Million Yuan in Fees, S. CHINA MORNING POST, Nov. 5, 2003 available at 2003 WLNR 5835367.
479 RSM, supra note 37, para. 207.
480 Miller, supra note 4.
481 Moir, supra note 478 (internal quotations omitted).
482 Miller & Clifford, supra note 3 (internal quotations omitted).
served as an effective barrier to litigation.483

Historically, high court fees are one of the main ways PRC courts have funded themselves, and are a regular feature of litigation in China and are often prohibitive.485 However, these court fees are actually a misapplication of the law. Articles 5.8 and 5.4 of the Measures on the Collection of Litigation Costs by the People’s Courts dictate that in bankruptcy cases where the bankrupt company’s property value is greater than RMB 1 million, the court fee may be up to 0.5% of this value with a ceiling of RMB 100,000.487

The court has broad discretion to reduce or defer payment and the defendant will ultimately foot the bill if the suit is successful.489

The court had initially miscategorized the case as a bankruptcy case, applying the 0.5% rate for court fees and blatantly ignoring the RMB 100,000 ceiling, when in fact it was an administrative case.490 Moreover, it applied this rate and ignored the ceiling de-

483 Moir, supra note 478.


486 Measures, supra note 484, §§ 5.4, 5.8.

487 See Supplementary Rules of the Supreme People’s Court on the Measures of the Collection of Litigation Costs by the People’s Courts, Supreme People’s Court, art. 3.8 (July 28, 1999) ISINOLAW 120-1999199 (last visited Apr. 1, 2006) (P.R.C.) (“The litigation cost for a case on bankruptcy shall be collected as per half of the standard for a property case on basis of the total property value of the bankrupt enterprise. However, it shall not exceed a maximum of RMB 100000.”).


489 See Wenhai Cai, Private Securities Litigation in China: Of Prominence and Problems, 13 COLUM. J. ASIAN L. 135, 149 (1999) (“It is a general rule well recognized by Chinese courts that the losing party should pay the litigation costs, usually exclusive of attorney fees, of the prevailing party.”).

490 Municipal governments are considered administrative under Chinese law and thus the case regarding the Hengqin land plot against ZMG is administrative. See, e.g., Diantou Longsheng Rock Materials Quarry v. City of Fuding, CHINACOURT.ORG (Fuding People’s Court, Apr. 11, 2002), at http://www.china-court.org/public/detail.php?id=17116 (last visited Apr. 1, 2005) (allowing an administrative suit against the City of Fuding). Moreover, APL aims to provide review of administrative actions by judicial organs. Conita S.C. Leung, Chinese
spite being "resolutely forbidden" to do so by the Supreme People’s Court, in a stern rebuke to all courts.\textsuperscript{491} As an administrative

\textit{Administrative Law Package: Limitations and Prospects}, 28 H.K.L.J. 104, 106 (1998). Thus, even if ZMG were not a party, the case could be considered administrative to the extent that the court’s decision regarding the Hengqin land plot court order is administrative. In turn, APL gives broad bases for suit, several of which could be used to demonstrate that RSM’s cases against both ZMG and ZLR are in fact administrative. The relevant provisions are as follows:

The people’s courts shall accept suits brought by citizens, legal persons or other organizations against any of the following specific administrative acts:

(1) an administrative sanction, such as detention, fine, rescission of a license or permit, order to suspend production or business or confiscation of property, which one refuses to accept;

(2) a compulsory administrative measure, such as restricting freedom of the person or the sealing up, seizing or freezing of property, which one refuses to accept;

\ldots

(4) refusal by an administrative organ to issue a permit or license, which one considers oneself legally qualified to apply for, or its failure to respond to the application;

(5) refusal by an administrative organ to perform its statutory duty of protecting one’s rights of the person and of property, as one has applied for, or its failure to respond to the application;

\ldots

(8) cases where an administrative organ is considered to have infringed upon other rights of the person and of property.

Apart from the provisions set forth in the preceding paragraphs, the people’s courts shall accept other administrative suits which may be brought in accordance with the provisions of relevant laws and regulations.

APL, \textit{supra} note 290, art. 11. While arguments can be made variously for all the above categories, Article 11(8) seems to be a catch-all that covers any action by ZMG or ZLR that the creditors believed infringed upon their property rights, even if not listed above.

\textsuperscript{491}"I. It is imperative to implement law seriously.

\ldots

II. It is imperative to forbid any and all random and indiscriminate collection of fees and charges. The people’s courts shall collect the litigation costs according to laws and rules, and any and all fees and charges without express stipulation shall be cancelled without exception.
case, the applicable fee was at most a mere RMB 100. It is questionable whether this misapplication of the law was a mere oversight by a careless judge or a barrier thrown up at the urging of ZMG. It is perhaps equally likely that the urging of ZMG led a judge who was ignorant of the law to just follow ZMG’s prescriptions. RSM’s initial reaction to the fee was to postpone the litigation. Their protests led the court to place the matter under review. In the end, the court ultimately reversed its initial decision and charged the correct statutory fee of RMB 100, in line with all the relevant laws and regulations.

ZMG’s tricks were not over yet. Once ZIC decided to accept the case with the RMB 100 statutory fee, they immediately transferred the case to XDC. As a result, the single appeal by right would be to ZIC, a court where ZMG holds considerable influ-

1. The following fees and charges shall be forbidden resolutely:


492 Measures, supra note 484, § 5.6.3.
493 See Moir, supra note 478 (“In the past, judges were predominantly party-appointed officials with little or no legal experience. While training on the bench is now being promulgated, the new talent coming to the system is largely fresh legal graduates. ‘You see very young judges . . . . Can you rely on a fresh graduate from medical school?’”). See also id. (suggesting that courts outside of China’s flagship areas are unsophisticated and do not realize China’s need to be open or its need to enforce contractual rights).
494 See, e.g., Chris X. Lin, A Quiet Revolution: An Overview of China’s Judicial Reform, 4 ASIAN-PAC. L. & POL’Y J. 255, 298 (2003) (“[T]he judiciary is heavily influenced by local party and government officials who often abuse their power by interfering with the court’s business.”).
495 Moir, supra note 478.
496 Miller, supra note 4.
497 Id.
498 Id.
ence. After another legal battle, ZIC ultimately accepted to hear the case, meaning the appeal would go to the Guangong High Court ("GHC") in Guangzhou. The applicable rule here was again that major cases involving foreign or Hong Kong-related issues should start in the intermediate level rather than the district level. Even once the case was accepted, problems continued in the form of long delays. While the case was accepted and expected to begin by May 2004, no trial date was set until September 16, 2004, despite numerous requests from RSM and the statutory time limit of six months having already long passed.

At the hearing, ZMG’s only defense was a familiar one: that neither ZKG nor ZKHK had any interest in the land or any right to commence legal proceedings. In response to a range of evidence submitted to the contrary by RSM, ZMG submitted that it had “no comments and no objection.” In November, two ZKG subsidiaries—Zhu Kuan Property Development Company Limited and Gongle New City Company Limited—that owned the said land and were supposed to have been under RSM’s control as liquidator, joined the proceedings and argued that RSM did not have any rights to commence proceedings and that they did not wish to commence proceedings against ZMG. Despite RSM’s various protests, the subsidiaries were permitted to join the proceedings and ZIC came down firmly on the side of ZMG, holding that ZKG and ZKHK, as represented by RSM, failed to provide evidence showing that the land was forfeited by ZMG and then dismissing the case.

RSM entered an appeal to GHC. In regards to the lack of evi-

499 See APL, supra note 290, art. 58 (granting the right to a single appeal at the next higher level).
500 Miller, supra note 4.
501 Id.
502 RSM, supra note 37, para. 215.
503 See APL, supra note 290, art. 39 (requiring a plaintiff to file a case with a people’s court within three months after finding out about the administrative act in question); id. art. 57 (requiring a people’s court to render a decision within three months after the plaintiff files the case).
504 RSM, supra note 37, para. 216.
505 Id. para. 217 (internal quotations omitted).
506 Id. para. 219.
507 Id. para. 220.
508 Id. para. 221.
dence that the land was forfeited, they stated that they had provided evidence from Ouyang confirming the forfeiture and, in any case, ZMG had not contested or responded to any of the evidence provided by RSM. 509 Going back even farther, RSM pointed out that ZLR had failed to allow RSM access to public information that could have proved or disproved the forfeiture. 510 Finally, the subsidiaries refused to cooperate with the parent once under RSM’s control, and it was also obvious that ZMG wielded strong influence over ZIC. 511 GHC had taken no action by January 2005. 512

From the beginning, the prospects were slim that the land would be returned for the benefit of creditors. In practice, PRC governments’ ability to revoke land-use rights functions is much like U.S. eminent domain but with even less restrictions on what the government can remove from SOEs. However, creditors’ argument for compensation was at least marginally stronger. ZMG can point to the fact that ZKD did not request compensation in the statutory time period, but it is difficult to ignore the fact that this would have been tantamount to ZMG requesting compensation from ZMG. Being difficult to ignore, however, does not prevent the PRC courts from ignoring it—as they in fact did—especially as those courts were under ZMG’s power.

2.8.4. Challenging ZMG’s seizure of additional properties

On August 6, 2004, RSM filed an application in ZIC contesting ZIC’s decision to grant the ZMG Finance Bureau’s petitions. On November 25, 2004, ZIC unsurprisingly ruled against RSM, who made immediate plans to file an appeal. 513

2.9. Intra-Liquidation Negotiations

In an attempt to bring ZKG out of liquidation in February 2005, ZMG offered HKD 2.52 billion, a 21.33% return for unsecured creditors. 514 It was not clear where this money would have come from, but ZMG said it would get a third party to provide the

509 Id. paras. 221.1–2.
510 Id. para. 221.4.
511 Id. paras. 221.3, 221.5.
512 Id. para. 222.
513 Id. para. 182.
514 Moir, supra note 48.
Supposedly, ZMG signed a RMB 3.5 billion syndicated loan agreement with the Guangdong branches of ICBC and Guangdong Development Bank and the Zhuhai branch of the SDB. If the creditors had accepted this loan, all claims against ZKG would have been dropped, and assets secured against loans to the banks would have been returned. However, the creditors predictably rejected this offer, opting instead for further negotiations. It was an open secret that the creditors were looking for a return of at least 30%. Moreover, this offer gave unsecured creditors barely 1% more return than the August 2003 offer of HKD 2.25 billion that creditors had already rejected. Most damningly, preparations for a counter-offer had already begun when news of this offer hit the press.

2.10. Final Resolution

After the February 2005 offer, the Zhu Kuan case stepped out of the media limelight and fell into quiet negotiations between ZMG, ZKG, and the creditors. Creditors still held out for a settlement, including the blessing of higher governmental levels, as meaningful legal remedy in PRC courts would have been costly at best and impossible at worst. Borrelli had even been hopeful for a settlement by the end of 2004, although this did not come to pass. The threat of liquidation loomed large over the creditors, as liquidation without the cash infusion ZMG had been working to provide would likely have made the end result for creditors worse than even the most recent offer in February of 2005.

During 2005, the push for higher returns diminished to some extent as more and more creditors sold their debt to other banks. This took some pressure off of ZMG. These banks that bought the

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515 Id.
516 Id.
517 Id.
518 Rejection of this was implicit in their acceptance of the July 2005 offer. LeeMaster, supra note 202.
519 Moir, supra note 48.
520 Id.
521 Id.
522 Moir, supra note 3.
523 Id.
524 Block Probe, supra note 365.
debt purchased at a discount and intended to make a profit off just a few percentage points difference. DBL, for example, increased its debt holding to HKD 536.3 million in January 2005, up massively from HKD 74.1 million, betting—ultimately correctly—that the price of the assets would rise.\footnote{Briefly: Korea Steel Maker Posts Jump in Profit, INT’L HERALD TRIB., Jan. 26, 2005, available at http://www.iht.com/articles/2005/01/25/bloomberg/sxbriefs.php (last visited Apr. 1, 2006).}

But RSM had not taken any potential solutions off of the table. Had negotiations failed, Borrelli was prepared to implement a “series of substantial legal steps,”\footnote{Moir, supra note 3. See also Interview, supra note 248 (detailing accounts by RSM and its legal counsel which describe actions similar to the previous case of China Tianjin International Economic & Technical Co-operative Corporation, in which a single disgruntled businessman entered judgments all over the world against an SOE and ultimately compelled the SOE to meet his demands). For a full discussion of the case, see Vincent A. Pace, Financing Chinese State-Owned Enterprises: The Lessons of Three Major Chinese Cross-Border Insolvency Cases, 6-12 (May 1, 2005) (unpublished manuscript, on file with author).} and issued a warning to potential third party investors that RSM was “certainly not going to let anybody take control of [the Hengqin land plot] until this dispute [was] resolved,”\footnote{Moir, supra note 3.} a statement which could easily be projected onto other the ZKG assets involved in the dispute. He further stated that part of RSM’s task ahead was to “ensure that both the Zhuhai government and the officers responsible [were] brought to account for what transpired before the appointment of provisional liquidators and the assets that have been stripped away since.”\footnote{Id.} One creditor has even specifically stated that “[u]ltimately, . . . the government will be pursued.”\footnote{Moir, supra note 52.} Such threats against the government officials involved—especially in a China, where charges of corruption could lead to a death sentence—carried significant weight in pushing those involved to the negotiating table.

ZMG’s asset-stripping, their previous threats of an impending liquidation, and their poor financial status, as well as the case of GITIC,\footnote{In GITIC’s liquidation, only RMB 20 million was validated, representing a minuscule return for creditors with claims on GITIC’s HKD 8.1 billion debt and coming only “in dribbles over a long period of time.” Block Probe, supra note 365. Creditors struggled just to get 15% back on their loans. Tom Mitchell, GITIC HQ Buyer Fails to Seal Deal; Three Large Payments Are Overdue As Banks Refuse to Lend to} suggested that ZMG’s ultimate strategy might have been
to liquidate after removing as much as possible from the reach of liquidators. Countervailing this, there were several factors pushing ZMG to appease creditors. Economically speaking, at some point in the future ZMG would want to borrow again and the better their current relationship with banks, the better the terms at which this would be able to happen. Perhaps even more potent than ZMG’s future economic status was the lurking question of corruption, as it would be an exception to the rule in the PRC if there were no corruption at all amid the vast amounts of money changing hands in relation to ZKG.531 As highlighted by the threats to attack officials involved, those who dipped their hands into this honey pot had a strong urge to make sure that creditors did not dig too far into records that might reveal illicit transactions. Finally, there was pressure, albeit muted, from Beijing to resolve the situation,532 since Beijing could hardly have been happy when such prominent debacles of state-sponsored corporate mismanagement splashed across newspapers and stung major institutional investors.

Ultimately, on July 29, 2005, ZKG’s creditors signed a memorandum of understanding to accept an HKD 3.2 billion settlement offer.533 True to the earlier reports, ZKG was bailed out by ICBC as part of a “far-reaching financing agreement” with ZMG.534 Assets seized by RSM in Hong Kong would be returned to ZKG and held by ICBC as security on the loan to ZMG. Furthermore, the winding-up proceedings would be stayed.535

Finally, after years of contentious negotiations, creditors were able to put this episode behind them. ZKG continues to conduct some of the activities that it was previously involved in.536 And ZMG finally received

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531 See Lubman, supra note 6, at 404-05 (noting the pervasiveness of corruption in China).

532 Block Probe, supra note 365.


534 Id.

535 Id.

536 Jiuzhou Development Company Limited was formerly known as Zhu Kuan Development Company Limited. The Group’s principal activities are the management of a holiday resort, theme park, and amusement park and the provi-
more financing with which it could pursue its lofty development plans.\textsuperscript{537}

\textbf{Table 2: Summary of Offers Regarding ZKG’s HKD 7.8 Billion Debt}

<table>
<thead>
<tr>
<th>Offer</th>
<th>Cash Amount (HKD billion)</th>
<th>Creditors' Return (%)</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2002\textsuperscript{538}</td>
<td>Over 4</td>
<td>45\textsuperscript{%}\textsuperscript{539}</td>
<td>Revised in June</td>
</tr>
<tr>
<td>June 2002\textsuperscript{540}</td>
<td>Over 4</td>
<td>Over 40\textsuperscript{%}\textsuperscript{541}</td>
<td>Majority of creditors accepted; ZMG reneged\textsuperscript{542}</td>
</tr>
<tr>
<td>July 2003\textsuperscript{543}</td>
<td>2.05\textsuperscript{544}</td>
<td>18\textsuperscript{%}\textsuperscript{545}</td>
<td>Creditors unanimously rejected\textsuperscript{546}</td>
</tr>
<tr>
<td>August 2003\textsuperscript{547}</td>
<td>2.25\textsuperscript{548}</td>
<td>21\textsuperscript{%}\textsuperscript{549}</td>
<td>Majority of creditors rejected\textsuperscript{550}</td>
</tr>
<tr>
<td>February 2005\textsuperscript{551}</td>
<td>2.52\textsuperscript{552}</td>
<td>21.33\textsuperscript{%}\textsuperscript{553}</td>
<td>Rejected\textsuperscript{554}</td>
</tr>
<tr>
<td>July 2005\textsuperscript{555}</td>
<td>3.2\textsuperscript{556}</td>
<td>40\textsuperscript{%}\textsuperscript{557}</td>
<td>Accepted\textsuperscript{558}</td>
</tr>
</tbody>
</table>

\textsuperscript{537} LeeMaster, supra note 202.
\textsuperscript{538} RSM, supra note 37, para. 227.
\textsuperscript{539} Id.
\textsuperscript{540} Moir, supra note 191.
\textsuperscript{541} Id.
\textsuperscript{542} Moir, supra note 48.
\textsuperscript{543} Moir, supra note 252.
\textsuperscript{544} Moir, supra note 38.
\textsuperscript{545} Moir, supra note 48.
\textsuperscript{546} Moir, supra note 191.
\textsuperscript{547} Moir, supra note 48.
\textsuperscript{548} Id.
\textsuperscript{549} Moir, supra note 191.
\textsuperscript{550} Id.
\textsuperscript{551} Moir, supra note 48.
\textsuperscript{552} Id.
\textsuperscript{553} Id.
\textsuperscript{554} Rejection of this was implicit in their acceptance of the July 2005 offer.

LeeMaster, supra note 202.
\textsuperscript{555} Id.
\textsuperscript{556} China’s ICBC, supra note 533.

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3. PROBLEMS APPARENT IN THE ZHU KUAN CASE

3.1. Poor Corporate Governance

3.1.1. State-induced corporate mismanagement

In the newly-capitalist Communist Party, members no longer rise through the ranks strictly by becoming an outspoken Marxist ideologue but instead must now raise capital and build things—the bigger, the better. There is perhaps no better case in point than Liang. Despite planning failures and ZKG's incurring massive debt under his watch, Liang has not been accused of any wrongdoing by creditors or anyone else. Far from it: Liang found himself promoted to membership on the NPCSC. Liang's continuing political success, and that of others like him, sends a perverse message to government officials: massive debts to international creditors funding high-risk speculative investments are alright as long as you can attribute some apparent development to your name. Lenders need to take heed of this incentive as an additional risk factor when lending to SOEs.

ZMG as a whole shared with Liang the goal of transforming Zhuhai with each individual subject to the same incentives as Liang. There was hardly even a suggestion that their goal was to create profit-bearing activities that would serve to repay the massive debts ZMG forced ZKG to incur to fund Zhuhai's development. Banks ignored these signals, and ZMG succeeded in transforming Zhuhai despite the massive collateral damage. Chinese officials—having seen that no matter how much their finances diverge from traditional lending standards, there has still been someone willing to lend to them (ZMG even arranged the loan in 2005 to help with ZKD's debt)—have had little reason to worry

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557 LeeMaster, supra note 202.
558 Id.
559 See, e.g., Joseph Kahn, Investment Bubble Builds New China, N.Y. TIMES, Mar. 23, 2005, at C1 (arguing that local governments often favor large infrastructure projects even when there may be better ways to spend money).
560 See supra notes 27-29 and accompanying text (noting the high level of development under Liang's watch).
561 Miller & Clifford, supra note 3.
562 Id.
about actually repaying loans to assure future affordable financing. Directors of SOEs such as ZKG hardly have the chance to take up the mantle of "profit-seeking corporate director" when forced to kowtow at the feet of their political masters. When determining risk in the PRC, creditors cannot afford to ignore that their goal (i.e., profit) will often conflict with the governments' goals (e.g., development) and, further, that local governments are not above fleeing once the funds have served their purpose.

3.1.2. Lack of transparency

From ZKD's request to shareholders to buy back and/or issue new stock to the blatant avoidance of court-mandated disclosure by removing records from Hong Kong, the lack of transparency was a pervasive problem in determining the financial status of ZKG. A representative of the creditors said of ZKG that "[t]here needs to be full transparency of the financial dealings of the group."563 Unfortunately, now that a deal has been concluded and given the potential for such transparency to reveal illicit activities or just embarrassing mismanagement, this did not and will likely never happen.

3.1.3. Illegal activities

When dealing with large amounts of money and relatively low-paid municipal administrators in the PRC, corruption is ubiquitous. While there is no smoking gun pointing to corruption in the ZKG case, the tendency for corruption in PRC SOEs and the adamantance with which ZMG has refused to divulge records suggests that there is likely corruption or other illicit activity hidden within the records of ZKG. Such activity is difficult to avoid when doing business in the PRC. It is also difficult to quantify the risk of its occurrence. Nevertheless, the potential for parties to be involved in illicit activities cannot be ignored when conducting business of any sort in the PRC.

3.1.5. Inability to hold directors and employees liable

Only seventeen countries have signed extradition treaties with the PRC; even Hong Kong and Macau have not.564 One oft-cited

563 Miller & Clifford, supra note 3.
564 CHAU PAK-KWAN & STEPHEN LAM, HONG KONG LEGISLATIVE COUNCIL
reason is the concern about PRC’s record on human rights, but just the chance of being dragged into the roulette wheel of the PRC legal system—even for simple economic misfeasance—seems a sufficient deterrent. In either case, the door is wide open for PRC nationals to simply stay out of the jurisdiction when it becomes likely that legal action could be taken against them. ZKG made ample use of this, beginning with ZKG’s alleged boarding up of its offices in 1998 and continuing with ZKG directors’ safety in Zhuhai. This effectively lets PRC nationals take the home field advantage in litigation.


565 Leahy, supra note 1.

566 Shutting operations and fleeing the jurisdiction seems to be a common strategy for PRC entities:

It is not just lenders who have been suckered by dreams of avarice in China. In the last couple of years, several privately owned Chinese companies listed in Hong Kong have failed spectacularly, leaving investors and the authorities helpless as the Hong Kong offices were shuttered and management stayed safely ensconced in the mainland, suitably enriched courtesy of gullible international investors.

Id.
3.2. Ineffective Legal Remedy in the PRC

3.2.1. Lack of an independent judiciary

In the PRC, the home field advantage is a big one. Courts in the PRC are a division of the government in which they sit, effectively making them beholden to the government’s prerogatives. McDonald said, “[w]hen you sit in front of a judge in Zhuhai, they don’t see it as their problem. The courts are seen as an element of the party!”\textsuperscript{567} Furthermore, “[t]he People’s Court has historically preserved and enforced the interests of ‘the State.’”\textsuperscript{568} Cairns elaborated, “[t]hey’re not an independent judiciary.... [T]hey’re there to follow party policy. If the policy is that we’ve borrowed this money from Johnny foreigner and we don’t have to pay it back, that’s what they are going to do.”\textsuperscript{569} Without judicial independence in the PRC, litigation which conflicts with state interests will rarely be successful unless a party can escape to a jurisdiction in which the state actor in question is less influential, as RSM did in the Zhu Kuan case.

3.2.2. Lack of professional judges

Beyond being beholden to government interests, judges often simply lack the knowledge required to rule effectively, especially outside of major cities. McDonald said, “Try to recover the loans and you’re dealing with courts that have a very poor understanding of liquidations.”\textsuperscript{570} The judges were more than willing to accept utterly false readings of PRC law, which would doubtless be overturned on appeal. Even assuming ZMG pressure, it would seem that the judiciary should have nevertheless been able to tell ZMG what the ultimate result would be. Unless they did so and ZMG used litigation as merely a delaying tactic, it seems that ZIC simply did not understand the laws. While litigating in large, sophisticated cities in the PRC can remediate this to some extent, the only sure-fire way to get a qualified judge is to file actions in a more mature legal system when possible.

\textsuperscript{567} Id.
\textsuperscript{568} Hilken, supra note 463.
\textsuperscript{569} Leahy, supra note 1.
\textsuperscript{570} Id.
3.3. Lack of Applicable Laws

Of the major problems in the Zhu Kuan case, the lack of applicable laws is the one most likely to show immediate improvement; the promulgation of the EBL is expected within the next few years after more than a decade of delay. The new law is being hailed as a quantum leap forward and is being welcomed across the board. It is largely consistent with international norms. It gives the liquidation administrator the power to review questionable transactions in the months leading up to the bankruptcy. Even those with reservations see the EBL as a step in the right direction.\(^\text{571}\)

Unfortunately, the proposed EBL is unlikely to live up to its full on-paper potential in the short term, as it will do nothing to remedy the problems of what McDonald calls a “rotten system.”\(^\text{572}\) Most prominently, no matter how good any law in the PRC is, enforcement will be extremely difficult, if not impossible when litigating against those closely connected to a government subdivision with power over the courts. The effectiveness of the new bankruptcy law, called into question as the courts’ role of protecting the interest of the state, is enshrined in the new law.\(^\text{573}\) The lack of expertise in the courts also poses a formidable problem. “The draft law places a lot of responsibility and discretionary authority on the People’s Courts. So the effectiveness of the law very much depends on the technical competence, experience and even availability of the court.”\(^\text{574}\)

McDonald doubts the efficacy of the EBL and questions whether it would have been of any use to ZKG’s creditors. Article 8 expressly provides for the recognition of foreign liquidations. However, they are only permitted if they do not violate the interests and rights of state and domestic creditors. This seems to guarantee the rights of government and domestic creditors over those of foreigners, which would have made many of ZKG’s asset transfers defensible. “If the draft law is to benefit investors and creditors,” McDonald explains, “the People’s Court must find a way to limit the rights of the State to interfere with the bankruptcy process so as to obtain preferential treatment for the State or domestic

\(^{571}\) Hilken, supra note 463.

\(^{572}\) Id.

\(^{573}\) Id.

\(^{574}\) Id.
As the Zhu Kuan case demonstrates, this seems unlikely to happen without major systemic changes.

4. LESSONS LEARNED FROM THE ZHU KUAN CASE

4.1. Determining Creditworthiness

4.1.1. Increased risks from unfounded positive predictions

Creditors must show greater care when analyzing the creditworthiness of entities and transactions in the PRC. ZKG and ZMG spewed out all sorts of rosy predictions about virtually everything they did while risk factors were minimized or simply not presented to potential lenders and investors. Creditors’ best approach here would be to simply hold Chinese companies up to the same standard they would a non-Chinese company. While that may not always be practical given the nature of the Chinese system, any raising of the bar before being convinced of the soundness of an investment would better protect creditors and investors from hazards such as the ones they faced with ZKG.

4.1.2. Increased risks from state demands on SOEs

Creditors would be wise to more carefully evaluate the risk of SOEs especially. ZKG played their cards quite well. When it suited them, they blurred distinctions to seem a governmental body, with all the benefits that status supposedly brought: most notably, presumed assumed protection from default. When trouble arose, suddenly ZKG became a private enterprise and the government was a separate entity with priority to get back the money ZKG allegedly owed to it. Lenders need to stop ignoring the now obvious fact that the state cannot be presumptively relied on to back loans to SOEs. Furthermore, powerful SOEs in a given jurisdiction often wield considerable political influence that can hinder or block effective judicial remedy. See, e.g., Matthew D. Latimer, Note, Gilding the Iron Rice Bowl: The Illusion of Shareholder Rights in China, 69 WASH. L. REV. 1097, 1109-11 (1994) (discussing how powerful SOEs can obstruct judicial enforcement of shareholder rights).
SOEs.

The benefits from state to SOE do not flow in only one direction, and creditors need to be aware of potential conflicting interests when dealing with SOEs.\textsuperscript{577} Under normal business circumstances, loans are used to improve a company's ability to make a profit, whether directly or indirectly. However, in the case of an SOE, the normal goal of seeking profits might be undermined by officials' desires to move up in the CCP. In the PRC, cadres who have built big are also often those that move up.\textsuperscript{578} This could lead to a situation in which an official might be perfectly content to ignore profit-seeking altogether and run an SOE into the ground, laden with debt, if he can tie some huge infrastructure project to his name, as was arguably the case in ZMG.

4.1.3. Increased risks from lack of accountability

Lacking accountability, local state actors in the PRC will follow the rules, whether contractual or legal, only when it suits them. ZKG broadly defied various court orders, regulations, and laws. Contractual abrogation was evident in the ZHC bonds; ZMG found it inconvenient to follow the terms of the contract and thus declined to do so, while ZKG flouted its contractual obligation because of a lack of funds. ZKD even disregarded its own articles of incorporation to prevent RSM from electing members to the board. When it suited their interests, ZMG gave ZKG the land-use rights to large tracts of land in Zhuhai.\textsuperscript{579} However, when it ran contrary to their interests, they took it back without compensation.\textsuperscript{580} S&P’s 2001 report said, "the abrogation of contractual obligations could have implications for the reputation of Chinese entities toward adherence to the enforcement of contractual obligations."\textsuperscript{581} Creditors must be extremely wary when relying primarily on contractual

\textsuperscript{577} See Simon Cartledge, Big Price, Big Risk, Big Hope for Hang Seng, S. CHINA MORNING POST, Dec. 20, 2003, available at 2003 WLNR 5948228 ("As both the collapse of Gitic and the ongoing saga at the Zhuhai government-controlled Zhu Kuan Group show, local governments in China can have interests that conflict with those of the banks which supplied them with money.").

\textsuperscript{578} See supra notes 559–61 and accompanying text.

\textsuperscript{579} See Miller & Clifford, supra note 3; see also supra notes 252–57 and accompanying text (explaining land deals between ZKG and ZMG).

\textsuperscript{580} See supra sections 2.5.2-.3 (discussing the land transactions between ZKG and ZMG).

\textsuperscript{581} Gesteland, supra note 14.
obligations to bind a state actor, as the Zhu Kuan case demonstrates that they are far from reliable.

The lack of accountability also applied in economic terms. International lenders' overeagerness to pounce on the Chinese market created a situation of moral hazard in which even directors who made economically poor choices continued to have access to capital. Furthermore, domestic Chinese banks were notoriously poor at assessing risk, thus opening the door for more easily replaceable financing.\(^\text{582}\) As long as financing continues to be had so easily, there is little incentive for economic actors to modify their behavior.

4.1.4. Increased risks from cultural attitude towards debt

There also seems to be an issue regarding state officials' attitude toward paying back loans. According to Cairns, "[t]here's a massive cultural disconnect [between international banks and Asian borrowers] . . . . [O]ften the banks bring a very Western mindset to things and it doesn't work. The banks lend some money and then ask for it back and the company says, '[B]ut you lent it to me!'"\(^\text{583}\) As with the Zhu Kuan case, this tendency is even more exaggerated when Chinese SOEs are involved. McDonald says, "All the money has been spent on government infrastructure . . . . there's this expectation that they'd never really have to pay the money back."\(^\text{584}\) Cairns offers solid advice in this regard: "There's no point criticizing China for it and saying 'why aren't you like the US?' They're not: that's the system. No one's forced to lend money to them. Don't criticize them for not being like us. It's unfair and unrealistic."\(^\text{585}\) The implication here is that creditors need to think of loans in the cultural terms that the borrowers do and include the increased likelihood that the loan will never be returned due to this attitude as part of their risk assessment.


\(^{583}\) Leahy, supra note 1 (internal quotations omitted).

\(^{584}\) Id. (internal quotations omitted).

\(^{585}\) Id. (internal quotations omitted).
4.1.5. Increased risks when SOE assets are in the jurisdiction of the state owner

The ultimate effective value of an SOE’s assets to creditors is extremely questionable when they are located in the jurisdiction of their governmental owner. Such assets should not be counted strongly as a risk-mitigating factor in the case of liquidation as, under the existing legal regime, the state actor can at least impede and, at most, completely block creditors from obtaining access to those assets.

4.1.6. Decreased risks when SOE assets are not in the jurisdiction of the state owner

On the other hand, the more assets an SOE holds outside of its own jurisdiction that cannot be easily removed to its own jurisdiction, the less the risk for creditors. Even an alternative jurisdiction in the PRC to the state actor’s home jurisdiction might be favorable. This is apparent in the Zhu Kuan case when ZMG attempted to have the ultimate appeal of the land-use rights forfeiture litigation sent to XDC so the ultimate appeal would be in ZIC. The creditors attack demonstrates the perceived value of taking the case to GHC, a move that would allow creditors to escape the problems of immediate control of the judiciary by what is essentially the other party in the litigation and, at least to some degree, the more general local favoritism. Thus, when litigation against SOEs in the PRC is the best course of action, creditors should minimize exposure to the jurisdictions immediately under the opposing state actor.

The benefits of an alternative jurisdiction are far more prominent, however, when the alternative jurisdiction is outside of the PRC, in places with more reliable legal systems. As many of the places where Chinese SOEs often go to conduct business activities fit this bill, such as Hong Kong or Macau, this can be a powerful tool for creditors. This approach amplifies the benefits of litigating elsewhere within the PRC by further removing state actors from the usually cozy guanxi they share with state actors outside of their immediate jurisdictions. Furthermore, it allows creditors to reduce or avoid exposure to other systemic problems in the PRC legal system, such as judicial incompetence or corruption that would not be avoided in other PRC jurisdictions. The repeated rulings in favor of the creditors by the Hong Kong, Macanese, and BVI courts all
demonstrate the utter inability of Chinese SOEs and state actors to extract the same kind of lopsided rulings that they can comfortably obtain in their home jurisdiction. These judgments all took a no-nonsense approach to cross-border insolvency that bodes well for creditors in the future, even when litigating against Chinese SOEs.

As the jurisdiction of choice for most PRC window companies, the Hong Kong case in particular has been hailed as a watershed because formerly PRC courts dealt with bankruptcies of mainland government investment arms or protracted debt work-outs occurred to prevent liquidation altogether. The Zhu Kuan case opens them all up to jurisdiction in Hong Kong and increases creditors' chances of recovering money by allowing them to avoid PRC litigation, provided there are assets in Hong Kong.

4.1.7. Increased risks when dealing with Zhuhai

Finally, perhaps without requiring mention, ZMG and its related SOEs are virtually worthy of blacklisting. Borrelli said in 2003, "based on what we've seen to date, . . . anyone considering extending substantial credit in similar circumstances to Zhuhai should proceed with extreme caution." In 2001, S&P reported that ZHC's default on bond payments would "have implications for future transactions involving the Zhuhai government and its affiliates." After the complete collapse of ZKG, the a fortiori conclusion is apparent: lending to ZMG and any enterprise that answers to it is likely to leave creditors burnt. ZKG creditors, at least, seem to have taken this to heart; as one creditor said, "Nobody in their right state of mind would lend [ZMG] money. . . . I really don't know how they are going to survive." Nevertheless, ZMG managed to borrow funds for the 2005 offer, although significant collateral was put up for them.
4.2. Managing Loans

4.2.1. Secure debt

With extremely high risks, creditors should take steps to secure their debts. ZKG's secured loans point to a tendency to give a better deal to other PRC companies, but international institutional investors should also have that option available when they are in a stronger bargaining position, such as before they actually provide the funds. The bail-out loan with the assets put up as security is a good example of this. Needless to say, low interest rates should not be an option for such risky SOEs, barring extensive assets as security.

4.2.2. Demand information disclosure

Creditors can demand regular disclosure requirements from debtors. To be even more aggressive, creditors may want to consider seeking representation in the board of companies they deem to be particularly risky, such as government-tied companies. While both of these methods are far from foolproof, early signs of insufficient disclosure could at least give creditors more time to prepare to protect their interests.

4.3. Litigating

4.3.1. Litigate outside of the PRC first

The broadest conclusion of the Zhu Kuan case is that it is a struggle for creditors to protect their rights in the PRC when dealing with SOEs, even when they are based outside the PRC. Steven Vickers, president of International Risk, a global risk management company, says, "[y]ou have poorly regulated markets in a

593 See Angela Wang, Partner, Angela Wang & Co., Inter-Chambers Breakfast Presentation: Managing Legal Risk When Doing Business and Taking Security in China (Jan. 12, 2005) (PowerPoint presentation and notes on file with author) (stating that one of the only effective ways to prevent the kind of asset stripping that occurred in the ZKG case is for those taking risks to insist on board representation and disclosure).

594 See Miller, supra note 4 ("The twisted story of the Zhu Kuan Group is also a reminder of how difficult it is for investors, even in Hong Kong-domiciled mainland companies, to protect their rights.").

https://scholarship.law.upenn.edu/jil/vol27/iss2/5
hothouse economy.... With variable enforcement you get an explosive mix [in which creditors can find themselves] fleeced by powers beyond their reach. 595 While relief may be available in other jurisdictions, that relief is limited to what that jurisdiction offers596 and by courts that are reluctant to take further measures.597 The two SARs have no jurisdiction over any other part of the PRC, and other PRC courts do not need to recognize their decisions.598

Nevertheless, alternative jurisdictions can often be preferable to the PRC. Practitioners have historically recommended litigation in the PRC only as a last resort, promoting instead other options such as resolving the problem in an offshore arbitration center.599 RSM’s litigation in the PRC does not suggest a movement away from this sound advice but rather a situation in which it was forced into litigation by the asset-stripping actions of ZMG.600 The persistent problems in the Chinese judicial system are myriad, and include prohibitive fees,601 corruption,602 poorly trained judges603 and lawyers,604 a lack of judicial independence,605 absence of rule of law,606

595 Luck, supra note 210.
597 Prosperfield Ventures, supra note 596, at ¶ 98 (refusing to grant an injunction that could permit fines, arrests, or even imprisonment for losing PRC parties should they enter Hong Kong for fear of the effects such a ruling would have on Hong Kong and PRC securities markets).
598 Luck, supra note 210.
599 Moir, supra note 478.
600 But see, id. ("The fact that liquidators—as in the Zhu Kuan case—in Hong Kong are even considering mainland courts for redress suggests a change in perception about the kind of justice on offer, albeit subtle. Alternatively, there is the possibility that potential litigants are more savvy to the risk management involved.").
601 See supra notes 484–85 and accompanying text (discussing high cost fees).
602 See Lubman, supra note 6, at 404 ("So tightly knit are corrupt practices into the fabric of modern Chinese society that they are almost invisible.").
603 See Moir, supra note 478 ("In the past, judges were predominantly party-appointed officials with little or no legal experience.").
604 Id. (asserting that the quality of lawyers is crucial because it is up to the lawyers to help judges—often poorly trained—to understand the case and sug-
local protectionism (including that of SOEs),\textsuperscript{607} decision making based on extrajudicial considerations,\textsuperscript{608} and enforcement difficulties.\textsuperscript{609} Notably at issue in the case of debt recovery is the lack of effective recovery mechanisms.\textsuperscript{610}

Kendall suggests some strategies for accessing courts in Hong Kong:

[F]oreign investors thinking about lending money to a PRC entity may consider establishing a Hong Kong connection as early as possible. This may be done by ensuring that the loan documentation is negotiated and executed in Hong Kong and made subject to Hong Kong law. Provision may also be made for the loan to be repaid through Hong Kong.\textsuperscript{611}

While this may not be conclusive evidence of sufficient connection to Hong Kong, it would increase the chances of a court accepting jurisdiction in circumstances where a winding-up becomes inevitable.\textsuperscript{612} It would be wise to take similar measures in other jurisdictions as well.

\textbf{4.3.2. Aggressively forum shop in the PRC}

When there is no choice but to litigate in the PRC, it is imperative to pick the optimal forum. In the Zhu Kuan case, ZMG's forum selection maneuvers were designed to place the final appeal of any result in the courts they could best influence, a move especially dangerous to creditors given the "locals never lose" rule when litigating in the PRC against the well-connected in their local jurisdiction.\textsuperscript{613}
4.3.3. Call on guanxi

Of course the importance of *guanxi* cannot be underestimated. While such connections are not apparent on the surface of the Zhu Kuan case, both the creditors on the one hand, and ZKG and ZMG on the other, used this to their best advantage. For creditors, this undoubtedly meant going to Guangzhou and Beijing to seek assistance from those best placed to help them. While nothing pointed directly to Beijing’s involvement, central officials can be assumed to have at least pressed ZMG to resolve this conflict, even as other central officials were pulling strings for ZMG. The lesson here for creditors is to not only use *guanxi* but also to make them in the first place.

5. CONCLUSION

Financial institutions have been lending to the PRC for years, despite the lack of bankruptcy law, transparency, or rule of law. Creditors claim that, at least in the case of dealing with SOEs, the lesson has been learned the hard way. Sullivan states that these practices are now a thing of the past:

We learned . . . . Our credit processes are being tightened and we are smarter, I hope, than we were [ten] years ago. At the end of the day, we are in the banking business and we take risks. But I think we are managing that as well as we can.

Another creditor noted, “[n]o more participation with mainland government enterprises . . . we are never, ever going to lend money for working capital where the government is the user of these funds. We learned our lesson.”

Nevertheless, while many international financial institutions have been hurt by PRC corporate downfalls, the chance of hitting it big, or even just getting established in the most populous country on Earth, will continue to keep memories short and allow investors and lenders to get burnt anew. For financial institutions that

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614 See Leahy, supra note 1 (describing the hazards of lending in China).
615 Moir, supra note 8, at 16.
616 Moir, supra note 3, at 2.
617 See Leahy, supra note 1 (“’You can’t afford not to be in China,’ [Cairns] says. ‘Banks know that: it’s too big to ignore. China’s always been the next big
cannot handle the effects of regular massive downfalls of indebted PRC companies, the best advice is to avoid domestic PRC enterprises altogether. For the majority of these major international financial institutions, however, the question is not whether to enter the PRC but how to minimize the risk when already in the PRC.

After various collapses related to the Asian financial crisis, "[b]usinessmen [in Asia] seem to be more conservative."618 However, the seeds of future collapses seem to have been planted already. According to Cairns, "[y]ou have a lot of money chasing a home. . . . [Y]ou see a yield and you go for it. A lot of the credit processes [get] squashed on the way. [An Asian financial crisis] will happen again."619 Appleby takes a similarly dark view, "Asia hasn't learned. For every shining example where corporate governance has improved, there are nine where they've gone down."620 Any slow down in the PRC economy is likely to force more bankruptcies like ZKG,621 and with those bankruptcies will be Zhu Kuan-like messes involving foreign financial institutions.

The pending bankruptcy law does offer some hope that the mess of PRC bankruptcy will simmer down. But even this will take time to filter through the system.622 In the best case scenario, there are at least several more years ahead in which international financial institutions must continue to deal with the corporate implosions they have become all too familiar with. Even when judges fully understand the new PRC bankruptcy law, systemic problems preventing an effective implementation of rule of law could render the law impotent.

The ambivalence of the PRC's still-transitioning economy is apparent in the Zhu Kuan case. With ZMG's broad corporate activities and interests, their function in this regard seems less like a municipal government and more like a parent company, albeit with goals not related to profits. This phenomenon is repeated throughout China at the provincial and mu-

618 Id. (quoting Dr. Marc Faber, Managing Director of Marc Faber Ltd.).
619 Id.
620 Id.
621 Miller & Clifford, supra note 3.
622 See Leahy, supra note 1 ("McDonald explains, 'It's one thing to say that China will have a bankruptcy law next year, but you've got to get that law implemented through the provinces. It will take time for new laws to be understood properly.'").
nicipal levels as well as in TVEs. Were there an effective legal means in the PRC to treat a bankrupt municipal government as a bankrupt parent company, problems such as fighting the share transfer to BVI would be resolved since the BVI enterprises would be subsidiaries of ZMG. Even if creditors had a legal remedy available to them, they would still face the PRC courts. In addition to the typical systemic problems, litigation in the court of the bankrupt subdivision in question would be tantamount to litigating in a department of the bankrupted company. For the time being, at least, investors and creditors have little choice but to continue dealing with the inherent ambivalence in the changing PRC system and all the accompanying risks and opportunities.