

HONG KONG / JUDGMENT

RE CRESVALE FAR EAST LTD

COURT

Court of First Instance

DECIDED

7 September 2007

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bjbj HCMP 3019/2004 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 3019 OF 2004

IN THE MATTER OF CRESVALE FAR EAST NOMINEES LIMITED (IN CREDITORS VOLUNTARY
LIQUIDATION) and IN THE MATTER OF THE COMPANIES ORDINANCE (CHAPTER 32) OF THE
LAWS OF HONG KONG

and HCMP 1871/2005 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 1871 OF 2005

IN THE MATTER OF CRESVALE FAR EAST LIMITED and IN THE MATTER OF THE COMPANIES
ORDINANCE (CHAPTER 32) OF THE LAWS OF HONG KONG

Before: Hon Barma J in Chambers (Open to the Public) Dates of Hearing: 24 & 25 January, 6
March 2007 Date of Judgment: 7 September 2007

J U D G M E N T

The applications There were before me two related applications by the liquidators of two companies, Cresvale Far East Limited () and Cresvale Far East Nominees Limited (CFEN), seeking directions as to how certain assets held by those companies, the ownership or entitlement to which the liquidators have been unable to determine, should be dealt with in their respective windings up. The assets in question and the claims to them The assets in question consist of the following:-

- (1) In the case of CFE:-
 - (a) A sum of US\$461,690.13 plus accrued interest in CFE s client account held under a sub-account designated as the account (the S-1 Fund);
 - (b) A sum of US\$790,098.75 plus accrued interest in CFE s client account held under a sub-account designated as the account (the S-3 Fund); and
 - (c) A sum of approximately US\$37,000 held in CFE s client account (the Residual Cash); and
- (2) In the case of CFEN:-
 - (a) A sum of JPY 58,172,500 received from a Japanese company called Nihon Kankyo Company Limited (), which has been notionally divided into three parts, in the following amounts:-
 - (i) JPY 7,500,000 (the NK Fund Part 1); (ii) JPY 12,500,000 (the NK Fund Part 2); and (iii) JPY 38,172,500 (the NK Fund Part 3);
 - (b) 341,200 shares in NK, which have been divided into the following three parcels:-
 - (i) 216,200 shares (the Parcel A NK Shares); (ii) 75,000 shares (the Parcel B NK Shares); and 50,000 shares (the Parcel C NK Shares); and
 - (c) 5,000 shares in another Japanese company called Clean Sanwa Company Limited (the Clean Sanwa Shares). Claims have been made to these assets by various parties, as follows:-
 - (1) Alps Electric Co. Ltd () claims to be the beneficial owner of the Parcel A NK Shares;
 - (2) Gun-Ei Chemical Co. Ltd (Gun-Ei) claims to be the beneficial owner of the NK Fund Part 3;
 - (3) Mr Akira Setogawa (Mr Setogawa) claims to be the beneficial owner of the S-1 Fund, the NK Fund Part 1, the Parcel C NK Shares and the Clean Sanwa Shares; and
 - (4) Mr Naoki Kumagai (Mr Kumagai) claims to be the beneficial owner of the S-3 Fund, the NK Fund Part 2 and the Parcel B NK Shares.
 - (5) Mr Alan Cohen (the US Receiver), who was appointed by an order of a United States court (the United States District Court for the Southern District of New York) dated 13 September 1999 as the temporary receiver of a group of companies (which included CFE and CFEN) the holding company of which was Princeton Economics International Limited (PEIL), opposes the claims of Mr Setogawa and Mr Kumagai. His position is that their claims are not made

out, and that the assets claimed by them should be dealt with as part of the assets of CFE or CFEN as the case may be, and as such, should be distributed to him, as the person entitled to receive their assets in the event of a surplus in their respective liquidations. So far as the claims of AEC and Gun-Ei are concerned, his position is essentially neutral, although at the hearing, Mr Anson Wong, appearing for him, indicated that to the extent that the court was not satisfied that AEC and/or Gun-Ei's claims were made out, the assets should be dealt with in a similar way to that which the US Receiver suggested in relation to the assets claimed by Mr Setogawa and Mr Kumagai. I shall deal with the claims of each of the four claimants referred to in paragraphs 3(1) to (4) above separately. However, before doing so, there is a certain amount of common background that can usefully be set out first. The general background PEIL is, as I have noted, the ultimate parent company of both CFE and CFEN. PEIL, an associated company known as Princeton Global Management Limited () and various subsidiaries of theirs were involved the promotion and operation of an investment scheme known as the Princeton Notes scheme. The persons principally involved in the Princeton Notes scheme were a Mr Martin Armstrong, together with Mr Setogawa and Mr Kumagai. In essence, the Princeton Notes scheme was a supposed investment programme under which funds were solicited for investment, with substantial funds being raised from various sources, including corporate clients in Japan. It was represented to the prospective investors that their funds would be invested for the most part in United States government or government agency fixed income securities, which would produce a rate of return well in excess of that obtainable from similar investments in Japan (a rate of return of about 6% per annum was offered, at a time when similar investments in Japan were producing minimal returns). It was also represented that, through an active investment strategy in relation to currencies, there would be minimal risk of adverse effects arising from unfavourable currency fluctuations. In fact, it seems that investors funds were not dealt with as represented. Funds received from different investors were mixed together, rather than being kept segregated from one another, and investments were made in speculative transactions from time to time. These matters eventually came to light in about September 1999, when the United States Securities and Exchange Commission (the SEC) and Commodity Trading Futures Commission (the CFTC) brought civil proceedings against Mr Armstrong, PEIL and PGM, alleging that they had engaged in a worldwide scheme to defraud investors. It was in the course of those proceedings that the US Receiver was appointed. Separately, it appears that there were also criminal proceedings against Mr Armstrong in the US, and against Mr Setogawa and Mr Kumagai in Japan, which resulted in their conviction and imprisonment on various criminal charges relating to the affairs of PEIL and PGM. Proceedings were also commenced by a large number of investors against Republic New York Securities Corporation (Republic) at which accounts were established for the investors in the Princeton Notes scheme. It appears that Mr Armstrong and others from time to time requested Republic to issue letters that PEIL or PGM sent to investors which (to Mr Armstrong's knowledge) misrepresented the amounts standing in the investors accounts. Republic was also involved in financing commodities trading by Mr Armstrong, which proved unprofitable, and eventually agreed with Mr Armstrong that funds held in the

investor accounts should be used to offset these trading losses, leading to substantial losses for the investors. After his appointment, the US Receiver participated in the negotiation of a global settlement scheme in respect of the investors claims against Republic and others. The settlement involved Republic, the SEC and the CFTC, and in effect resulted in Republic compensating the investors who had suffered losses on a basis that reflected their respective losses. As part of the settlement, the investors who had received such compensation agreed with the US Receiver on a pro rata distribution scheme by which they agreed to share proportionately in any losses on assets held by PEIL. Quite apart from the US Receiver's appointment, PEIL was wound up in its home jurisdiction (the Turks and Caicos Islands). It was as a consequence of PEIL's liquidation that CFE and CFEN were put into liquidation in Hong Kong. The liquidations of CFE and CFEN are now almost complete. The main outstanding matters to be resolved relate to the status of the assets to which I have referred above. The liquidators received claims to the assets from the claimants whom I have identified, asserting that the assets in question belonged, beneficially, not to CFE or CFEN, but to the respective claimants. Having received such claims, the liquidators sought to come to a view as to whether or not the claims were justified and should be accepted. However, they felt unable to accept the claims on the evidence available to them, as the records of CFE and CFEN which they had (which were admittedly far from complete) was in their view at best (from the claimants point of view) equivocal, and contained indications that the claimants might not in fact be beneficially entitled to the assets in question. The liquidators, having received from the claimants such material as they were able to provide, also sought input from the US Receiver as to whether or not the claims were valid, but no clear response indicating his position was received prior to the issue of these proceedings. Thereafter, it was indicated on behalf of the US Receiver that he would not object to the release of the assets claimed by AEC and Gun-Ei to them, provided that their claim was on the basis that they were entitled to the assets under a constructive trust. Shortly before this hearing, the US Receiver made his position (as I have summarized above) known through the evidence which he filed and his counsel's skeleton argument. If the assets in question are beneficially owned by the claimant asserting an entitlement to them, they will not form part of the assets of CFE or CFEN, as the case may be, and would fall to be distributed in specie to the relevant claimant. However, as the effect of a finding that all of the assets in question are not assets of the companies in liquidation would mean that the companies would not have sufficient funds with which to make this application, the liquidators, at the outset, sought and obtained from Kwan J. a Berkeley Applegate order in respect of each set of proceedings so that the liquidators will be entitled to have recourse to the assets in order to fund their costs (see *Re Berkeley Applegate Ltd* (No. 2) (1988) 4 BCC 279). However, as the Berkeley Applegate case makes clear, while the making of such an order provides some protection for the liquidator, it does not determine finally how the costs and expenses of establishing the beneficial entitlement to particular assets should be borne as between the company's assets and the trust assets, or whether (if the company has, at the end of the day, sufficient other assets out of which to meet its costs) any part of those costs should be borne by the trust assets. This is a matter that can and will be revisited at the end of the day. Here, the

liquidators have, in addition to seeking directions as to how the claimed assets should be dealt with, also sought directions as to out of which assets their costs should be paid. At the hearing, however, it was agreed by all parties appearing that this was a matter that should await further argument after the principal question of ownership and treatment of the assets concerned had been determined. Against this general background, I turn to consider the claims of each of the claimants. AEC's claim to the Parcel A NK Shares AEC has asserted a claim to the Parcel A NK Shares. NK was a Japanese company in which various persons and entities related to CFE and CFEN, AEC, Gun-Ei and others had shareholdings. In late 1998 and early 1999, NK was in financial difficulties and in need of funds. It was, apparently, nonetheless envisaged and hoped that NK might ultimately be listed on the Japanese stock market, perhaps in about 2001. Although CFEN is registered in NK's register of shareholders as the holder of the 216,200 Parcel A NK Shares, the liquidators do not suggest that CFEN is beneficially entitled to them. According to the evidence filed by AEC, it is entitled to the Parcel A NK Shares because it agreed to invest a sum of US\$5 million in NK at about the end of 1998, and the Parcel A NK Shares, which were registered in CFEN's name, were acquired for AEC on its instructions. In an affirmation filed by Mr Junichi Umehara, AEC's Deputy General Manager of Corporate Intellectual Property and Legal Affairs, Mr Umehara deposes to the circumstances underlying AEC's claim. According to Mr Umehara, on 11 December 1995, a then wholly-owned subsidiary of AEC known as Mercury Company Limited (Mercury) purchased a promissory note (the PGM MCO Note) with a face value of US\$91 million, which had been issued by Princeton Global Management MCO Limited (PGM MCO), a special purpose wholly owned subsidiary of PEIL, which had been formed for the purpose of issuing the PGM MCO Note. This represented an investment of about US\$91 by Mercury in the Princeton Notes Scheme, as the terms of the note were such that the note proceeds were to constitute a fund to be invested in various investments. Mercury, as the holder of the PGM MCO Note, would be entitled to regular coupon payments of interest. Management of the proceeds was to be carried out by a subsidiary of PEIL called Princeton Economics International (Asia) Limited, with PEIL acting as advisor. Management and performance fees were payable to the manager. The note could be redeemed prior to maturity in accordance with its terms. It is not disputed that Mercury did acquire the PGM MCO Note. Mr Umehara goes on to say that thereafter, in December 1998, Mr Setogawa approached a Mr Ichiyama of Mercury, and requested that Mercury agree to make an investment of US\$5 million in NK, which was then in need of funds. Mr Setogawa requested that the investment should be made out of Mercury's investment in the PGM MCO Note. Mr Ichiyama agreed to do so, and on 24 December 1998, wrote to Mr Armstrong, confirming that US\$5 million could be invested in NK out of PGM MCO portfolio subject to your agreement. It is clear from accounting and banking records that the sum of US\$5 million was in fact transferred from PGM MCO to CFE on 12 January 1999. CFEN (which did not, it seems, maintain separate books from CFE) then recorded an acquisition of 2,162,000 NK shares, which were recorded as being held for the account of PGM MCO. This treatment was consistent with what had earlier been stated in an e-mail from a Mr John Gracey, an employee of CFE/CFEN on 25 December 2005, where he stated that US\$5 million would be

coming out of PGM MCO to buy shares in NK . Mercury (or more accurately, its successor company following a merger and name changes) later assigned to AEC, its parent, all its rights and interests in the Parcel A NK Shares. As the result of a later restructuring of NK, ten old shares became one new share, with the consequence that the Parcel A NK Shares now consist of 216,200 shares in NK. The question that the liquidators had to resolve, and now ask the court to resolve, is whether the Parcel A NK Shares should be regarded as being beneficially owned by AEC, or as assets of PGM MCO. It is fair to say that the internal accounting records of CFEN tend to suggest that the Parcel A NK Shares are to be regarded as assets of PGM MCO. Mr Umehara says, however, that the intention of Mercury had been to make an investment in NK by acquiring shares in NK, and that to the extent that the CFEN records suggest otherwise, they are inaccurate and should be disregarded. Apart from Mr Umehara's evidence, AEC also rely on a number of other documents and matters as indicating that the Parcel A NK Shares should be regarded as the property of AEC and not PGM MCO. These are:-

- (1) The terms of Mr Ichiyama's letter of 24 December 1998 to Mr Armstrong suggest that the US\$5 million investment in NK that was mentioned was to be made by withdrawing that amount from the PGM MCO portfolio. Mr Chan, appearing for AEC, submitted that this indicates that what was envisaged was the removal of the amount of the intended investment from the PGM MCO portfolio, in effect by the early redemption or termination of part of the investment. Mr Chan also submitted that if what was intended was simply an investment by PGM MCO, there would have been no need to seek Mr Armstrong's agreement, as there would then be no reduction in the amount of assets under management.
- (2) The transaction was one which was out of the ordinary, in that Mercury did not involve itself in the investments by PGM MCO under the PGM MCO Note. However, in this case, the making of an investment in NK was specifically instructed by Mercury. This, Mr Chan said, suggested that it was not an investment by PGM MCO, as, if it had been, Mercury would not have been involved in giving the instruction to do so.
- (3) Although other aspects of Mr Gracey's understanding were said by AEC to have been less than perfect, Mr Chan submitted that the terms of Mr Gracey's e-mail dated 25 December 1999 were consistent with the terms of Mr Ichiyama's letter of the previous day, in stating that the US\$5 million was coming out of PGM MCO.
- (4) Mr Chan also places considerable reliance on documentation which, he says, indicate that the relevant US entities (such as the US Receiver and the United States Attorney's Office) involved in the process of settlement of investors' claims in the United States have accepted that the investment in NK was made by, and consequently, the Parcel A NK Shares, were owned by, Mercury (and now AEC). Particular reliance is placed on the following matters:-

- (a) In the course of determining the amount for which Mercury (and hence AEC) was entitled to participate in the global settlement, the US\$5 million disbursement from the PGM MCO fund in January 1999 was treated as an authorized reduction in the amount of the fund, so as to reduce the ultimate shortfall suffered by Mercury and/or AEC. This appears from various documents including:-
- (i) An undated flowchart prepared by or for the US Receiver or other US authorities showing the disbursements from the PGM MCO account, which included the US\$5 million as a disbursement, with a note indicating that this had been authorized by Mr Ichiyama for the purpose of an investment by AEC (then Mercury) in NK. (ii) An undated analysis of activity in the PGM MCO account which similarly records the withdrawal of US\$5 million from the securities held by PGM MCO under the PGM MCO Note, but describing it only as a disbursement to CFE. (iii) Perhaps most importantly, a document dated 18 October 2000 setting out a calculation of the net cash out-of-pocket amount for the Mercury Note MCO (which is a reference to the PGM MCO Note), in which the net cash out-of-pocket amount is stated to be US\$36,351,735, this figure being arrived at after treating the US\$5 million investment in NK as being paid to Mercury, and thus not an amount in respect of which Mercury was out of pocket.
- (b) The terms of a settlement agreement dated 20 November 2001, entered into by AEC and others with Republic and others, in which AEC and its associated companies agreed to settle with Republic and, as part of the settlement, to assign to Republic its claims against Mr Armstrong and others in relation to the Princeton Notes scheme, subject to certain excepted items, which included any of its claims against any person or entity that relate to [NK] . This, it was said, tended to confirm that the investment in NK was not an investment by PGM MCO, as was also illustrated by the documents referred to in the preceding sub-paragraph.
- (c) A letter from the United States Attorney s Office dated 20 July 2006 to the liquidators which confirmed that with regards to restitution payable to [AEC] and related entities a [US]\$5 million deduction was made in relation to the [PGM] MCO Note as a result of a wire transfer to [CFE] in that amount apparently to permit an investment in [NK] the [US]\$5 million referred to above continued as a deduction and [AEC] never received restitution for that amount .
- (5) Finally, Mr Chan relies on the fact that the US Receiver has taken an essentially neutral view on AEC s application, and has not positively argued that the Parcel A NK Shares should be treated as the property of PGM MCO. Mr Chan points out that if there were a basis for the US Receiver to claim this asset for PGM MCO, he would have been duty bound to do so. His failure to do so should, therefore, be taken as persuasive evidence that there is no basis for any such claim, leaving AEC as the only available claimant to the Parcel A NK Shares. Given the state of CFE and CFEN s internal records, and the information obtained from contemporaneous and other documents in the possession of the liquidators, I do not think that the liquidators can be criticized for feeling unable to come to a view as to the ownership of the Parcel A NK Shares and for seeking the directions of the court. Nor do I think that any

particular criticism can be laid at their door for the manner in which they have sought such guidance. However, having considered all of the evidence which is now before me, I am satisfied that the Parcel A NK Shares should be regarded as being beneficially owned by AEC, and that they were held by CFEN as nominees or trustees for AEC. In coming to this conclusion, I consider the following matters to be of particular significance:-

- (1) The position taken by the US Receiver does, I think, provide real support for AEC's claim. I am of the view that had the US Receiver been able to mount a viable claim for the Parcel A NK Shares on behalf of PGM MCO, he would have done so. Given that the Parcel A NK Shares were held by CFEN not for itself, but for either PGM MCO or AEC, the fact that no claim to them has been advanced on behalf of PGM MCO suggests that AEC's claim is a valid one.
- (2) More significantly, the evidence referred to in paragraph 24(4) above also, in my view, supports AEC's position. That evidence, although not contemporaneous, does suggest that the shares should be regarded as having been acquired by or on behalf of AEC (or rather, its predecessor, Mercury) from the outset. Were this not the case, there would have been no basis for excluding this amount from the losses suffered by AEC for which they should be compensated. Even if the view taken by the US Receiver and AEC in the context of the settlement with Republic were not correct, I do not think that it would have been open to the US Receiver now to resile from that position (which he has not sought to do). The contemporaneous documents relied upon by AEC, although to my mind slightly less compelling, do also tend to suggest that the US\$5 million investment in NK was to be removed from the PGM MCO portfolio. If this were not the case, there would seem to have been no real need for Mr Armstrong's agreement to the course proposed to have been sought. I regard Mr Umehara's evidence as being of less weight, as he was not personally involved in the process leading up to the investment. In my view, his evidence should be regarded more as a helpful attempt to marshal the various pieces of evidence that supported AEC's position. Mr Wong, appearing for the US Receiver, had indicated in his submissions that the US Receiver had no objection to the Parcel A NK Shares being treated as assets of AEC provided that this was on the basis of constructive trust. In my view, the more appropriate basis on which it can be said that the Parcel A NK Shares are assets of AEC is, in terms of Hong Kong law, that they were held on a resulting trust for AEC, which provided the purchase monies for them, and authorized their acquisition. Mr Wong also sought an express statement by the court to the effect that its decision in this matter should not prejudice the distribution procedures under the global settlement in the United States. This appeared to be an attempt to reserve the US Receiver's position in the event that the assets in question turned out to be worth more than the US\$5 million which was withdrawn from the PGM MCO Notes. That seems, on the evidence available at present, to be a somewhat unlikely scenario. However, while I would certainly accept that the effect of my decision on whatever claims or arguments might in future be advanced in proceedings elsewhere would be a matter for the court seised of such proceedings to determine, it does seem to me that if, as I have concluded, the Parcel A NK Shares were beneficially owned by AEC, then AEC would be entitled to whatever value they might have. I shall therefore direct the liquidators

to treat the Parcel A NK Shares as assets beneficially owned by AEC, and not as assets of CFEN which are available for distribution to its creditors in its liquidation. Although AEC also sought orders for the delivery of the shares to them or their representatives, I shall defer consideration of that aspect of the matter until such time as the question of costs of these applications is resolved. This is because it seems to me that if it is ultimately concluded that the costs of the application should, whether in whole or in part, fall on the assets concerned (whether in any event, or only potentially, in the event of an insufficiency of other assets out of which the liquidators can recoup their own costs) it may be necessary to consider whether or not it would be appropriate to direct such delivery without some form of safeguard being volunteered or put in place to cover any liability for costs that might ultimately fall to be met out of the shares themselves. Gun-Ei's claim to the NK Fund Part 3. Gun-Ei asserts a claim to the NK Fund Part 3. This represents part of the payment made by NK to CFEN pursuant to a debt restructuring or rehabilitation plan (akin to a scheme of arrangement) in respect of NK, by which its creditors received a reduced amount in satisfaction of their debt claims against NK. The amount constituting the NK Fund Part 3 represented what was said by NK to relate to a loan of US\$3 million made to NK by CFEN in early 1999. Gun-Ei says that it is entitled to the NK Fund Part 3 because the loan of US\$3 million which resulted in the NK Fund Part 3 being paid to CFEN was in fact a loan made to NK by or on behalf of Gun-Ei, in a similar way to that in which the NK Parcel A Shares were acquired by or on behalf of AEC. In effect, it is said that Gun-Ei agreed to lend a total amount of US\$3 million to NK at the request of Mr Setogawa, and that it agreed to do so by withdrawing US\$3 million (in a number of stages) from its investments in the Princeton Notes scheme, and lending the funds to NK instead. The circumstances leading up to the loan are deposed to in affirmations filed on behalf of Gun-Ei by Mr Seiichi Ooi, the Managing Director of Gun-Ei in charge of its Control Division, and Mr Toshiaki Hashizume, who is head of the Environment, Safety and Health Team at Gun-Ei. Both of them say that they had the circumstances of the loan explained to them by Mr Yoshikazu Arita, Gun-Ei's President. Those circumstances are essentially that Mr Arita was approached by Mr Setogawa in about March 1999 with a request that Gun-Ei make a loan of US\$3 million to NK, which was then still in need of funds. It was suggested by Mr Setogawa that the loan should be made by effecting a partial redemption of three Princeton Notes held by Gun-Ei so as to release from them the sum of US\$3 million, which would then be lent to NK. Gun-Ei had in fact invested in a series of Princeton Notes, each with a value of US\$10 million, issued by special purpose companies incorporated for the purpose of issuing the notes and investing their proceeds. The three Princeton Notes in question in this case were issued by Princeton Global Management I-11 Limited (PGM I-11), Princeton Global Management I-12 Limited (PGM I-12) and Princeton Global Management I-13 Limited (PGM I-13). Each provided for payment of coupon interest at the rate of about 6%. Each also (like the PGM MCO Note) had provision for payment of management fees on the funds under management. The three notes had different maturity dates, falling due in successive years after 2001. Gun-Ei also held other notes issued by other companies in the same series of companies, with earlier maturities. In the event, US\$3 million was lent to NK in March and April 1999. US\$1 million

was lent from funds held by PGM I-13 in March. US\$1 million was lent from funds held by PGM I-12 in two tranches of US\$500,000 each in March and April respectively. Finally, US\$1 million was also lent from funds held by PGM I-11 in April. Accounting and banking records in the possession of the liquidators establish that these sums were indeed lent from funds held by each of these PGM companies. The liquidators are also in possession of correspondence prepared by Mr Setogawa, which throws some further light on the arrangements. On 1 March 1999, Mr Setogawa sent an e-mail message to Mr Armstrong and others stating that Gun-Ei had agreed to extend assistance to NK, and that this would take the form of US\$750,000 from each of four PGM companies PGM I-11, I-12 and I-13, and another company in the series called Princeton Global Management I-10 Limited (PGM I-10). On 9 March 1999, Mr Setogawa wrote to Mr Arita, seeking his cooperation. The document was headed Memorandum to Request Co-operation . The material parts of it are as follows:-

- (1) Paragraph 2, which reads To lend US\$3,000,000 in all to [NK] (US\$1,000,000 each from the three notes, I-11, I-12, and I-13 whose redemption dates are after autumn 2001 when [NK] is planning to go public). A note went on to explain that the original proposal of lending from four notes had been revised since the maturity date of the PGM I-10 note (26 June 2001) fell before the expected date of NK s going public.
- (2) Paragraph 3(1), which made the point that the amount proposed to be released from each note was just over 10% of its value, which was not a significant portion.
- (3) Paragraph 3(2), which explained that each amount of US\$1 million would be encashed by disposing of underlying US Government agency bonds held by the relevant note issuing company, but that the loan to NK would carry interest at the same rate as was being received on the US Government agency bonds in question, so that there would be no detriment to Gun-Ei.
- (4) Paragraph 3(3), which stated that the investment would be recorded in monthly valuation statements issued to Gun-Ei as venture capital at a constant value of US\$1 million.
- (5) Paragraph 3(4), which stated that we will repay all at once to the notes of I-11, I-12 and I-13 at the time going public in autumn 2001.
- (6) Paragraph 8, which indicated that if the proposal were acceptable, a letter of acceptance would have to be sent to Mr Armstrong. Thereafter, Mr Setogawa wrote to Mr Armstrong by e-mail on 16 March 1999, stating that Mr Arita would most likely sign a letter of agreement in the same terms as that signed by Mr Ichiyama on behalf of Mercury in December 1998. Finally, on 19 March 1999, Mr Arita wrote to Mr Armstrong as Mr Setogawa had indicated, stating in his letter that a maximum amount of US\$3 million can be invested in [NK] out of PGM I-11, I-12, I-13 portfolios subject to your agreement. Thereafter, as I have noted, funds were in fact transferred to NK, with entries in monthly statements issued by the PGM companies to Gun-Ei showing the amounts transferred as venture capital , as mentioned in paragraph 3(3) of Mr Setogawa s letter of 9 March 1999 to Mr Arita. Although the liquidators

expressed initial doubts as to whether or not the US\$3 million which was lent to NK in March and April 1999 had come from Gun-Ei's funds, at the hearing, Ms Ismail, who appeared for them, accepted (and indeed demonstrated from supporting accounting and banking documentation) that this was in fact the case. However, the liquidators remained uncomfortable with simply accepting that Gun-Ei was entitled to the proceeds of the recovery from NK represented by the NK Fund Part 3, particularly in the light of the statements issued by or on behalf of PGM I-11, PGM I-12 and PGM I-13 to Gun-Ei, which showed an investment of US\$1 million in venture capital in each case. The liquidators considered that this might indicate that the loan was in fact made to NK, not by Gun-Ei, but by the respective PGM companies, so that the loan formed part of the assets of those companies, which would then simply be indebted to Gun-Ei under the terms of the notes issued by each of them to Gun-Ei. On that basis, the proper claimant in respect of the NK Fund Part 3 would be the US Receiver, rather than Gun-Ei. For Gun-Ei, Mr McLeish contends that there is sufficient evidence to show that what in fact was intended, and happened, was that Gun-Ei agreed to a partial redemption of each of the notes concerned, and then directed the funds released thereby to be lent to NK as agreed with Mr Setogawa. In support of his contention, Mr McLeish relies on the following matters:-

- (1) The terms of Mr Arita's letter of 19 March 1999 to Mr Armstrong, which was in materially identical terms to that sent to Mr Armstrong by Mr Ichiyama in December 1998, suggest (in the same way) that the US\$3 million loan to NK was to be made by withdrawing that amount from the various PGM companies' portfolios. Mr McLeish submitted that this indicates that what was envisaged was the removal of the amount of the intended investment from the respective portfolios, and that there would otherwise have been no real need to have sought Mr Armstrong's agreement, as there would otherwise have been no reduction in the amount of assets under management. Mr McLeish acknowledged that there was nothing in the notes issued by PGM I-11, PGM I-12 and PGM I-13 that expressly permitted early redemption, but submitted that this was neither here nor there, as it was open to the parties to the notes concerned to vary the terms of the note so as to permit early redemption, and that this was what had happened in this case.
- (2) The transaction was one which was out of the ordinary, in that there was a loan to NK rather than investment in the type of securities that would ordinarily form part of the PGM companies' portfolios.
- (3) The statement in Mr Setogawa's letter to Mr Arita of 9 March 1999 to the effect that the funds lent to NK would go back into the PGM I-11, I-12 and I-13 notes on repayment when NK went public also suggested that there was intended to be a partial redemption and thereafter a loan by Gun-Ei to NK.
- (4) Mr McLeish also relies on the terms of a settlement agreement entered into by Gun-Ei with Republic and others, which is in materially identical terms to that entered into by AEC and its associated companies. As in the case of AEC, Gun-Ei agreed to settle with Republic and, as part of the settlement, to assign to Republic its claims against Mr Armstrong and others in

relation to the Princeton Notes scheme, subject to certain excepted items, which included any of its claims against any person or entity that relate to [NK] . This, it was said, tended to confirm that the investment in NK was not an investment by PGM MCO, as was also illustrated by the documents referred to in the preceding sub-paragraph. Although Gun-Ei did not have either of the other documents that AEC had been able to point to in support of this view of the matter, Mr McLeish submitted that the fact that the same terms appeared in Gun-Ei s settlement agreement did suggest that the same approach was being taken.

- (5) Finally, Mr McLeish also relies on the fact that the US Receiver has taken an essentially neutral view on AEC s application, and has not positively argued that the NK Fund Part 3 should be treated as the property of the various PGM companies concerned, when he would have been obliged to do so had there been a basis for such a claim. Thus, Gun-Ei was the only available and active claimant to the NK Fund Part 3. Mr McLeish acknowledged that the inclusion of the loans to NK as venture capital in the monthly statements might, on the face of it, be an indication that the loans were by the PGM companies and not Gun-Ei, but submitted that as this was specifically mentioned in Mr Setogawa s letter to Mr Arita of 9 March 1999, this had to be considered in the light of that letter overall, and that when this was done, other parts of the letter tended to negate this view of the matter. Mr McLeish also drew my attention to the fact that interest paid on the loan appeared to have been paid to the PGM companies. However, he submitted that this was in fact a neutral factor, as such a treatment was consistent with either view of the matter given that the intention was that the funds should ultimately return to the PGM companies portfolios, it was not particularly surprising that interest payments should do the same, since interest received from the portfolios investments would have been available for re-investment. Finally, Mr McLeish suggested that it was inherently more likely that the arrangement was as deposed to by Gun-Ei s deponents, as there would have been little reason for Gun-Ei to have left the loans in the portfolio so as to attract management fees, when there was little in the way of management required in respect of the loans, in contrast to the usual range of investments that might be made. My attention was not, however, drawn to any evidence showing whether or not management fees were charged on the basis that the loans formed part of the PGM companies portfolios. As with the Parcel A NK Shares, given the state of CFE and CFEN s internal records, I do not think that the liquidators can be criticized for feeling unable to come to a view as to the ownership of the NK Fund Part 3 and for seeking the directions of the court as to this. I would also say that the evidence in relation to the NK Fund Part 3 is substantially less clear than the evidence that was available in relation to the Parcel A NK Shares. Nonetheless, I am satisfied on the balance of probabilities that the initial loan to NK in March and April 1999 should be regarded as having been made by or on behalf of Gun-Ei, out of its own funds (derived from a partial redemption of its investment in the various PGM notes concerned), so that the NK Fund Part 3 should be regarded as belonging not to the PGM companies concerned, but to Gun-Ei. In coming to this conclusion, I think that the position taken by the US Receiver is, as it was in the case of AEC s claim, significant, for much the same reasons. In my view, the fact that no claim to be the lender to NK has been

advanced on behalf of the PGM companies suggests that Gun-Ei's claim is a valid one. Similarly, the terms of the settlement agreement also tends to support this view, for reasons which I have already adumbrated in the context of AEC's claim. The contemporaneous documents relied upon by Gun-Ei, although again less compelling, do suggest (as in the case of AEC) that the US\$3 million loan was removed from the PGM companies portfolios, as there would otherwise have been no real need for Mr Armstrong's agreement to the course proposed to have been sought. The evidence of Gun-Ei's deponents is less weighty, as they were not personally involved in the arrangements with which we are concerned. However, at the end of the day, I am satisfied that the NK Fund Part 3 should be regarded as representing the repayment of a loan by Gun-Ei to NK, and as such should be treated as being beneficially owned by Gun-Ei and not any of the PGM companies. So far as immediate payment out to Gun-Ei of such funds is concerned, however, I think, for much the same reasons as I declined to order immediate transfer of the Parcel A NK Shares to AEC, that it would not be appropriate to make any such order until the question of the costs of this application have been dealt with. Mr Setogawa's claims Mr Setogawa has claimed that he is the beneficial owner of the S-1 Funds, the Parcel A NK Shares, the Clean Sanwa shares and the NK Fund Part 1. As I have noted, Mr Setogawa is one of the persons principally involved in the Princeton Notes scheme. Mr Setogawa's claim is set out in a number of letters that he has written to the liquidators of CFE and CFEN, and to the court. None of what he asserts has been put forward in the form of an affidavit or affirmation, and thus, his statements are all unsworn. I have, however, considered them in the light of the other available evidence, and have had regard to the submissions of Ms Ismail for the liquidators, and Mr Wong for the US Receiver. I think that the starting point for the consideration of Mr Setogawa's claims is the status of the S-1 Fund. This is because the funding for the acquisition of the Parcel A NK Shares and for the loans which led to CFEN holding the Clean Sanwa shares and the NK Fund Part 1 do appear, on the evidence which is available, to have originated (in large part, although, as will be seen, not entirely) from monies in the S-1 Fund. The S-1 Fund consists of a part of the monies in CFE's client account. This has always been treated in CFE's accounts as an asset of CFE, with the relationship between CFE and its clients whose funds were held in its client account being treated as one of debtor and creditor. Mr Setogawa, as a senior employee of CFE was, or must have been, aware of this. Such treatment is inconsistent with the S-1 Fund being an asset beneficially owned by Mr Setogawa, even assuming that he is properly to be regarded as the client entitled to monies in the S-1 Fund (I shall deal below with whether or not he has established this). On this basis, he would at best be able to make a claim to the amount standing in the S-1 Fund by lodging a proof of debt in CFE's liquidation for that amount. Such a proof would be adjudicated upon by the liquidators in the usual way, and, if admitted (whether in whole or in part) would entitle Mr Setogawa to be paid a dividend in CFE's liquidation, ranking along with any other creditors whose proofs are admitted. So far as Mr Setogawa's position as the client of CFE whose funds were maintained in the S-1 Fund in CFE's client account is concerned, however, the picture is far from clear. The S-1 Fund at present consists of the amounts that remain standing to its credit in the CFE client account. However, there were, over the years, a number of payments into

and out of the S-1 Fund. It was first established on 27 March 1998, when there was an initial deposit into CFE's client account of some US\$1.7 million from one of CFE's bank accounts in the United States. On the same day, there had been a payment into CFE's United States bank account of some US\$1.45 million odd from an account of PEIL. According to Mr Setogawa, only the US\$1.45 million odd was credited to the S-1 Fund. Mr Setogawa asserts that the initial deposit into the S-1 Fund came from the redemption (in the amount of US\$1.45 million odd) of what he describes as the S-1 Note a Princeton Note designated by that reference. He says that the S-1 Note was held in the name of a Mrs King, which was a name he used in order to disguise his beneficial ownership of the S-1 Note. However, Mr Setogawa has produced no evidence as to the source of the source of funds used to acquire the S-1 Note in the first place. Nor does there seem to be any account opening or other account maintenance documentation (such as statements of the sort issued to other holders of Princeton Notes) which would establish that Mr Setogawa was the owner of the S-1 Note. The US Receiver's evidence does establish that the initial deposit into the S-1 Fund originated from an account of PEIL. He too has been unable to locate any evidence to link Mr Setogawa with that initial deposit. He also points out that it has been established that there was widespread commingling of funds in respect of various PEIL client investments, and that in the circumstances, it cannot be safely assumed that Mr Setogawa was in fact the source of the funds that were used for the initial deposit into the S-1 Fund. On the evidence before me, I am only able to conclude that the initial deposit into the S-1 Fund originated from PEIL. It does not seem possible to say, one way or another, what the origin of those PEIL funds was. In these circumstances, I am not able to accept that the initial deposit into the S-1 Fund can be regarded as the property of Mr Setogawa so as to constitute him the client for whose account CFE held the S-1 Fund in its initial stages. I should also note that the CFE liquidators are in possession of a counter-indemnity provided by Mr Setogawa in respect of a guarantee provided by CFE to Alps Credit, in which Mr Setogawa represented that he was the owner of the funds in the S-1 Fund. I do not think that this, of itself, suffices to establish Mr Setogawa as the source of the initial deposit into the S-1 Fund. Moreover, even if it did, it would not, in my view, go further than to establish that Mr Setogawa should be regarded as the client in respect of the S-1 Fund, and render that fund an asset held on trust for him (as opposed to a debt owed by CFE to him). Thereafter, there were, in July and September 1998, acquisitions of a total of 500,000 NK Shares (now the Parcel C NK Shares), which appear, on the evidence available, to have been funded from the S-1 Fund. These involved the use of some US\$1.1 million odd of the funds then in the S-1 Fund, leaving a balance of around US\$360,000 in the S-1 Fund. In October 1998, there was a further deposit of some US\$880,000 odd into the S-1 Fund, increasing its balance to about US\$1.24 million. Mr Setogawa claims that this deposit was made by him. He has produced documentation to show a withdrawal of an Australian dollar amount of approximately equivalent value from an account held by himself and his wife in their joint names. There does not, however, appear to be any documentation that clearly links that withdrawal with the deposit into the CFE client account that was credited to the S-1 Fund. Shortly after that deposit was received, a loan of JPY 240 million (equivalent to US\$2.04 million odd) was recorded as having been made to NK, against the security of the

Clean Sanwa shares. There was a withdrawal of this amount from the S-1 Fund, placing in a negative position (i.e. overdrawn) to the extent of nearly US\$800,000. About a month later, there was a deposit of some US\$1.4 million into the S-1 Fund, bringing it back into credit to the extent of some US\$631,000 odd. At the same time, a deduction of some US\$3,000 odd was made in respect of what was described as overdraft interest, presumably representing interest in respect of the one month period that the S-1 Fund was in deficit. A few days later, on 26 November 1998, there was a further withdrawal of some US\$700,000 from the S-1 Fund, which was used to acquire JPY 85 million which was lent to NK (this is now represented by the NK Fund Part 1) sending it back into deficit (although a relatively small one of some US\$70,000 odd) for about 2 weeks, until further funds of US\$500,000 were received, at which time a small amount of overdraft interest was again debited to the account. Mr Setogawa says that the further deposits of US\$1.4 million and US\$500,000 were also made by him. As to this, while there is some evidence that this may be the case, the position is not entirely clear. In my view, however, it is not necessary to come to a firm conclusion as to this, as it seems to me to be clear that the S-1 Fund cannot be regarded as either a trust asset held by CFE for Mr Setogawa, or as being a debt to which he alone is entitled, having regard to the conclusion to which I have come as to the initial deposit into the S-1 Fund. It seems to me that there are insuperable difficulties in the way of holding that the amount standing to the credit of the S-1 Fund should be regarded as an asset belonging beneficially to Mr Setogawa, so as to take it out of the ownership of CFE for the purposes of its liquidation. First, the treatment of the CFE client account in its own accounts indicates that the funds in it are assets of CFE, for which it is accountable as debtor to the particular client in question. Thus, even if Mr Setogawa had been able to establish (which he has not) that he was the client of CFE to whom it owed whatever balance stood to the credit of the S-1 Fund, he would only be entitled to lodge a proof in respect of it, and not claim the fund as being, in equity, his property. Second, the fact that the S-1 Fund was operated as a running account, which went into deficit on two occasions when overdraft interest was charged is also cogent evidence showing that the relationship between CFE and the client whose account it was was one of debtor and creditor, and not trustee and beneficiary. Third, and in any event, as I have concluded that Mr Setogawa has not been able to establish that he was the sole source of the credits to the S-1 Fund, I do not see that it can be regarded as his asset so as to take it outside CFE's liquidation. For all of these reasons, I consider that the S-1 Fund should be regarded as an asset of CFE for the purposes of its liquidation, out of which its liquidation expenses can be paid, and (to the extent that there is a surplus of assets at the end of the day) out of which dividends can be paid to CFE's creditors. So far as Mr Setogawa's position is concerned, it will be for the liquidators to adjudicate on any proof of debt that he may file (or have already filed), having regard to any claims that they may have against him. So far as the Parcel C NK Shares are concerned, it does appear that they were acquired with funds out of the S-1 Fund. However, they were acquired at a time when the only funds in the S-1 Fund were the initial deposit, which I am not satisfied belonged to Mr Setogawa. That being so, I do not think that the Parcel C NK Shares can be regarded as a trust asset belonging to Mr Setogawa. Although the US Receiver has suggested that the Parcel C NK

Shares should be regarded as belonging to PEIL, it seems equally unclear whether or not PEIL was itself the beneficial owner of the funds transmitted to CFE and used to initiate the S-1 Fund. In these circumstances, it seems to me that the appropriate course to take would be to direct the liquidators simply to treat the Parcel C NK Shares as assets of CFE for the purposes of its liquidation, which may be realized and applied in the normal way. I bear in mind that the Parcel C NK Shares are in fact held by the liquidators in their capacity as liquidators of CFEN, but given that CFEN was used to hold assets as a nominee and not in its own right, I think that the Parcel C NK Shares should be regarded as assets not of CFEN, but of CFE, which was the immediate source of the funds from which they were acquired. As for the Clean Sanwa shares, it appears that they were acquired as a result of the JPY 240 million loan to NK, having been pledged as security for that loan. If the S-1 Fund had had sufficient funds in it to make that loan, and it were clear that Mr Setogawa was the client in respect of the S-1 Fund, it might have been possible to conclude that the loan was effected by the withdrawal by Mr Setogawa of his funds from the S-1 Fund followed by the making of the loan using those funds, so as to constitute him in effect the lender and thus the person entitled to the benefit of the security provided. However, that is not a conclusion that can be reached in the circumstances of this case. First, it is not established (for reasons which I have already given) that Mr Setogawa was the client of CFE in relation to the S-1 Fund. Second, the loan to NK that was secured by the Clean Sanwa shares cannot be regarded as a loan made purely on behalf of Mr Setogawa. The funds used to make the loan were made up of the initial deposit, the second deposit (for which there is some, but not very clear evidence that Mr Setogawa may have been the source) and in part CFE's own funds (which it may have lent to the client or clients whose account the S-1 Fund was). In these circumstances, I do not think that it can be said that Mr Setogawa can be regarded as the person, or at least the only person to whom the Clean Sanwa shares belong, and I think it more appropriate to direct the liquidators to treat these shares, too, as being assets of CFE which may be dealt with on that basis. For the same reasons as are mentioned at the end of the preceding paragraph, I am of the view that it would be appropriate to treat these shares as assets of CFE rather than CFEN. Finally, so far as the NK Fund Part 1 is concerned, it is again reasonably clear that the loan of JPY 85 million to NK, repayment of which is represented by it, was made, again in part, from the S-1 Fund. As with the earlier loan, the effect of the making of this loan was to put the fund into overdraft. Given that Mr Setogawa cannot, in my view be regarded as the client (or only client) interested in the S-1 Fund, it seems to me that this loan should be treated in the same way as the earlier loan of JPY 240 million, and the NK Fund Part 1 treated as an asset of CFE to be dealt with as such in its liquidation. Mr Kumagai's claim A claim has been made to the S-3 Fund, the Parcel B NK Shares and the NK Fund Part 2 by Mrs Kumagai on behalf of Mr Kumagai. The claim is made by letter to the court dated 26 May 2006. It is not supported by any affidavit or affirmation, nor by any documentation supplied by Mrs Kumagai. So far as CFE and CFEN are concerned, there is some evidence to show that the S-3 Fund may have been the property of a client called Owlet Ltd. The evidence is somewhat scant, but there is a limited amount of internal CFE documentation to suggest that the initial deposit into the S-3 Fund was made by

Owlet, and that Owlet gave instructions in respect of the S-3 Fund. So far as the S-3 Fund itself is concerned, there is nothing to show that it was not treated in the same way as any other client account of CFE that is, that it represented a debtor/creditor relationship whereby CFE was the debtor of the client whose account it was. That being so, I do not think that the S-3 Fund should be regarded as anything other than an asset of CFE, available for distribution in its liquidation in the normal way. There is also evidence to show that the Parcel B NK Shares and the NK Fund Part 2 derive from the S-3 Fund, and therefore might be regarded as being the property of the client whose account the S-3 Fund represented. However, Owlet itself has made no claim in respect of any of these assets. Its interests had at one time been represented by Merrill Lynch, who had previously given instructions to CFE on behalf of Owlet. However, it appears that Merrill Lynch have not for some time been able to make contact with Owlet's beneficial owners, and that Owlet was, at the time of the hearing, on the verge of being struck off the register in its home jurisdiction. Mr Kumagai's claim is that he is the beneficial owner of Owlet. However, neither he nor Mrs Kumagai has put forward any evidence to establish this. There is some evidence from former employees of CFE and CFEN to the effect that they regarded Mr Kumagai as the beneficial owner of Owlet, but this appears to have been an impression obtained by them principally from Mr Setogawa, which is not founded on any more concrete evidence. In these circumstances, I am not able to find that Mr Kumagai has established that he is the beneficial owner of either the Parcel B NK Shares or the NK Fund Part 2. As Owlet has not itself made any application to these assets (or to the S-3 Fund), there is no other claimant to them, and in the circumstances, bearing in mind that CFEN does not hold assets for its own account, it seems to me that it would be appropriate that the S-3 Fund, the Parcel B NK Shares and the NK Fund Part 2 should be treated as being the assets of CFE to be dealt with in its liquidation in the normal way. The residual cash in the CFE client account. There being no claimant in respect of this sum, it seems to me that it would be appropriate to treat this as an asset of CFE. This treatment would also accord with the way in which the sums in its client account were regarded by CFE in its own accounts. US Receiver's request for transmission of assets to him. In the course of the hearing, Mr Wong for the US Receiver suggested that assets which were directed to be treated as assets of CFE or CFEN should be released to the US Receiver forthwith. I do not think that this would be appropriate, particularly when the liquidations of the companies are not concluded, and there are likely to be further expenses (including the costs of these applications) which may have to be met out of them.

Disposition and costs For the reasons which I have given, I shall direct the liquidators:-

- (1) To treat the Parcel A NK Shares as being assets held by CFEN on trust for AEC;
- (2) To treat the NK Fund Part 3 as being an asset held by CFEN on trust for Gun-Ei;
- (3) To treat the remainder of the assets which are the subject matter of this application as assets of CFE. So far as costs are concerned, I do not think it appropriate to attempt to make a costs order nisi in respect of these applications. The parties may therefore make arrangements for a date to be fixed to deal with the question of the costs of these applications. (Aarif

Barma) Judge of the Court of First Instance High Court Ms Roxanne Ismail instructed by Messrs Allen & Overy for the Liquidators of both Companies Mr. Robin McLeish instructed by Messrs Victor Chu & Co. for the Creditor (Gun-ei Chemical Industry company Limited) Mr. Jeremy S.K.Chan instructed by Messrs Stephenson Harwood & Lo for the Alps Electric Company Limited Mr. Anson M.K. Chan instructed by Messrs O Melveny & Myers for the U.S. Receiver PAGE - 1udk 1udk H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R S T U V i\$&`G e&}^ hccw (for Susan Kwan only).dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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