

HONG KONG / JUDGMENT

RE TIFFIT SECURITIES (HONG KONG) LTD

COURT

Court of First Instance

DECIDED

19 January 2007

CASE / FILE NUMBER

HCMP1479/2006

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bjbj PxJ z; HCMP 1479/2006 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 1479 OF 2006

IN THE MATTER of TIFFIT SECURITIES (HONG KONG) LIMITED (ADMINISTRATORS APPOINTED) and IN THE MATTER of the Securities and Futures Ordinance (Cap. 571)

Before: Hon Kwan J in Chambers Date of Hearing: 18 January 2007 Date of Decision: 18 January 2007 Date of Handing Down of Reasons for Decision: 19 January 2007

REASONS FOR DECISION

This is the further hearing of a summons issued by the administrators of Tiffit Securities (Hong Kong) Limited (the Company) on 19 October 2006, for directions and orders in respect of the disposal of securities held in the name of the Company on behalf of clients with the Central Clearing and Settlement System (CCASS). The summons was made pursuant to section 213 of the Securities and Futures Ordinance, Cap. 571 and the inherent jurisdiction of the court. The summons was first heard by Barma J on 10 and 20 November 2006. He granted directions and orders substantially in terms of the summons (the First Order). The First Order is analogous to an order nisi. It provided for a further hearing not less than six weeks therefrom, to give an opportunity to eligible parties to make submissions to the court if they wish on issues concerning the method of the return to them of securities, warrants or dividends. The administrators did not receive any notice from any eligible party in this respect and no one has appeared at the further hearing in opposition. The administrators sought an order to confirm the First Order. I have made an order in terms of the draft submitted and these are the reasons for decision. The background The background may be briefly stated as follows. The Company is a licensed

securities dealer with the Securities and Futures Commission (the SFC) and provided brokerage services to clients. On 18 July 2006, the SFC issued a restriction notice on the Company pursuant to sections 204 and 205 of Cap. 571, after an investigation which revealed serious deficiencies in the operation of the Company including possible misappropriation of clients assets. The administrators were appointed by an order of the court made on 24 July 2006, which was confirmed and continued by subsequent orders on 28 July 2006 and 29 September 2006. The administrators have established that there is a significant shortfall between clients claims to securities purchased on their behalf by the Company and actual securities on hand in the Company s CCASS account as at 18 July 2006, being the last trading day before the cessation of business. The shortfall is in the region of about \$54.1 million worth of securities. The Company s clients are eligible for compensation to a maximum of \$150,000 per client out of the Investors Compensation Fund (the ICF) administered by the Investors Compensation Company Limited (the ICC), a wholly owned subsidiary of the SFC. The ICC is given a right of subrogation under section 87 of Cap. 571 where it makes payment out of the ICF in respect of claims by clients on default of a broker firm. The issues The administrators sought confirmation of the First Order on the following issues:

- (1) confirmation of the proprietary entitlement of clients to the securities, dividends and warrants (the Securities) held by the Company in its account with CCASS or otherwise;
- (2) the principles by which the Securities are to be allocated;
- (3) the incidence of the administrators fees, costs and expenses, and levying a processing fee;
- (4) the proposed mechanics of the allocation and return of the Securities;
- (5) the extent and nature of the statutory right of subrogation of the ICC arising from payments out of the ICF to clients; and
- (6) the proposed manner of dealing with a sum held by the Company in a trust account on behalf of a client, Sit Wing Hei. The proprietary entitlement As far as CCASS is concerned, the Securities purchased by the Company on behalf of its clients are held for the Company s account. As between the Company and its clients, the Securities were purchased by the Company as broker for its clients. Each of the clients acquired proprietary interests in the Securities purchased with his funds and on his instructions, subject to the lien of the Company if the client had failed to reimburse the Company (Re CA Pacific Finance Ltd. (in liquidation) & Anr. (No. 1) [1999] 2 HKC 632). The principles of allocation The administrators have divided the Securities into two categories: categories A and B. Those in category A are where Securities available are equal to the Securities claimed. Those in category B are where there are more claims than Securities available. For Securities in category A, I have made an order that these Securities be returned to the clients, subject to the payment of expenses and a processing fee mentioned below. For Securities in category B, I have adopted the administrators proposal of the pari passu ex post facto approach, which involved allocating a line of Securities to clients claiming those Securities on a pari passu basis, subject also to expenses and a processing fee. Where the allocation has resulted in fractional shares, these

would be rounded down. I have directed that the allocation of the Securities will be subject to:

- (1) the verification of each claim by checking the records of the Company and CCASS;
- (2) the payment of a proportionate share of (a) all expenses incurred by the administrators in maintaining the portfolio of securities in the Company's account with CCASS since their appointment, and (b) all direct expenses incurred and to be incurred in connection with the realisation of the portfolio and the distribution of the proceeds;
- (3) the payment of a processing fee for investigating and verifying entitlements to the Securities, handling and administering the return of the Securities and payment of the proceeds thereof to clients; and
- (4) any lien or charge in favour of the Company for any unpaid amounts due and owing to the Company. The administrators fees, costs and expenses and processing fee By the First Order, the administrators were allowed to apply a sum of \$580,356.12, being a cash amount held by the Company as a result of the CCASS closing out exercise, towards payment of the fees, costs and expenses of the administrators. This is on the basis that the said sum is trust property held on behalf of clients entitled to the Securities. The First Order also permitted the administrators to apply the net proceeds from selling fractional shares of the Securities in the same way. As to the balance of the administrators fees, costs and expenses, I have allowed that to be met out of the assets of the Company. The Company has assets of approximately \$291,000 at present and a number of contingent assets, the most significant of which is a claim of \$15 million under a fidelity insurance policy. Although the underwriter has agreed in principle to meet this claim, the timing of payment of the settlement sum is not yet certain. If and when the settlement sum is received, this will form part of the general assets of the Company (*In re Harrington Motor Co. Ltd., ex p Chaplin* [1928] 1 Ch 105 at 118). If a winding up order is made against the Company, the Third Parties (Rights against Insurers) Ordinance, Cap. 273 will apply. The settlement sum may not be received by the time distribution is to be made, so that the sums available would be insufficient to meet the balance of the fees, costs and expenses. Hence, the administrators proposed levying a processing fee payable upfront out of the clients entitlements to the Securities. This processing fee is to be calculated by taking the amount of the proposed costs, dividing it by the value of the portfolio, and then applying these against the clients entitlements to the Securities, both as at the value date of 18 July 2006. Notwithstanding that the clients entitlement to the Securities are trust assets not beneficially owned by the Company, there is jurisdiction and discretion to require an allowance to be made for the administrators fees and expenses to be paid out of these assets, to remunerate the administrators for their skill and labour expended on the allocation exercise, which benefited the trust property and would have to be carried out in order to verify allocation, on the principle in *In re Berkeley Applegate (Investment Consultants) Ltd.* [1989] 1 Ch 32. See also *Re CA Pacific Finance Ltd. (in liquidation) & Anr. (No. 2)* [1999] 2 HKC 652 at 657F to 658B; *Re Law Siu Kong Christopher trading as Lawsons Securities Company (Administrators Appointed)*, HCMP No. 2477 of 2002,

Kwan J, 24 February 2006, para. 25. In the event the Company recovers sufficient assets to cover the costs of the allocation process, the administrators proposed that such costs should be borne by the Company and the processing fee or the unused balance thereof could then be returned pro rata to those clients who have paid a processing fee. This is recognised in the First Order and I have also confirmed this. A winding-up petition may be presented against the Company at any time. If the Company goes into liquidation, the priority for distributing its assets will be regulated by the Companies Ordinance, Cap. 32 and the Companies (Winding-up) Rules. These statutes do not provide for the fees or disbursements of administrators appointed under section 213 of Cap. 571. The present application is unrelated to any winding up of the Company. It was submitted by the administrators that the directions and orders regarding their fees, costs and expenses already approved in the First Order should not be affected by any subsequent winding-up petition. Liquidation may intervene before the bills of the administrators are assessed by a Master. In that situation, as the settlement sum to be received from the underwriter will form part of the Company's estate, the position of the administrators costs and expenses will be uncertain. The administrators asked to set aside out of the Company's assets a sum which is equal to the total amount billed by them, less the sum of \$580,356.12 mentioned above and the net proceeds from selling fractional shares of the Securities, to be held in an interest bearing account (the Fees Account), pending taxation of their bills. After taxation, the administrators can then settle the balance of their bills as taxed, using the funds in the Fees Account, with surplus being paid to the Company's estate. In that way, the funds in the Fees Account will be regarded as trust funds for the purpose so specified, and will not be treated as general assets of the Company. I have endorsed this proposal. The mechanics of allocation The administrators have issued a second circular to all clients with economic interest in this matter, pursuant to the First Order, to notify them they may make submissions to the court at the further hearing on issues concerning the method and process of the return of the Securities. I have given directions for a third and fourth circular to be issued by the administrators. The third circular is to inform each client of his entitlement to the Securities and providing for a time within which he may object to the administrators adjudication. The fourth circular is to enclose an allocation statement; to ask for the upfront payment representing the maintenance and allocation expenses, and, if applicable, a processing fee and a sum representing the right of subrogation of the ICC; and to invite clients to collect the physical scrip of the Securities to which they are entitled. The right of subrogation of the ICC If a client has been fully compensated out of the ICF, the administrators proposed dealing with the ICC as if it were the client. If the client has received partial compensation, the administrators proposed to give him all his securities entitlement in specie, subject to his payment of a sum representing the ICC's right of subrogation, in advance of receipt of the physical scrip of the Securities. In this way, the client could get back all his securities entitlement, with the ICC being refunded in cash its entitlement pursuant to its statutory right of subrogation. If the client does not want to take his securities entitlement in specie, the administrators will sell the shares; the ICC will receive the sum representing its right of subrogation out of the proceeds and the rest will be

paid to the client after making all necessary deductions. The right of subrogation is governed by section 87 of Cap. 571, which is a new provision. I agree with the submission that section 87(1)(b)(ii) would appear to indicate that securities held on trust by the Company for its clients are one class of assets against which the ICC may exercise its right of subrogation. Trust account allocation The final matter is the proceeds of a trust account held with the Hang Seng Bank Limited. Most of the amount is attributable to one client, Sit Wing Hei. I have endorsed the proposal of the administrators of returning the sum to that client 1udk 1udk 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 hccw (for Susan Kwan only).dot setup Microsoft Word 9.0 Judiciary Hong Kong Title X z; X z; X z; Microsoft Word Document MSWordDoc Word.Document.8

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