IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2014-404-001381
[2016] NZHC 1489

BETWEEN	CADRE INVESTMENTS LIMITED, MICHAEL WILLIAM SCOTT STANBRIDGE AND TREASURY MERCHANT FINANCE LIMITED Plaintiffs / Counterclaim Defendants
AND	ACTIVEDOCS LIMITED Defendant / Counterclaim Plaintiff

Hearing:	2 November 2015
Appearances:	D E Wackrow and I F F Peters for Plaintiffs / Counterclaim Defendants L A O'Gorman and A L Harlowe for Defendant / Counterclaim Plaintiff
Judgment:	1 July 2016

JUDGMENT OF COURTNEY J

This judgment was delivered by Justice Courtney
on 1 July 2016 at 4.30 pm
pursuant to R 11.5 of the High Court Rules

Registrar / Deputy Registrar

Date…………………………

Introduction

[1] In 2002 the plaintiffs, Cadre Investments Ltd, Michael Stanbridge and Treasury Merchant Finance Ltd, were shareholders in the defendant, Activedocs Limited (the Company)[1] The Company was in desperate need of more working capital. It offered preference shares to existing shareholders as a means of raising further capital. The plaintiffs subscribed.[2] There is now a dispute between the plaintiffs and the Company over the extent of the plaintiffs' entitlement to preferential dividends and whether the preference shares have been validly converted to ordinary shares.

[2] Under the terms on which the preference shares were issued, a preferential dividend of 15 per cent per annum was payable when the shares were converted to ordinary shares. Conversion was to occur two years from the date of issue unless the Company was unable to pay the dividends that had accrued at that date.[3] If that happened conversion was to be postponed until either the accrued dividends were paid or a preferential shareholder required shares to be converted.

[3] The Company could not pay any dividend on the nominated conversion date. It treated the preferential dividends as continuing to accrue and made provision for the accrued dividend entitlement in its financial statements each year. In 2007 and 2008 it made dividend payments in respect of the 2003 and 2004 years' entitlements. No other dividends were authorised. In 2013 the Company changed its position; it determined that the preference shareholders had no entitlement to any further dividend and purported to convert the preference shares to ordinary shares.

[4] The plaintiffs say that as at the nominated conversion date of 8 November 2004 dividends had accrued in respect of 2003 and 2004 and the Company's inability to pay them meant that conversion was postponed. As a result, dividends continue to accrue until conversion of the shares, which has not yet occurred. They say, further, that the Company's purported conversion of the preference shares in 2013 was invalid and that the company has acted in a manner that is oppressive, unfairly

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1 Prior to 1 April 2006 the Company was known as Keylogix Limited.
2 The plaintiffs were issued 50,000, 83,334 and 15,000 preference shares respectively.
3 There were other exceptions but they are not relevant to the issues in the case.

discriminatory or unfairly prejudicial to them in their capacity as shareholders. They seek:

(a) declarations that the preference shares are still in full force and effect in accordance with the terms of issue; the purported decision in 2013 to convert the shares was ineffective; and the preference shares are restored to the company register; or

(b) an order quashing or setting aside the 2013 decision to convert the shares; and/or

(c) specific performance requiring the company to perform the terms of issue of the preference shares;

(d) an injunction restraining the company from paying dividends to ordinary shareholders until the preference share dividends are paid in full;

(e) damages equivalent to what would be the accrued unpaid dividend entitlement as at the date of judgment; or

(f) relief under s 174 of the Companies Act 1993 in similar terms to the relief sought at (a) – (e).

[5] The Company maintains that dividends cannot accrue until they have been authorised, and because no dividends were authorised prior to 8 November 2004 there were no accrued dividends as at that date so the preference shares converted automatically. Alternatively, only two years' worth of dividends were ever payable and had been paid by 2008 so that the preference shares either converted automatically in 2008 or were validly converted by the Company in 2013. The Company counterclaims, seeking:

(a) declarations that the preference shares have been validly converted, that there are no accrued dividends or liabilities to pay in respect of them and that the company's actions have not been oppressive or unfairly discriminatory to the preference shareholders; or

(b) alternatively, relief pursuant to s 174 of the Companies Act on terms that the Court thinks just, taking into account the impact on the company and its other shareholders.

[6] The questions to be determined are:

(a) were there accrued dividends as at 8 November 2004?

(b) was the dividend entitlement of preference shareholders limited to two years or does the right to receive dividends continue to accrue until the shares are validly converted by the payment of all accrued dividends?

(c) have the preference shares been validly converted and, if so, when did that happen?

(d) what relief is appropriate?

Background

The company needs more capital

[7] The Company is a software developer. In 2000 it raised $2 million by issuing Ordinary Shares at $1 each in order to continue to develop its software and to fund a marketing push into the US. That sum proved insufficient. In late 2001 the company raised a further $3.5 million by issuing another tranche of Ordinary Shares at $1 each. Still there were insufficient funds. By June 2002 the Company was critically short of cash.

[8] The directors began to consider methods of raising further capital. One of those directors, Christopher Due, is also a director of the first-named plaintiff, Cadre. In his affidavit Mr Due described a decision by the board in mid-July 2002 to seek

$1.2m of additional funding by way of a rights issue.[4] The Company approached ABN AMRO Craigs for advice. The plan was derailed by the release of the Company's annual accounts, which included a "Fundamental Uncertainty" note in the auditor's report. It advised that if the Company was unable to raise capital in the future to generate a sufficient level of profitability and cash flow, it might be unable to continue in operational existence for the foreseeable future.

[9] The annual report was circulated to shareholders under cover of a letter of the Chairman, Mr Gedye, who expressed disappointment with the revenue results but advised that major sales were expected over the next few months and that the directors intended seeking shareholder approval to raise a further $1.25 million. But two days later ABN AMRO Craigs advised that the firm was now not confident of being able to raise the additional capital.

[10] After further discussions the board settled on preference shares as the only viable option, given the level of risk to investors, which Mr Due described in this way: "if we did not get more capital, in the absence of greatly increased revenue, it was really a situation of having to effectively close the doors as a business going forward."

[11] By the beginning of August 2002, concern was spreading among other shareholders. These included the third-named plaintiff, Treasury Merchant Finance, whose director, Antony Bishop, arranged a meeting of other major shareholders unhappy with the Company's revenue position. Michael Stanbridge, the second-named plaintiff, attended that meeting. Mr Bishop's unchallenged evidence was that:

> At the meeting there was talk about the problems and some fairly general discussion about whether you could raise money by ordinary shares – everyone accepted that would not be supported. Then there was some discussion of convertible notes but the Company directors were concerned about the solvency test. Then there was discussion of preference shares and it was thought that preference shares were where the solution would lie.

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4 By consent, the hearing of this matter proceeded on the basis of affidavit evidence and none of the deponents were required for cross-examination.

[12] It is evident that preference shares were regarded by the Company as a "last resort" solution in terms of raising essential working capital and a correspondingly risky investment for those who subscribed. Moreover, it is clear that all three plaintiffs knew this.

[13] The Annual General Meeting was held on 2 September 2002. In advance of the meeting the board circulated a draft resolution seeking approval to raise further capital by way of a preference share issue to existing shareholders. The attached explanatory note said:

> Current revenue and cost projections indicate that the Company should achieve sufficient revenue over the next six months so that a further equity injection may not be required. However the Board considers that taking into account some uncertainty as to the exact timing of when the projected revenue will be received, it is prudent to undertake a small capital raising at this time.
>
> Given the recent fluctuations in overseas equity markets, the Board's view is that the offering should be on terms that are attractive in the current market. Consequently the proposal is to offer to existing shareholders $1 Preference Share for every 20 Ordinary Shares held which will convert in two years to four Ordinary Shares and which, up until conversion, will attract a preferential dividend of 15% per annum …

[14] At the AGM Mr Gedye acknowledged the disappointing results for the 2001/2002 year but went on to describe the company's main strategies, which were starting to produce results. He expected that "the company should be cash positive by year end if not sooner". He then referred to ongoing negotiations with potential customers and, leading into the preference share issue, said:

> Because your directors are conscious of the decision-making time frames within large organisations we believe it is prudent to seek additional capital to ensure the cash requirements of the business can be assured up until the time trading income exceeds costs. Consequently directors are recommending a rights issue on the terms set out in the notice of meeting …

[15] The Chairman's presentation at the AGM conveyed optimism that the Company would improve its revenue position within a relatively short time. Nevertheless, I am satisfied that the directors and the plaintiffs knew just how precarious the company's position was.

[16] The resolution approving the preference share issue was passed unanimously. There was a subsequent resolution of the Board authorising the issue in terms that differed slightly from the original draft resolution. A Short Form Prospectus and Investment Statement dated 20 September 2002 (the prospectus) was issued in the terms of the second resolution. I consider the precise terms of these documents later.

The Company cannot pay dividends

[17] The preference share issue raised a total of $1,270,000. The Company's position did not improve. In the 2003 financial year it sustained a deficit in excess of $2 million and had negative shareholders' equity. In the 2004 financial year there was a deficit of more than $600,000, again with negative shareholders' equity. As a result, it was not able to authorise any dividends prior to the expected conversion date of 8 November 2004.

[18] The Company proceeded on the basis that conversion of the preference shares would be postponed and the preferential dividend would continue to accrue until payment could be made and the shares converted. In February 2005 the Company wrote to shareholders advising that:

> Each Preference Shares [sic] was to convert to four Ordinary Shares two years from the date of issue and a preferential dividend of 15% per annum is payable at the time of the conversion.
>
> The terms of issue of the Preference Shares allow for conversion to be postponed in the event that the Company is unable to pay dividends accrued as at the conversion date until either the Company makes payment of all accrued dividends or a holder of Preference Shares requires that the Preference Shares held by that person are converted.
>
> Keylogix Limited is not currently in a position to pay the accrued dividends. Accordingly the Company is unable to convert the Preference Shares to Ordinary Shares.
>
> *The preferential dividend right of 15% per annum will continue to accrue until the Company is in a position to carry out the conversion process by making payment of the accrued dividends*.
>
> (emphasis added)

[19] Despite a modest surplus for the year ending 31 March 2005 the Company was still unable to authorise a dividend. The notes to the financial statements for the

year ended 31 March 2005 referred to the preference shares as continuing to accrue dividends:

> The shares will have right to a preferential dividend of 15% per annum payable at the time of conversion to Ordinary Shares in the company. As at 31 March 2005 the accrued rights to a preferential dividend totalled $452,321 …

[20] The Company continued to treat the preference shares as valid and as continuing to accrue dividends of 15% per annum. Eventually the board authorised two dividends. On 20 March 2007 it resolved to pay dividends in respect of the years ending 31 March 2003 and 31 March 2004. The first of those dividend payments, which totalled $193,849, was paid in May 2007. The second, totalling $193,852, was paid in April 2008.

The Company changes its position

[21] The company's financial statements continued to show the liability to pay 15 per cent on the preference shares as accumulating each year. The financial statements for the year ending 31 March 2012 showed the provision for the preference share dividend as $1,421,581. By then, the ever-increasing size of the provision for accrued dividends had come to be seen as a constraint on the company's growth and a barrier preventing it from raising further capital. The Company began to reassess its position.

[22] In September 2012 the number of shares in the company was reduced by consolidation with the result that both preference share numbers and ordinary share numbers were reduced to 10 per cent of what they had been. In 2013 the Company obtained a second legal opinion, on the basis of which it determined that the preference shares should be treated as having automatically converted on 8 November 2004 or, at the latest, by April 2008, when the dividend payments in relation to the 2002/03 and 2003/04 years had been paid. On 17 December 2013 the board resolved to correct the share register to reflect the conversion of the preference shares to ordinary shares, adjust the balance sheet to reflect that change and reverse the provision for preference share dividends.

The terms on which the preference shares were issued

[23] The prospectus set out the rights attaching to the preference shares as follows:

> Each Preference Share will carry the following rights and restrictions:
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> - *The right to be paid a preferential dividend of 15% per annum in priority to the payment of dividends to the holders of Ordinary Share in the Company, payable at the time of conversion of the Preference Share to Ordinary Shares in the Company*.
>
> - The right on the liquidation of the Company to receive NZ$1 together with any accrued but unpaid preferential dividend in priority to any payment to the holders of Ordinary Shares in the Company but ranking behind creditors of the Company.
>
> - *Subject to the exceptions specified below, each Preference Share will automatically convert to four Ordinary Shares in the Company on the date two years from the date of issue.*
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> The exceptions are:
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> - That the Company may accelerate conversion of the Preference Shares by written notice to the holder if at any earlier time an offer is made for 50% or more of the Ordinary Shares in the Company or there is a change in ownership of 50% or more of the Ordinary Shares through one transaction or a series of linked or related transactions or there is a sale of all or substantially all of the Company's business or assets.
>
> - *Conversion will be postponed in the event that the Company is unable to pay dividends accrued as at the Conversion Date until either the Company makes payment of all accrued dividends or a holder of Preference Shares by notice in writing to the Company requires that the Preference Shares held by that person are converted.*
>
> In all other respects the Preference Shares will rank equally with the Ordinary Shares issued by the Company. In particular, the Preference Shares will carry the same voting rights as the Ordinary Shares. For details of the rights attaching to the Ordinary Shares investors should refer to the Constitution of the Company which may be inspected during normal business hours at the registered office of the Company.
>
> (emphasis added)

[24] The prospectus contained a number of defined terms, including "Conversion Date" which meant:

> The intended date of conversion of the Preference Shares to Ordinary Shares being the date 2 years after the date of issue of the Preference Shares under this offer.

[25] The Preference Shares were issued on 8 November 2002, making the Conversion Date 8 November 2004.

Were there accrued dividends as at 8 November 2004?

Preference shares are presumed to be cumulative as to dividend

[26] Preference shares are a class of share that attracts rights different to those attaching to ordinary shares. They are commonly used as a form of company finance and have been described as often being "virtually indistinguishable from debentures except that they afford less assurance of getting one's money back or a return on it until one does".[5]

[27] The terms on which preference shares are issued vary but, at the least, they ordinarily include a right to a fixed dividend and/or return of capital ahead of ordinary shareholders. In terms of dividend entitlement, preference shares are either cumulative or non-cumulative. Where the preference shares are cumulative and there are insufficient funds to pay the preferential dividend in full in a particular year the dividend becomes payable in a subsequent year in which there are sufficient profits.[6] By comparison, if the preference share is non-cumulative any shortfall or deficit in the relevant year cannot be made good from profits in subsequent years; if no dividend is declared in the relevant year the dividend entitlement arising in that year is lost.[7]

[28] Whether there were accrued dividends as at 8 November 2004 depends on whether the preference shares are cumulative or non-cumulative. The cumulative or non-cumulative nature of preference shares is commonly specified in the terms on which the shares are issued. If it is not specified, the true nature of the rights

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5 Paul L Davies and Sarah Worthington *Gower and Davies: Principles of Modern Company Law* (9th ed, Sweet & Maxwell, London, 2012) at 866.

6 *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd* PC27/94, 17 November 1995 at 5.

7 John Farrar, Susan Watson and Lynne Taylor (eds) *Company and Securities Law in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2013) at 640.

conferred by a preference share is a matter of interpretation of the instrument that created the shares. There are, however, a number of recognised canons of construction that assist in the interpretation of such instruments. Developed in the late nineteenth century in response to the lax drafting of instruments creating preference shares, they are now viewed as so well established as not to be in any doubt.[8]

[29] One of the canons of construction relates to the nature of dividend entitlement. Where (as in this case) the terms on which preference shares are issued are silent as to whether the shares are cumulative or non-cumulative as to dividend they are presumed to be cumulative, though that presumption can be rebutted by language showing that the dividend is to be paid only from the profits of the particular year.[9] *Henry v Great Northern Railway Co*[10] and *Webb v Earle*[11] are typically cited for the former proposition and *Staples v Eastman Photographic Materials Company* for the latter.[12]

[30] In *Webb v Earle* preference shares were issued according to a resolution which left the exact dividend entitlement still to be arranged. Following the resolution, a letter was sent to shareholders, enclosing the resolution and including the following explanatory passage:[13]

> The preference capital authorised is £250,000, carrying dividend at £10 per cent per annum, payable half-yearly, and entitled to a pro rata participation in surplus dividends after £10 per cent has been paid on the ordinary share capital of £650,000.

[31] Second preference shares were later issued, ranking behind the first preference shares but before the ordinary shares in terms of dividend entitlement.

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8 *Gower and Davies,* above n 5, at 869, referring to the more extensive discussion in the fourth edition of the text: LCB Gower *Gower's Principles of Modern Company Law* (4th ed, Stevens & Sons, London, 1979) at 414-421.

9 John Farrar, Susan Watson and Lynne Taylor (eds) *Company & Securities Law in New Zealand,* above n 7, at 640; *Gower and Davies*, above n 5, at 868; RP Austin and Ian M Ramsay *Ford, Austin & Ramsay's Principles of Corporations Law* (16th ed, LexisNexis, online edition, 2016) at [17.390]; Darryl J Cooke *Private Equity: Law & Practice* (5th ed, Sweet & Maxwell, London, 2015) at 5-49; *Halsbury's Laws of England* (5th ed, reissue, 2009, online ed) vol 15 Companies at [1059].

10 *Henry v Great Northern Railway Co* (1857) 44 ER 858 (Ch).

11 *Webb v Earle* (1875) LR 20 Eq 556 (Ch).

12 *Staples v Eastman Photographic Materials Co* [1896] 2 Ch 303 (CA).

13 *Webb v Earle*, above n 11, at 560.

The dispute was as to whether the ordinary shareholders were entitled to be paid dividends each year once the £10 per cent obligations to the preference shareholders had been paid out, or whether the company first had to pay out for previous years in which the £10 per cent preferential dividends had not been paid. Citing *Henry v Great Northern Railway Co*, Sir G Jessel, MR, said:

> When you look at the resolution, articles and letter together, it clearly means this, that the dividend on the preference share is to be paid out of the dividend declared, if there is one – in other words, that the right is restricted to this, that it is to be paid out of what is declared so far as it will go, and that the preference shareholders cannot get anymore, and that they cannot get it when there is no dividend declared. They are to have it if there is anything to pay; if there is nothing to pay they are to go without until there is something to pay; but it does not mean that if there is not enough to pay one half year they are not to have it the next half year, or the third or fourth or fifth half year.

[32] In *Staples v Eastman Photographic Materials Company* the English Court of Appeal considered preference shares issued on the basis that the holders would be "entitled out of the net profits of each year to a preference dividend at the rate of £10 per cent per annum". After two consecutive years of the preference dividend being paid in full, there followed a year where no dividend was paid and two years where only a partial preference dividend was paid. In the next year the directors proposed to pay £10 to the preference shareholders and a dividend to the ordinary shareholders. In an action by the preference shareholders for a declaration that they were entitled to be paid the deficiency for the years in which only a partial preferential dividend had been paid before payment could be made to ordinary shareholders, the Court held that they were not so entitled because, on the wording of the memorandum of association creating the shares the preference shareholders only had a right to be paid the preference dividend from the profits in the particular year (i.e. non-cumulative).

[33] Lindley LJ contrasted the nature of cumulative and non-cumulative dividends:

> The question before us is, what is the preference given to the holders of preference shares? Are they to have cumulative dividends, or are they to have dividends only according to the share of profits in each year in which there are profits? The language is this: "the holders of preference shares shall be entitled out of the net profits of each year to a preference dividend at the rate of £10 per cent per annum on the amount for the time being paid or

> deemed to be paid up thereon." What is the meaning of that? Is that the language employed when it is intended to give a cumulative dividend so that if there are no profits in one year the arrears of dividend are to be carried forward and paid out of the profits of the subsequent years. I confess I do not think that is so.

The Company's argument as to interpretation: no presumption

[34] Whether the shares are cumulative or non-cumulative is critical to the Company's argument that they converted automatically in November 2004. Ms O'Gorman submitted that this question should be approached as one of ordinary contractual interpretation. She argued that, given the lack of any modern authorities, the development of the current legislative scheme governing company law and the development of modern principles of contractual interpretation, the issue whether the preference shares are cumulative or non-cumulative is properly viewed as a question of interpretation rather than presumption. This would mean that the plaintiffs' entitlement would be determined by reference to the ordinary principles of contractual interpretation summarised in *Firm PI 1 v Zurich Australian Insurance Ltd*.[14]

[35] I cannot accept this submission. As I have noted, the leading texts in the area all treat preference shares that are not identified as cumulative or non-cumulative as subject to a rebuttable presumption that they are cumulative. No case was cited to me that put the prevailing view in doubt. The fact that there are no modern cases on the point is no doubt explicable by the fact that instruments creating preference shares almost invariably specify whether the shares are cumulative or non-cumulative.

[36] Nor do I consider that the current statutory provisions justify any change in the existing approach. Ms O'Gorman referred to the fact that under the Companies Act 1993 directors are precluded from authorising any dividend unless the company can satisfy the insolvency test.[15] This was a precursor to the argument, which I

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14 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60]–[61], citing *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 897 (HL) at 912 per Lord Hoffmann; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 at [14] per Lord Hoffmann; *Bank of Credit & Commerce International SA v Ali* [2001] UKHL 8, [2002] 1 AC 251 at [39] per Lord Hoffmann.

15 Companies Act 1993, ss 4, 52(1) and 53(1).

consider later, that since the parties must have contracted on the basis of the statutory constraint on authorising dividends, the prospectus could not have contemplated that any dividend entitlement would accrue in years when no dividend could legally be authorised.

[37] I do not accept that the existence of the current statutory constraints should displace the long-standing approach of treating preference shares that are not specified as either cumulative or non-cumulative as being presumptively cumulative. This is because the current statutory provisions broadly reflect the common law as it existed prior to the introduction of the Act. Previously, companies were constrained in the payment of dividends by the capital maintenance doctrine and cases determining that dividends should not be paid out of profits.[16] In *Hilton International Ltd v Hilton*, Tipping J said:[17]

> In cases of balance sheet insolvency, directors, when declaring and paying a dividend, are in essence paying themselves and their shareholders out of money which should be regarded as belonging in justice to the creditors. In a case of trading insolvency it is in my view quite inappropriate and unjust to declare a dividend when the company is unable to pay its debts to its creditors as they fall due.

[38] The principles that Tipping J identified in *Hilton* were applied by Williamson J in the High Court in *Mosgiel Ltd v The Mutual Life & Citizens Assurance Co Ltd*.[18] On the subsequent appeal the Privy Council implicitly approved those principles, observing that:[19]

> the mandatory direction to pay [dividends] pre-supposed the existence of … profits out of which a preference dividend up to the redemption date had been or would be declared …

[39] The constraints on authorising dividends introduced by the Companies Act are broadly similar to those identified in *Hilton*.

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16 See Law Commission *Company Law* (NZLC PP5, 1987); Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989); and for a succinct description of the history and problems of the situation that existed previously see *Kitchener Nominees Ltd v James Products Ltd* HC Auckland M1515-IM01 15 May 2002.

17 *Hilton International Ltd v Hilton* [1989] 1 NZLR 442 (HC) at 475.

18 *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd* (1992) 6 NZCLC 67,784 (HC) at 67,799.

19 *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd*, above n 6, at 6.

[40] I therefore proceed on the basis that the preference shares are presumed to be cumulative unless the Company can show that, on a proper interpretation of the prospectus, they were intended to be non-cumulative.

The meaning of "accrued": does the wording of the prospectus displace the presumption?

[41] Under the prospectus the dividend entitlement was "15 per cent per annum … payable at the time of conversion of the Preference Shares to Ordinary Shares in the Company". Conversion was intended to occur two years from the date the shares were issued (the Conversion Date). But conversion (and therefore payment) could be postponed under the second exception if the Company was "unable to pay dividends accrued as at the Conversion Date until … the Company makes payment of "all accrued dividends".[20]

[42] The Company argued that since it was known to all parties that the directors could not authorise a dividend unless the solvency test was met, the phrase "accrued dividends" in the second exception is properly interpreted as meaning dividends that have been authorised. Since the Company's financial position did not allow a dividend to be authorised on or before the Conversion Date there were no "accrued" dividends for the purposes of the second exception. Therefore the shares automatically converted on 8 November 2004. Ms O'Gorman's argument was based on general principles of contractual interpretation but, given my conclusion that the shares are presumed to be cumulative, I approach it as an argument that the wording of the second exception operates to displace the presumption that the shares are cumulative. On the Company's argument the right to be paid a preferential dividend would arise only if a dividend had been declared prior to November 2004.

[43] In arguing that "accrued" dividends referred only to dividends that had been authorised, the Company relied on *Re Ganong,* a Canadian case which concerned the interpretation of a will in which the phrase "all dividends accrued due" was used.[21] Crocket J, for the Supreme Court of Canada, considered that this phrase could only mean dividends that had become payable by the company to the shareholder.

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[20] There is no significance in the fact that these phrases use the words in a different order.

[21] *Ganong v Belyea* [1941] SCR 125, [1941] 1 DLR 433 (SCC) at 134-135.

[44] The rationale for this conclusion was, however, the express terms of the share certificate; the Judge seemed to acknowledge that, absent such terms, a preferential dividend entitlement would accrue without any dividend having actually been declared:

> *A preferential dividend at a fixed rate may be said, of course, to be always running between fixed dividend periods and perhaps in that sense to be accruing from day to day*, but how can these dividends in the face of the express terms of the share certificates and of the by-law, in pursuance of which they were issued, possibly be said to have "accrued due" or to be "accruing due" when no profits have been earned to provide for their payment and no declaration has been made by the directors fixing any payment therefor? The shareholders acquire no right to payment of any dividends until there are net profits out of which alone they can be paid and until such time as the directors determine they shall be paid.
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> (emphasis added)

[45] Mr Wackrow, for the plaintiffs, relied on the later case of *Re Indalex* in which *Ganong* was discussed and the following observation made:[22]

> The word "accrue" connotes the ability to calculate a precise amount of money. The word "due" connotes that it is payable whether or not the time for payment has arrived.

[46] I agree with this distinction. I consider that the second exception is concerned with dividend entitlement in the future, not whether dividends are currently payable. In that context there is no basis for interpreting "accrued" as being limited to dividends that have actually been declared so as to rebut the presumption that the shares are cumulative. The natural and ordinary meaning of the word describes a right to be paid at a future date, not the existence of a debt actually payable.

[47] Nor did the other cases on which Ms O'Gorman relied show any principled basis for concluding that, in the context of a going concern, dividend entitlement depends on a dividend having been declared. First, all the cases concerned preference shares that were specified as either cumulative or non-cumulative in the instrument creating the shares. Secondly, all but one of the cases were decided in the context of a winding up, where the question of dividend entitlement was being

22 *Re Indalex* [2010] ONSC 1114 at [36]; the distinction was upheld on appeal to the Supreme Coutr of Canada: *Sun Indalex Finance LLC v United Steelworkers* 2013 SCC 6.

determined in relation to existing rights. In contrast, since the Company is a going concern, the focus in the present case is on the future rights of the preference shareholders.

[48] The first two cases relied on were *Re Accrington Corporation Steam Tramways Company*[23] and *Re Roberts and Cooper Ltd*.[24] They were both decided in the context of a winding up. In *Re Accrington Corporation Steam Tramways Company* there had been a deficiency in the preferential dividend declared in previous years and the holders of the preference shares (both cumulative and non-cumulative) argued that, even though no dividend had been declared, they should nevertheless be entitled to be paid the deficiency made good from the company's assets rather than the assets being distributed rateably among the shareholders.

[49] Finding against the shareholders, Eady J cited *Bond v Barrow Haematite Steel Co* in which Farwell J affirmed that the declaration of a dividend was necessary as a condition precedent to an action to recover.[25] In the context of a winding up, however, the question can only be whether there is an enforceable debt and, since no dividend exists until it is declared, declaration of a dividend is a necessarily a prerequisite to recovery. This decision has no application to cases such as the present, where shareholders are not asserting an enforceable debt but merely a right to receive a dividend in the event one is declared in a later year. Eady J specifically noted that the rights of preference shareholders were limited to the payment of a preferential dividend while the company was a going concern.[26]

[50] *Roberts and Cooper Ltd* was, likewise, decided in the context of a winding up. Prior to the winding up no dividend had been declared but after winding up there was a surplus. The preference shares were specified to be cumulative. The terms on which they were issued included that, on winding up, the preference shareholders were entitled to "any arrears of dividend due there". Eve J considered that no dividends having been declared, none were due and therefore there were no arrears. But, again, the case was concerned with whether there was any dividend actually

23 *Re Accrington Corporation Steam Tramways Company* [1909] 2 Ch 40.
24 *Re Roberts and Cooper Ltd* [1929] 2 Ch 383.
25 *Bond v Barrow Haematite Steel Co* [1902] 1 Ch 353.
26 Citing *Re Crichton's Oil Co* [1902] 2 Ch 86 at 95.

due; that could only be the case if a dividend had been declared. It did not consider the issue that arises in this case, whether, in the absence of any declared dividend there existed a right to receive a dividend in a later year.

[51] Eve J's decision turned not on the meaning of "arrears", but on the presence of "due", and he considered that this distinguished the case from others cited to him. One of the cases cited was *Re Springbok Agricultural Estates Ltd*, also decided in the context of a winding up.[27] The preferential shareholders were entitled to a cumulative preferential dividend and, on a winding up, to have surplus assets applied, first against paid up capital on the preference shares and, second, "in paying off the arrears, if any, of the preferential dividend". No preference dividend had ever been declared. It was held that the preferential shareholders were, nevertheless, entitled to be paid the "arrears" of the preferential dividend. Lawrence J held that there could be arrears of dividends even though no dividends had been declared and that, on its true construction, the meaning of "arrears" of preference dividend was "the amount by which the dividends, if any, paid out of profits while the company was a going concern fell short of the full dividend".[28]

[52] Ms O'Gorman also relied on two Australian decisions, *Heesh v Baker*[29] and *Trojan Equity Ltd v CMI Ltd*.[30] *Heesh* was decided in the context of a voluntary administration; the holders of redeemable cumulative preference shares were found not to be creditors for the purposes of the voluntary administration. The company's constitution provided that the shares were to be redeemed on or before the specified redemption date "by the payment to the holders thereof the sum paid up on such share, and all arrears of dividend". The redemption date was defined, in part, by provision for the company to give notice of its intention to redeem "together with "any accrued cumulative dividends".

[53] Barrett J held that the company's obligation to redeem (and therefore the obligation to make the payment required on redemption) did not become due for performance unless profits or proceeds of new issue enabled the company to redeem

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27 *Re Springbok Agricultural Estates* [1920] 1 Ch 563.
28 At 566.
29 *Heesh v Baker* [2008] NSWSC 711.
30 *Trojan Equity Ltd v CMI Ltd* [2009] QSC 114.

the shares within the relevant statutory constraints. These included the requirement that shares be redeemed only from profits or from an issue of new shares made for that purpose. Barrett J was not being asked to consider the nature of the preference shareholders' rights in the context of a continuing shareholding. However, he did make general observations regarding the nature of cumulative preference shares that are of assistance. The prospectus had specified that the shares were cumulative, meaning that "should the cumulative preferential dividend component at the Distribution Rate not be declared, the undeclared entitlements of the Investor are carried forward into the next succeeding period until declared". Barrett J observed that:[31]

> Where dividends are expressed to be cumulative, it is not, strictly speaking, correct to speak of "default" or "arrears" if there are no profits available for dividend or those available are sufficient to cover part only of the dividend. The shareholders' right to have the deficiency carried forward in the way described so that stated priority is enjoyed as to future profits; *Godfrey Phillips v Investment Trust Corporation Ltd* [1953] 1 All ER 7. Carrying forward is the prescribed method of dealing with the right to the extent that it is not satisfied by payment.
>
> All this is expressly recognised … in the prospectus. Dealing with the situation where a preference dividend is not "declared", that provision says that the "undeclared entitlements" are "carried forward into the next succeeding period until declared". *This not only states explicitly what is implied by the description "cumulative"* but also makes it clear that the determinant of whether the "entitlement" for a particular period is satisfied is whether a dividend in fulfilment of the entitlement is "declared".
>
> (emphasis added)

[54] Nor does the decision in *Trojan Equity* assist the Company. That case concerned preference shares specified as non-cumulative. The holders of the shares were not entitled to vote except, relevantly, during a period in which a dividend or part of a dividend was in arrears. The proceedings were brought in 2009 and no dividend had been paid since 2007 because the directors had resolved not to declare a dividend. The question was whether the preferential dividend was in arrears.

[55] The shareholders argued that because the company's constitution precluded the payment of dividends to the holders of ordinary shares, unless there had been full payment of the dividends to which the preference shareholders were entitled over the

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31 At [29] and [30].

preceding four quarters, the words "in arrears" were properly construed as extending to the situation where no dividend had been paid, even if that was because no dividend had been declared. The Judge agreed with the company that because no dividend had been declared no payment was due and therefore no dividend was in arrears. But that conclusion is clearly a reflection of the fact that the dividend entitlement under a non-cumulative preference share does not arise unless a dividend is declared in the relevant year.

[56] The decision does, however, include a helpful discussion on the nature of cumulative and non-cumulative shares:

> In focussing on the status of the shares as non-cumulative preference shares Mr MacKenna QC relied on the discussion in *Coulson v Austin Motors Company Limited* where such shares were described as ones whose dividend rights in respect of a particular financial period lapse if the relevant preconditions are not satisfied. The usual preconditions would include the existence of sufficient profits during the period to pay the dividend and a declaration of a dividend in respect to the period by the company or its directors.
>
> With cumulative preference shares, however, dividend rights accumulate over time so that, whether or not a dividend has been declared for a particular period, the shareholder retains a conditional right to be paid the accumulated amount in a future dividend period, subject to there being sufficient profits and an appropriate declaration of a dividend or, in a winding up, if authorised by the company's constitution.
>
> …
>
> *Prima facie, therefore, where the directors have not declared a dividend to be payable, it is difficult to see how any amount the [preference] shareholders may otherwise have been entitled to could be in arrears. They have no claim to it in the strict meaning of the words "in arrears" used by Tomlin J in Coulson*[32] *to refer to "a sum which had become due and payable and had not been paid". His Lordship referred to a possible use "in a secondary sense to indicate some deficiency which was capable, either certainly or contingently, of being made good" in a context where it is clear he was referring to a cumulative preferential right to dividends …*
>
> (emphasis added)

[57] In the circumstances of the present case, where the company is a going concern, the second exception is clearly focused on shareholders' rights to be paid a dividend in the future. There is no principle that requires that such entitlement be

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[32] *Coulson v Austin Motors Co Ltd* (1927) 43 TLR 493 at 494–495.

determined by whether a dividend has been authorised. The wording of the prospectus, particularly the reference to "accrued dividends", does not displace the presumption that the preference shares were cumulative as to dividend.

Does the wording of the prospectus displace the presumption: other aspects

[58] There are three other aspects of the wording of the prospectus that I consider make it clear that the shares are cumulative so that the presumption is not rebutted.

[59] First, providing for conversion to be postponed is, in itself, consistent with the preference shares being cumulative rather than non-cumulative; because no dividend can be declared once the shares have been converted,[33] postponing conversion preserves the shareholders' rights to have their dividend entitlement carried through to later years. In comparison, where preference shares are non-cumulative the right to a dividend in relation to a particular year is lost at the expiry of that year if no dividend is declared; whether conversion occurs immediately or is postponed makes no difference to the entitlement of non-cumulative preferential shareholders. In particular, postponing conversion would not address the concern that the Company cannot pay a dividend that has already been authorised. Once a dividend is authorised it becomes payable as a debt whether or not the shares have been converted.

[60] Secondly, the law is clear that when a cumulative dividend of an amount that reflects prior short or non-payment is paid, it is treated as a single dividend for the year in which it is paid, not as a dividend in respect of any previous year.[34] Therefore, the dividend entitlement under a cumulative preference share cannot depend on a dividend being declared in a particular year; otherwise there would be no possibility of a dividend being declared in later year in respect of that earlier year, which is the defining feature of a cumulative preference share.

[61] In *Godfrey Phillips Ltd v Investment Trust Corporation Ltd* the company had wrongly calculated dividends payable on cumulative preference shares with the

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[33] *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd*, above n 6.

[34] *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd,* above n 6, at 5, citing *In Re Wakley* [1920] 2 Ch 205 and *Godfrey Phillips Ltd v Investment Trust Corporation Ltd* [1953] 1 WLR 41.

result that the holders of the shares had been under-paid for some years.[35] In proceedings brought by the company to determine its obligations Wynn-Parry J said:

> It is well established that, in respect of a right to dividend on a share, no debt is created until the dividend is declared. Over the maximum period involved…. too small a dividend was declared on each occasion. *In respect of each dividend actually declared a debt was created in favour of each holder* of "B" preference shares; but in respect of what I may call "the shortfall", on no such occasion was any debt created. *The full effect was not given to the rights of the holders of the "B" preference shares but the continued existence of those rights was not affected by reason of such failure.*
>
> It follows that, apart from any question of waiver or estoppel … the holders of the "B" preference shares could insist as against the company and the holders of the shares and stock of the inferior classes that, before any further distribution of profits should be made, the amount by which the payment of dividend in respect of the "B" preference shares over the period of October 31, 1939, was short should first be distributed in respect of those shares.

And later the Judge went on:

> So long as no dividend or an insufficient dividend is declared, a "B" preference shareholder has no right to sue for the recovery of any monies. His only right would be to sue for a declaration that the company is not entitled to pay any dividend on any inferior class of shares without first satisfying in full the rights of the holders of "B" preference shares, and for an injunction on the footing of such a declaration. Such an action would be for the enforcement of a legal right and the injunction would be sought merely in aid of that legal right.

[62] In the present case, the fact that two years' dividends were expected to be declared at once, and that it was explicitly provided that payment of dividends could be delayed if necessary through the postponement of conversion, points to the shares being cumulative. If they were not cumulative the dividend entitlement would be lost at the end of each year and postponing conversion would not prevent that.

[63] Finally, the provisions of the winding up clause do not detract from the interpretation of the second exception. This clause confers the right to payment of "any accrued but unpaid preferential dividend" in priority to any payment to the holders of ordinary shares. Since dividends only become payable if declared, arrears, even of cumulative dividends, are prima facie not payable on a winding up unless previously declared. Ms O'Gorman relied on *Mosgiel* as clear authority that

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35 Above n 34.

there would have been no "accrued but unpaid preferential dividend" unless such dividends had already been declared. This must be right. However, it is the additional words "but unpaid" that make it clear that a declaration of the dividend was required because those words carry the implication that the dividends had become payable.

Was the right to the preferential dividend limited to two years?

Correct approach to interpretation

[64] The Company's alternative argument was that the preferential dividend was payable only for two years and that, since two years' worth of dividend was subsequently declared and paid, nothing further was owing. Unlike the question as to the cumulative or non-cumulative nature of the preference shares, this issue does fall to be determined on the usual principles of contractual interpretation without the aid of any particular presumption:[36]

> … The proper approach is an objective one, the aim being to ascertain "the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

The resolution of 2 September 2002

[65] Ms O'Gorman argued that the intention to limit the preferential dividend to two years was clear from the resolution authorising the issue of the shares; that, although the terms of the prospectus differed somewhat from the terms of the resolution, the meaning was still the same; and that, in any event, the parties were aware of the terms of the resolution and of the fact that the directors were authorised only to offer the preference shares in the terms of the resolution.

[66] The resolution proposed and approved was in the following terms:

> The Board is authorised to issue preference shares in the Company by way of a renounceable rights issue to existing shareholders to raise up to $1,400,000 in capital, on terms to be determined by the Board but including terms with the following substantive effect: …

[36] *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 14, at [60]–[61].

> Each preference share will carry the following rights and restrictions or rights and restrictions determined by the Board which are substantially the same:
>
> …
>
> ii the right to be paid a preferential dividend of 15 per cent per annum in priority to the payment of dividends to the holders of ordinary shares in the Company, payable at the time of conversion of the preference share to an ordinary share in the Company.
>
> …
>
> iv the preference share will automatically convert to four ordinary shares in the Company on the date 2 years from the date of issue provided that:
>
> …
>
> B the holder may delay conversion in the event of non-payment of the preferential dividend until such time as the dividend is paid in full.
>
> The Board may in its discretion determine any other terms or conditions of the issue including (without limitation) the timetable and key dates of the offering and any minimum acceptance level.

[67] Ms O'Gorman pointed to the use of the definite article "the" and of "dividend" singular as showing that the preferential dividend was limited to two years; the wording suggested a dividend that was both identifiable and identical at the time of conversion being postponed and at the time of payment. That could only happen if the dividend was known to have been limited to a period of two years.

[68] I do not consider that this is the correct interpretation. The wording of the resolution contemplates a dividend being paid only once, upon conversion of the shares. Even on the Company's interpretation, if conversion had occurred on the Conversion Date, only one payment would have been made in respect of two years' dividend entitlements. As I have already noted, when payment of a cumulative dividend is made in a later year it is only treated as a dividend in that year.[37] If payment were made in a later year in relation to all accrued dividend entitlements it would still be only a single dividend. Only the amount of the dividend entitlement increases year on year, not necessarily the number of payments. Therefore, even on the Company's interpretation, it would be incorrect to conclude that the use of "the"

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[37] *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd,* above n 6.

and "dividend" singular were intended to convey that the dividend entitlement was limited to two years.

The resolution of 20 September 2002

[69] There is another difficulty with Ms O'Gorman's reliance on this wording of the resolution: in a Board Resolution dated 20 September 2002, the same day the prospectus was issued, the directors resolved that the Company issue preference shares in accordance with the prospectus. It is, therefore, the terms of the prospectus that govern the parties' rights.

[70] Under the terms of the prospectus the dividend entitlement clause is the same but the second exception refers to "dividends" plural. Ms O'Gorman argued that these words should be interpreted as making it clear that the Company was required to pay the value of two years of dividends even if they had been declared separately in each respective year. But that interpretation does not reflect the dividend entitlement clause, which gives no indication that the dividend entitlement is limited, only in that it ceases upon conversion.

[71] In the second exception one may compare the reference to "dividends accrued" at the start of that clause second exception with "all accrued dividends" appearing in the third line of the clause. The use of the word "all" signals a difference between the dividends anticipated to exist at the time conversion is postponed and the dividends that exist when the share are eventually converted. If only two years' worth of dividends were payable, regardless of when conversion takes place, the more natural and appropriate wording would have been to make it clear that the dividends referred to later in the clause are those that had accrued as at Conversion Date, itself referred to at the start of the clause. That could easily have been done by referring to the Company making payment of "the accrued dividends", but the use of "all" is inapt if it were expected that the dividend ultimately payable would represent only the first two years regardless of when conversion took place. Rather, the use of "all" conveys the possibility of further dividends accruing after November 2004.

[72] In reality, the only basis on which the Company can assert that the parties intended the dividend entitlement to be limited to two years is the fact that conversion was intended to occur in November 2004. But that fact is overborne by the provision for the date of conversion to be postponed.

Is that meaning consistent with the background?

[73] Ms O'Gorman argued that to interpret the prospectus as entitling shareholders to dividends beyond 2004 would be contrary to what all the parties understood the commercial context to be. The contextual aspect relied on was the parties' expectation that the Company would be cash positive by January 2003.

[74] I do not accept that either the directors or the shareholders were as optimistic as that. I have already outlined the circumstances in which the preference shares came to be issued. The directors and the shareholders all understood that the Company's position was precarious. The share issue was the third in three years and the Company was still in desperate need of working capital. The discouraging audit report meant that there was no alternative source of funds. There was significant risk to those investing and the terms of issue were framed to provide an incentive for existing shareholders to put more money into the Company.

[75] In this regard the prospectus must be read as a whole. Although the letter from the Chairman stated that "it is projected that the Company will be cash positive by January 2003", in a later section investors were advised:

> [The Company] can give no assurance that it will achieve or sustain profitability or reach its projected sales targets …
>
> If [the Company] fails to meets its revenue targets, it may suffer operating losses. The Directors will, in these circumstances, be required to carry out remedial action, which could include seeking a further capital injection (thereby potentially diluting the holdings of existing shareholders) … it is not certain that [the Company] will be able to raise the required additional funding in these circumstances. If [the Company] is unable to raise additional funding, this is likely to have a significant effect on the value of investments in [the Company].

[76] Given the circumstances in which the shares were issued, it is implicit that the postponement would benefit the shareholders in some way. There is nothing,

either in the wording of the prospectus or in the surrounding circumstances that detracts from that conclusion.

Is the meaning commercially absurd?

[77] The effect of accumulating preferential dividends on the Company's financial position is described by one of the directors, Mr Roulston, who provided a summary showing the dividend accumulating at $193,851 per annum. As at December 2014 that had produced an accumulated dividend slightly over $1.9m. To put that in context, the Company's total operating revenue for the same year was slightly over $1.6m and its total liabilities (excluding dividends) were slightly over $1.3m. Mr Roulston expressed the view (unchallenged) that this level of liability would not only deter potential investors but also mean that the Company was insolvent.

[78] Ms O'Gorman argued that the parties cannot have intended that the preference shares would attract a ongoing cumulative dividend of 15 per cent per annum because that would have been objectively unreasonable when the Company was suffering from solvency problems and such an obligation would strangle the Company, preventing it from making the very investments that the capital raising was designed to achieve. Although not advanced as such, this submission is essentially that that the plaintiffs' interpretation would lead to a commercially absurd result, and therefore the defendants' interpretation that there was a two-year limit must be the correct one.

[79] In *Firm PI 1 v Zurich* the Supreme Court said:[38]

> Where contractual language, interpreted in the context of the contract as a whole has a natural and ordinary meaning, the courts will generally give effect to that as they "do not easily accept that people have made linguistic mistakes, particularly in formal documents".[39] The "primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage.[40] It requires a "strong case" to

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38 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 14, at [88].

39 Citing *Investors Compensation Scheme Ltd v West Bromwich Building Society,* above n 14, at 193 per Lord Hoffman.

40 Citing *Bank of Credit & Commerce International SA v Ali*, above n 14, at [39] per Lord Hoffman.

> persuade a court that something must have gone wrong with the language.[41]
> …
>
> But if consideration of the relevant background forces a court to the conclusion that something has gone wrong with the contractual language, it is not required "to attribute to the parties an intention which they plainly could not have had".[42] Just as the courts have accepted that understanding the commercial purpose of a commercial contract is relevant to its interpretation, so have they accepted that if a particular interpretation produces a commercially absurd result, that may be a reason to read the contract in a different way than the language might suggest. However, it has also been accepted that a court is not justified in concluding that a contract does not mean what it seems to say simply because the Court considers that, so interpreted, the contract is unduly favourable to one party.[43] There is an obvious tension between these two positions and it will often be difficult to determine whether particular cases fall within one category or the other.

[80] After citing from Neuberger LJ's decision in *Skanska Rasleigh Weatherfoil Ltd v Somerfield Stores Ltd* the Court concluded:[44]

> All this means that where contractual language, viewed in the context of the whole contract, has an ordinary and natural meaning, a conclusion that it produces a commercially absurd result should be reached only in the most obvious and extreme cases.

[81] There is no indication that the implications of accumulating dividend entitlements were actually considered when the shares were issued. It is clear that the terms of issue were intended to provide an incentive for shareholders to put money into what was plainly a risky investment. In that sense the ongoing accumulation of the preferential dividend fulfilled that objective. Had the parties considered the potentially detrimental effect on the Company of the ongoing accumulation of preferential dividends they may very well have been concerned about it. Or perhaps they would have thought it a risk worth taking, having regard to the urgent need the Company had for funds at the time. But the wording of the prospectus does not disclose an intention either way.

[82] Ms O'Gorman submitted that that if the accrued dividends are indeed at this level, no dividends can be declared and, in the event of liquidation, the plaintiffs will

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41 Citing *Chartbrook Ltd v Persimmon Homes Ltd*, above n 14, at [15] per Lord Hoffman.
42 Citing *Investors Compensation Scheme Ltd v West Bromwich Building Society,* above n 15, at 913 per Lord Hoffman; and *Chartbrook Ltd v Persimmon Homes Ltd*, above n 14, at [14] per Lord Hoffman.
43 Citing *Chartbrook Ltd v Persimmon Homes Ltd*, above n 14, at [20] per Lord Hoffman.
44 *Skanska Rasleigh Weatherfoil Ltd v Somerfield Stores Ltd* [2006] EWCA Civ 1732.

not recover any of the claimed dividends because no dividend will have been authorised. However, as Mr Wackrow noted, there is no obligation on the directors to authorise a dividend. The Company is not insolvent merely by reason of making provision for accrued dividends. The major difficulty the Company has is finding fresh funding and investment if it is required to provide for the ever-increasing potential liability of the preferential dividends.

[83] Overall, the commercial context does not indicate that the plain and ordinary meaning of the words of the prospectus is incorrect. The parties framed the terms of the preference shares against a background of urgent need for fresh capital and the terms of the prospectus reflect that. The result was not anticipated (though it could have been) and is disadvantageous to the Company but it is not commercially absurd. It is, for example, no more absurd than the position the Company would have found itself in if it had borrowed the amount that it needed rather than raised it through the issue of preference shares.

Subsequent conduct

[84] Finally, I deal with the fact that for some ten years the Company treated the dividend entitlement as accruing and made provision for it in its financial statements. The plaintiffs rely on as this as subsequent conduct that is admissible to show that the parties intended that the dividends were to accumulate beyond 2004. I have not included this evidence in my earlier discussion because, as I explain next, I do not consider that it is admissible.

[85] The admissibility of subsequent conduct is sometimes regarded as settled by the decision in *Gibbons*. In *Gibbons Holdings Ltd v Wholesale Distributors Ltd* Tipping J, with whom Anderson J concurred, considered that subsequent conduct should be admissible only if it has an element of mutuality so that it could be regarded as the conduct of both parties.[45] Mutuality would avoid ex post facto subversion of earlier jointly shared intentions. There was, however, no majority position on whether such conduct had to be mutual; Thomas J (with whom Elias CJ concurred) was in favour of the admission of subsequent conduct even if it was not

[45] *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [52], [59], [60] and [62].

mutual on the basis that "conduct which is not, and has not been, "shared" or "mutual" may nevertheless point to a meaning contrary to the meaning later asserted by one of the parties.

[86] Mr Wackrow submitted that Thomas J's approach was the correct one and that Tipping J had acknowledged as much in *Vector Gas v Bay of Plenty Energy*. The admissibility of subsequent conduct was not actually in issue in *Vector*, which concerned the admissibility of pre-contractual negotiations. In the course of his discussion, however, Tipping J expressed the view that subsequent conduct could properly be approached in the same manner as pre-contractual conduct, i.e. as part of the factual matrix:[46]

> In *Gibbons Holdings Ltd v Wholesale Distributors Ltd* … I suggested that, in order to be admissible, post contract conduct should be shared or mutual. I saw that as a way of emphasising the need to exclude evidence which demonstrated only a party's subjective intention or understanding as to meaning. I now consider that the approach I am taking in these present reasons is a simpler and clearer translation of the appropriate principle but one which still preserves the essential line between subjectivity and objectivity of approach.
>
> There is no logical reason why the same approach should not be taken to both post-contract and pre-contract evidence. The key point is that extrinsic evidence is admissible if it tends to establish a fact or circumstance capable of demonstrating objectively what meaning both or all parties intended their words to bear.

[87] These *obiter* comments suggest that the question of mutuality is still open. However, I do not need to address this question because I consider that, even if mutuality were not required, the subsequent conduct in this case would not be a sufficiently reliable objective indicator of what the parties intended to be taken into account.

[88] Ms O'Gorman argued that the evidence was inadmissible because it simply reflected the Company's reliance on legal and accounting advice (now regarded as incorrect) and is not probative of the parties' respective and objectively intended meaning at the time the shares were issued. The Company's evidence on this point came from Mr Roulston, who was a director during the period that the financial statements were produced. He explained that the inclusion of accruing preferential

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46 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [30] and [31].

dividends was contrary to his own view about the terms on which the preference shares had been issued. But Mr Roulston's subjective view is irrelevant and, in any event, he signed the financial statements, which makes it difficult for him now to disavow them.

[89] Nevertheless, I find that the financial statements are not a reliable indicator of the parties' intentions. A company's conduct is the product of the intentions and acts of its directors and managers.[47] The directors who determined that the financial statements would show preferential dividends continuing to accrue after 2004 were not the same directors as those who finalised the terms on which the preferential shares would be issued. Although the subjective intentions of directors are not relevant, the fact that their identity differed in the relevant periods means that the acts of the Company in subsequent years is not necessarily a reliable objective indicator of its previous intention. I therefore decline to place any weight on the treatment of the preferential dividends in the financial statements for the years following 2004.

Have the preference shares been validly converted to ordinary shares?

[90] I have concluded that the second exception was triggered on 8 November 2004 as a result of the Company being unable to pay the accrued dividends. Consequently, conversion did not occur then but was postponed until all the accrued dividends were paid.

[91] I have concluded that the preference shareholders' dividend entitlement continued beyond November 2004 until conversion of the preference shares. Conversion would only occur upon payment of the accrued dividends. The dividend payments made in 2007 and 2008 represented only two years' worth of dividends and therefore did not constitute payment of all the accrued dividends that existed at that date. Consequently, conversion of the preference shares did not occur in 2008.

[92] Since entitlements to the preferential dividend continued to accrue each year and dividends of the accrued amount have never been authorised the shares could not

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47 *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153 (HL), citing *Bolton (HL) (Engineering) Co Ltd v T J Graham and Sons Ltd* [1957] 1 WLR 454 (HL).

have been validly converted. The purported conversion of the shares in 2013 was therefore invalid. The preference shares remain in existence on the terms set out in the prospectus.

Relief

[93] It will be evident from my findings that relief ought to be granted. I consider that a declaration regarding the status of the preference shares and the purported conversion of them in 2013 is appropriate.

[94] I do not consider that any of the other forms of relief sought are appropriate. In particular, since the dividend entitlement has not resulted in a debt, an order for specific performance would have no practical effect and no loss has been sustained that requires compensation by way of damages. Neither party explained the exact type of relief under s 174 of the Companies Act relief that might be appropriate and nor do I see a need for any of the possible forms relief that could be granted under that section.

Result

[95] I have found, first, that there were accrued dividends as at 4 November 2008 and conversion of the preference shares was therefore postponed. Secondly, the dividend entitlement under the prospectus was for a preferential dividend at 15 per cent per annum until the shares were converted and was not limited to a period of two years. Thirdly, the shares will only be converted upon payment of all the accrued dividends, which has not yet happened.

[96] I therefore make declarations that:

(a) The preference shares remain in full force and effect in accordance with the terms of issue with the result that dividends continue to accrue at 15 per cent per annum until the shares are validly converted by repayment of all accrued dividends;

(b) The purported decision in 2013 to convert the shares was invalid, as was the change to the Company's share register.

[97] Counsel may address the issue of costs by way of memoranda filed on behalf of the plaintiffs within 14 days of the date of the judgment and the Company within 21 days of the date of the judgment. The plaintiffs may reply within 28 days of date of the judgment.

P Courtney J