

*Jiangsu State Farms and Agribusiness Corp. v. Ho*, 7 ROP Intrm. 268 (Tr. Div. 1998)

**JIANGSU STATE FARMS AND AGRIBUSINESS CORP.,  
PUKOU JIANGSU NONGKEN INDUSTRIAL AND COMMERCE CO.,  
and NANJING ORIENTEX GARMENTS CO, LTD.,  
Plaintiffs,**

**v.**

**FRANK HO, ORIENTEX PALAU, INC.,  
WAISEI, INC., KEN YOKKEN, ALAN R, SEID,  
IBEDUL Y. M. GIBBONS and GLENN SEID,  
Defendants.**

CIVIL ACTION NO. 170-97

Supreme Court, Trial Division  
Republic of Palau

Issued: December 21, 1998

BEFORE: JEFFREY L. BEATTIE, Associate Justice.

This action involves a dispute concerning shares of stock in Orientex Palau, Inc. (Orientex), a corporation incorporated under the laws of the Republic of Palau. After hearing the testimony presented at trial, reviewing the exhibits, and considering the arguments of counsel, the Court makes the following findings of fact and conclusions of law.

#### PROCEDURAL BACKGROUND

Before trial, the claims of Nanjing Orientex Garments Co. Ltd. were dismissed, as were all claims against defendants Gibbons, Alan Seid, Glenn Seid, and Waisei, Inc. The claims against defendant Ken Yokken, also known as Ken Yokeno, were dismissed for lack of personal jurisdiction in that the summons and complaint were not served on him. The trial of the case was bifurcated at the request of all parties. The first phase of the trial was to determine the liability, if any, of defendants Ho and Orientex, for breach of an alleged agreement under which Pukou Jiangsu Nongken industrial and Commerce Co. (Pukou) was to acquire shares representing 40% ownership of Orientex. The second phase of trial would be to determine the damages, if any, to be awarded. Only the first phase of trial has been completed.

#### FACTS

Jiangsu State Farms and Agribusiness Corp. (Jiangsu) is a corporation organized under the laws of the People's Republic of China ("China"). It is owned by the government of Jiangsu Province, China. Pukou, which is also a corporation organized under the laws of China, is a wholly owned subsidiary of Jiangsu. Su Nan Jun (Su) was the general manager of Jiangsu in 1992, and he later became its chief engineer.

Frank Ho (Ho) is owner of all of the shares of a Hong Kong corporation called World Fame Trading Ltd. Nanjing Orientex Garments Co. Ltd. is a corporation owned by World Fame (51 %) and Pukou (49%) which, in 1992, was in the business of manufacturing garments in China. Garments which are imported to the United States from China face import restrictions. In July of 1992, Ho proposed to Su that they start a garment manufacturing business in Palau where, due to the Compact of Free Association with the United States, many of the import restrictions could be avoided.

In October of 1992, Su, Ho, and Heng Yifan, who was the general manager of Pukou, came to Palau. They met with Alan Seid, Glenn Seid, and Ibedul to discuss setting up a garment manufacturing business in Palau. Ken Yokeno, a Japanese citizen who is a long time friend of Ho's, was also present. At the 1269 meeting, the participants agreed to form a corporation to operate a garment manufacturing business in Palau. They agreed that the corporation would be owned as follows: 20% by Waisei, Inc., a Palauan corporation owned by Glen Seid, Alan Seid and Ibedul; 20% by Yokeno, and 60% by the group represented by Ho and Su. Ho and Su agreed that Ho would own 20% and Pukou would own 40% of the stock of the corporation. As payment for Pukou's stock, the parties agreed that Pukou would contribute prefabricated buildings, equipment, and living facilities for workers having a value of \$220,000. Waisei was to contribute; services for its shares. The other parties were to pay cash. Orientex Palau, Inc. was then incorporated as the company that would own and operate the garment manufacturing business. The Articles of Incorporation of Orientex were signed on April 2, 1993, and it received its corporate charter on April 27, 1993. The initial officers of the corporation were Ibedul, who was president, and Glenn Seid, who was vice -president and secretary. In April of 1993, Pukou had not yet received its permit to invest in Palau from the Chinese government, so there was some discussion between Ho and Su about having their shares issued to Nanjing Orientex. Nanjing Orientex, however, was not allowed to invest outside of China. Orientex already had orders for garments, and it needed Pukou to contribute the manufacturing facilities and equipment so it could fill the orders. Ho and Pukou agreed that Pukou's shares would be issued in Ho's name and that Ho would hold them for Pukou until Pukou received its investment permit from the Chinese government. Thus, the initial shareholders of record of Orientex were Waisei, Yokeno, and Ho. On April 2, 1993 all of the officers of Orientex signed an affidavit, which was filed with the Registrar of Corporations, stating that all of the authorized stock of the corporation had been issued as follows: Waisei - 2,000 shares; Yokeno - 2,000 shares; and Ho - 6,000 shares. The affidavit was filed with the Palau Registrar of Corporations.

Pukou then borrowed US\$300,000 from the Bank of China, Jiangsu Branch, in order to make its investment in Orientex. Although Pukou's investment was originally going to be in the amount of US\$220,000, it was increased to \$300,000 because of the needs of Orientex. Ho agreed to increase his investment as well. Pukou made its first withdrawal of funds from its loan account at the Bank of China on May 13, 1993, when it withdrew \$40,000 for employee living expenses and labor to set up the facility in Palau. It also withdrew \$45,673.22 to pay for shipping moveable houses from Shanghai to Palau. By the end of June, 1993, Pukou had contributed \$316,706.56 to Orientex, the extra \$16,706.56 resulting from a drop in the value of the U. S. dollar against the Hong Kong dollar. Pukou's contribution consisted of cash, buildings,

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equipment, materials, and some services.

Ho contends that many of these items were contributed by Nanjing Orientex and not by Pukou. The invoice for the purchase of sewing machines and pressing equipment, for example, is made out to Nanjing Orientex. These items were purchased from Sang Lee Sewing Machine Co. of Hong Kong. The testimony of Pukou's witnesses, which the Court finds to be credible, was that these items had to be purchased and shipped through Nanjing Orientex due to Chinese government restrictions on the activities of Pukou. Pukou was not permitted to purchase items outside of China or to export items from China. Nanjing Orientex could do both. For that reason, Pukou withdrew \$88,335.13 from the Bank of China to open a letter of credit in the name of L270 Nanjing Orientex in Hong Kong. <sup>1</sup> Nanjing Orientex then purchased the equipment in Hong Kong, using the letter of credit as payment. The seller of the equipment did not deliver it to Nanjing Orientex, but shipped it to Palau from Hong Kong with directions that Orientex Palau, Inc. be notified upon its arrival. Thus, Nanjing Orientex was merely a conduit through which Pukou purchased the equipment for Orientex. Nanjing Orientex itself did not invest in Orientex.

Ho also argues that Nanjing, Orientex guaranteed the loan to Pukou from the Bank of China, so that the contributions, made to Orientex should be considered Nanjing Orientex contributions. Although Nanjing Orientex did initially guarantee the loan to Pukou, Ho has supplied no legal authority to support his contention that the mere act of guarantying the loan put Nanjing Orientex in the status of an investor in Orientex. There is no evidence that Nanjing Orientex ever was called upon to make any payment on the loan. To the contrary, after it initially guaranteed the loan, Nanjing Orientex was removed as guarantor and replaced by Jiangsu, who is now the guarantor.

The accounting records of Orientex, such as they are, confirm Pukou's investment. Xia Zhengrong was the accountant for Orientex from July of 1994 to August of 1996. He prepared a balance sheet for the corporation dated September 30, 1994. On that date, the accounting records of Orientex showed that Pukou had contributed capital in the amount of US\$300,000. The additional \$16,706.56 that Pukou contributed due to the currency fluctuation mentioned earlier was carried on the corporation's books as an account payable to Pukou.

On August 19, 1993, Pukou received its permit to invest in Palau from the Chinese government. Shortly thereafter, Heng Wan and other representatives of Pukou asked Ho to transfer the shares representing Pukou's 40% ownership of Orientex to Pukou. Ho did not transfer any stock to Pukou, giving various excuses when pressed to do so.

Under continuing pressure from Pukou, in September of 1995, Ho caused a corporate resolution to be prepared and presented it to Glenn Seid, who was the secretary of Orientex, for certification. The resolution stated that the initial shareholders of Orientex were Waisei, Ho, Yokeno, and Pukou. It did not specify how many shares were held by any of the shareholders, but it was certified by Glenn Seid as adopted on April 2, 1993. Ho then asked William Ridpath,

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<sup>1</sup> The transaction took place four years before control over Hong Kong was transferred to the People's Republic of China.

*Jiangsu State Farms and Agribusiness Corp. v. Ho*, 7 ROP Intrm. 268 (Tr. Div. 1998) the attorney for Orientex, to prepare a letter which stated that the resolution set forth the names of the initial shareholders of Orientex. Ridpath prepared the letter, and Ho sent the resolution and letter to Justin Ma, the attorney for Pukou in China.

Justin Ma was not satisfied with the letter and resolution. In October of 1995, he and other Pukou representatives came to Palau to investigate the matter and attempted to get the Orientex shares to which Pukou was entitled. Ho told him that Pukou was not going to get any shares.

## DISCUSSION

Defendants Ho and Orientex contend that Pukou was never a party to any subscription agreement for shares in Orientex, so it has no right to any shares. According to defendants, any contribution to Orientex by Pukou was a loan and not a capital 1271 contribution. They contend that the agreement under which Orientex was incorporated is the “Memorandum of Agreement” dated October 18, 1992 (“MGA”). According to defendants, the parties to the MGA were Waisei, World Fame Trading, Ltd., and Jiangsu State Industry Co. It is clear, however, that the MGA was not the agreement pursuant to which Orientex was formed. The signature of Glenn Seid on behalf of Waisei is forged. Moreover, neither Ho nor Yokeno were parties to the MGA, although they were both initial shareholders of Orientex. The credible testimony establishes that Pukou was a party to a subscription agreement under which it was to receive shares representing 40% of the initial stock issued by Orientex. Although, due to Chinese government restrictions, it may not have been clear at first whether the stock would be owned by Nanjing Orientex, Jiangsu or Pukou, ultimately it was agreed that Pukou would invest in Orientex and own 40% of the corporation’s stock. There is no written contract<sup>2</sup>, but stock subscription agreements need not be in writing under Palau’s statute of frauds. 39 PNC § 504.

Although there is a split of authority concerning whether a pre-incorporation subscription agreement is binding on the corporation,<sup>3</sup> *see* 18A Am. Jur. 2d *Corporations* § 589 (1985), it is settled that where, as here, the corporation is formed and it accepts the payment for the shares, it is bound by the agreement. *Id.* § 588.

It is generally held that the creation of the corporation within a reasonable time after the subscription amounts to an acceptance of the offer of a stock subscription, without any further act on its part, and that it gives rise to a binding contract between the subscriber and the corporation from which the latter cannot withdraw.

*Id.* § 589 at 493-94.

The fact that the Pukou and Ho agreed that Ho was to hold Pukou’s stock for it in his

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<sup>2</sup> Some of the witnesses stated that there was a “Memorandum of Understanding” signed by some of the parties, but no such document was offered into evidence.

<sup>3</sup> Palau has no statute addressing the question whether pre-incorporation subscription agreements are enforceable.

*Jiangsu State Farms and Agribusiness Corp. v. Ho*, 7 ROP Intrm. 268 (Tr. Div. 1998) name until the Chinese government issued a permit does not affect Pukou's right to obtain its shares from Ho. Pukou performed its obligations by contributing the agreed amount of capital to Orientex. Orientex performed its obligation by issuing Pukou's shares to Ho<sup>4</sup> -- Pukou agreed that Ho would be its nominee. Ho's duty was to assign the 4,000 shares to Pukou when Pukou requested him to do so in August of 1993.

Defendants also argue that the agreement under which Pukou invested in Orientex is illegal and unenforceable because Pukou had no permission from the Chinese 1272 government to invest in Orientex at the time Pukou entered into the agreement. Defendants presented no evidence of any Chinese law that Pukou violated by entering into the agreement. Pukou admits, however, that at the time it made its capital contribution to Orientex, it did not yet have permission from the Chinese government to do so. There is a question whether Pukou's delay in obtaining its permit excused Ho from performing its contractual obligation to assign the 4,000 Orientex shares to Pukou.

The first issue to determine is whether Palauan law or the law of the People's Republic of China governs the effect of illegality, if any, on the agreement. The general rule is that where, as here, the parties do not specify what country's law will govern an issue concerning a contract, the law of the country that has the most significant relationship to the transaction and the participants will be applied. *Restatement of Conflict of Laws* (Second) § 188(1) (1971).<sup>5</sup> The factors to be considered in determining the country with the most significant relationship to the transaction include (1) the place of contracting, (2) the place of negotiation of the contract, (3) the place of performance, (4) the location of the subject matter of the contract, and (5) the domicile, residence, nationality, place of incorporation and place of business of the parties. *Id.* § 188(2). Here, the contract was negotiated, entered into and was to be performed in Palau. The subject matter of the contract, the garment manufacturing business, is in Palau. Orientex is incorporated in Palau. Although Pukou is incorporated in China and Ho is a United States citizen, it is clear that Palau has the most significant relationship to the transaction at issue. Indeed, "if the place of negotiating the contract and the place of performance are in the same [country], the local law of this [country] will usually be applied . . . ." *Id.* § 188 (3). Thus, issues relating to the contract under which Pukou invested in Orientex will be determined by applying the laws of Palau. *Id.* § 202.

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<sup>4</sup> It is not necessary for a corporation to issue a stock certificate in order to make a person a shareholder. *Id.* § 733; *Molina v. Largosa*, 465 P.2d 293, 295 (HI 1970). Thus, Pukou became an initial shareholder in Orientex even though no certificates were issued. Its shares stood in the name of Ho in the records of Orientex as shown on the affidavit filed with the Registrar of Corporations. If Orientex had issued share certificates to the initial shareholders, a certificate would not have been issued in Pukou's name because of the agreement that Ho would act as its nominee for the shares.

<sup>5</sup> The Court is bound to apply the common law of the United States as expressed in the Restatement of the Law. 1 PNC § 303. The Restatement of Conflict of Laws applies to conflicts of law between one or more states of the United States and "are generally applicable to cases with elements in one or more foreign nations." *Restatement of Conflict of Laws (Second)* § 10 (1971)

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Defendants do not claim that Pukou violated any Palauan law by entering into the contract to invest in Orientex nor in performing its obligation under the contract by contributing capital to Orientex without first obtaining the permission of the Chinese government. Therefore, the fact that China did not give its approval to Pukou's investment until after the investment had already been made did not excuse Ho from performing his obligation to assign to Pukou the Orientex shares he held as Pukou's nominee.

### PUKOU'S REQUEST FOR SPECIFIC PERFORMANCE

Having concluded that Ho breached his agreement to assign the 4,000 shares to Pukou, the Court will address the appropriate remedy for the breach. Pukou has requested that it be granted specific performance and that the Court order Orientex to issue a stock certificate to Pukou evidencing Pukou's ownership of 40% of the outstanding shares of Orientex.

Specific performance is an equitable remedy and is not available if an award of damages would adequately compensate the injured party. *See Restatement of Contracts (Second)*, § 359 (1981). Pukou's expectation under the agreement was that it would receive 1273 stock in Orientex. Orientex is a closely held corporation and there is no active market in its stock. Therefore, it is doubtful that an award of damages would enable Pukou to obtain Orientex stock and thereby protect Pukou's "expectation interest" in the agreement. *See Id.*

Even though damages may not be a fully adequate remedy, there is no absolute right to specific performance. 71 Am. Jr. 2d *Specific Performance* § 6 (1973). Specific performance will be granted or denied in the discretion of the Court based upon a consideration of all the circumstances of the case. *Restatement of Contracts (Second)* § 357 (1981). For the reasons discussed below, the Court finds that it should not grant specific performance in the form requested by Pukou in view of the circumstances of this case.

The Articles of Incorporation of Orientex state that the authorized capital stock of the company is 10,000 shares. All 10,000 shares were issued on April 2, 1993 as follows: Waisei - 2,000; Yokeno - 2,000; Ho 6,000. As we have seen, Ho held 4,000 of the 6,000 shares as nominee for Pukou. On February 23, 1995, Ho executed an Assignment of Shares under which he purported to assign 3,000 shares of Orientex stock to Tsai Rong Tai, aka Ken Tsai. Glenn Seid, the secretary of Orientex, testified that the corporation was aware of the purported transfer. Unless the transfer to Tsai was invalid or ineffective as against the claims of Pukou, Ho only holds 3,000 of Pukou's shares. Thus, the Court could not order Ho to transfer 4,000 shares to Pukou without first declaring that the transfer to Tsai was ineffective. However, Tsai is not a party to this case, and the Court is therefore unable to enter any judgment adversely affecting his rights. *Martin v. Wilks*, 109 S.Ct. 2180, 2184 (1989).

Another factor militating against specific performance is that, although the initial Articles of Incorporation authorized 10,000 shares, the precise number of shares which are now authorized, issued and outstanding is not clear from the evidence presented at trial. <sup>6</sup> The

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<sup>6</sup> Not only did the evidence presented at trial fail to establish precisely how many Orientex shares are authorized, issued and outstanding, but it is questionable whether the number

*Jiangsu State Farms and Agribusiness Corp. v. Ho*, 7 ROP Intrm. 268 (Tr. Div. 1998) secretary of Orientex signed a Certificate of Amendment of Articles of Incorporation which states that in February of 1995, the Articles of Incorporation of Orientex were amended to increase the number of authorized shares to 130,000 shares with a par value of \$10.00. Ho testified that he now holds 26,000 shares. Assuming that is true, and further assuming that the purported amendment to the Articles of Incorporation was effective, Ho would be able to assign 4,000 shares to Pukou. The problem is that 4,000 shares would not represent 40% of the shares of Orientex.

It is one thing to say that Pukou had a right to 40% of the shares of Orientex when it was incorporated in 1993. It is quite another to say that Pukou had a right to maintain 40% ownership if the number of authorized and 1274 issued shares were increased -- and to do so without contributing additional capital for its additional shares. The parties never agreed that the Articles of Incorporation would not be amended or that Pukou would have preemptive rights to buy additional shares in order to maintain its percentage ownership if the number of authorized shares were increased and new shares issued. An order of specific performance in the form requested by Pukou not only runs the danger of causing Orientex to violate paid-in capital rules,<sup>7</sup> but may well result in Pukou receiving more than it would have received in the absence of a breach by Ho, all to the detriment of Orientex and other shareholders.

In view of these factors, the Court finds that it should exercise its discretion and deny specific performance in the form requested by Pukou -- an order which instructs Ho to assign 40% of the outstanding stock of Orientex to Pukou and instructing Orientex to issue a stock certificate for those shares. Accordingly, the Court finds that Ho is liable to Pukou for damages for breaching his agreement to transfer to Pukou the: Orientex shares he held as nominee for Pukou when he was first requested to do so in August of 1993. The Court finds that Orientex performed its obligations under the agreement by issuing Pukou's shares in 1993 when it was incorporated. It was with Pukou's agreement that its shares were issued in Ho's name, and there was no breach of contract by Orientex. Orientex is liable to Pukou for any unpaid balance on the \$16,706.56 contributed by Pukou to Orientex and treated as a payable by Orientex.

Because of the bifurcation of the trial, the Court will not at this time determine the amount of damages to be awarded Pukou. A pre-trial conference will be held at 10:30 a.m. on January 11, 1999 in order to define the issues relating to damages that remain to be tried and to

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could be determined from the records of Orientex. In response to plaintiffs' request for production of documents, Orientex was unable to locate any balance sheets for the years end December 1994, 1995, 1996, or 1997. It was also unable to locate stock books. Moreover, Orientex did not file an annual report with the Registrar of Corporations for 1994, 1995, 1996, or 1997. In Ho's deposition, he testified that he owned 2,000 shares, but at trial he testified that he owned 26,000. Ho testified that there are records of stock ownership, but that they were not produced because it would have taken too much time. The Court found Ho's testimony to lack credibility. Thus, the corporate records appear to be nonexistent and the testimony of the president of the corporation is unreliable.

<sup>7</sup> "No corporation shall issue any share of stock having a par value . . . for any consideration . . . the value of which is less than the par value of the share." Palau Corporate Regulations, Chapter 1, Part 3, § 3.7.

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set a trial date for the final phase of trial. Counsel shall confer prior to the pretrial conference in order to attempt to narrow the issues, discuss settlement, and reach any stipulations that will reduce the length of trial.