Judgement of the Lords of the Judicial Committee of the Privy Council on the Appeal of the Government of Newfoundland v. *The Newfoundland Railway Company and others, from the Supreme Court of Newfoundland; delivered 7th February* 1888.

Present:

LORD FITZGERALD.
LORD HOBHOUSE.
SIR BARNES PEACOCK.
SIR RICHARD COUCH.

[*Delivered by Lord Hobhouse.*]

In this case, the Defendant is the Government of Newfoundland. The Plaintiff Company was incorporated for the purpose of constructing and working a railway in pursuance of a contract with the Government, for which the Government undertook to pay a subsidy and to make grants of land. The other Plaintiffs as trustees for bondholders of the Company are assignees of a portion of that railway, of whatever right the Company have to the subsidy, and of the grants of land in respect of such portion. The Plaintiffs contend that the Government is bound to pay a certain amount of subsidy and to make grants of land for a completed portion of the railway, though as a whole it is not completed. The Government denies the liability, but, if it exists, sets up certain counter claims against the Company.

The precise points in issue are explained in a series of questions which, by consent of the

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parties, were submitted for the judgement of the Court before going into evidence upon questions of fact, and which it is convenient to set forth.

The questions are,—

1. Whether by the non-completion of the whole railway within the time stipulated, the Company forfeit their right to the payment of the subsidy in respect of so much of the line as is complete and operated ?
2. Whether by the non-completion of the whole railway within the time stipulated, the Company have forfeited their right to grants of land in respect of the completed portions ?
3. Are the trustees for the bondholders, the petitioners Evans and Adamson, entitled to have payment made to them, or to the Company on their behalf, of the proportionate parts of the subsidy attributable to the completed parts of the railway so long as the same are operated, even though the Company be in default as to the completion of the whole line, and the Government may have a good claim for damages against the Company in its corporate capacity ?
4. Are the trustees for the bondholders, the petitioners Evans and Adamson, entitled to have the grants of land attributable to the sections of railway already completed made to them or to the Company on their behalf, even though the Company be in default as to the completion of the whole line, and the Government may have a good claim for damages against the Company in its corporate capacity ?
5. Whether, if the first question is decided in favour of the petitioners, the Go-

vernment can set off or counter claim against the claim of the petitioners to the subsidy any claims by the Government against the Company?

6. Have the Defendants the right in these proceedings to make set off or counter claim as in their answer they do?
7. If such set off or counter claim be valid as against the Railway Company, is it valid as against the other Plaintiffs, the trustees for the bondholders?

The Supreme Court answered all the questions in a sense favourable to the assignee Plaintiffs. Upon this it was unnecessary to debate any questions of fact, and on the 5th of January 1887 the Court decreed that the Government should pay the proportion of subsidy, and should make the grants, mentioned in the decree. From that decree the Government has appealed. The question turns entirely on the application to the events which have occurred, of the provisions of an Act of the Newfoundland Legislature, which embodied a contract between the Government and a Syndicate organized to construct the railway, and also a charter of incorporation for the Company.

The Act was passed on the 9th of May 1881. It shows that the Government had intended itself to construct the railway, and had in the preceding year obtained the requisite powers from the Legislature; but afterwards it was thought more desirable that the work should be done by a Company, and a contract had been made for the purpose with the parties afterwards incorporated. It then ratifies the contract, and sets it out at full length.

The contract bears date the 20th April 1881. By paragraph 1 the Company covenants to locate, construct, equip, maintain, and continuously operate 340 miles of railway, com-

mencing at St. John's and running to Hall's Bay, with certain connections and branches, and to provide stations and other essentials necessary to the efficient operation of the road, at such places as will best accommodate the public and the shipping interests of the country. And by paragraphs 10, 11, and 12 it is provided that when the line is completed the Company shall have a specified minimum of plant and equipment; that it shall furnish more as the business developes, so that the travel and shipping interests of the country may be fully accommodated; that it shall efficiently and continuously operate the lines; that there shall be at least one passenger train each way each day over the whole line; that it shall provide the Government with all necessary facilities for transporting mails over the line, attaching a mail car to each through daily passenger train each way.

The most material paragraphs are 13 and 14, which run as follows :—

"13. The said railway and branch lines shall be completed and in operation within five years from the date of this contract. In consideration of the premises, and of the due and faithful performance by the said Syndicate Company of all and singular the covenants and agreements herein contained on their part to be performed, the Government of Newfoundland covenants and agrees :—

"14. To pay the Syndicate Company, upon the construction and continuous efficient operation of the line, a subsidy of one hundred and eighty thousand dollars per annum, in half-yearly payments, in gold, in London, England, on the first day of January and the first day of July in each year, for a period of thirty-five years; such

annual subsidy to attach in proportionate parts and form part of the assets of the said Company, as and when each five-mile section is completed and operated, or fraction thereof at terminus at Hall's Bay."

Then follow, under the heading of "Grants "of Land," several paragraphs relating to that subject. The first sentence of paragraph 15 is the most important, and is as follows :—

"*Grants of Land.*

"15. The Government to grant in fee simple to Syndicate Company five thousand acres of land for each one mile of railway completed throughout the entire length of three hundred and forty miles. The said fee simple grant of five thousand acres of land per mile to be made to the said Syndicate Company upon completion of each section of five miles of railway, or fraction thereof at the terminus at Hall's Bay."

In the rest of paragraph 15 and in paragraphs 16 and 17 are contained provisions for ascertaining the lands to be granted.

By paragraph 20 it is stipulated that all land necessary for the railway shall be provided by the Government, who may, to recoup themselves, retain 90,000 dollars out of the last annual subsidy.

Paragraph 22 is as follows :—

"22. The said Syndicate Company, within three months after the execution of this contract, shall deposit with the Government of Newfoundland, as security for the performance of this contract, bonds of the United States of America, or other approved securities, in amount

equal to one hundred thousand dollars, the same to be returned to the said Syndicate Company upon completion of the three hundred and forty miles of railway; the interest in the meantime shall be paid to said Syndicate Company."

By paragraph 28 the Government takes power to purchase, at any time after the expiration of 35 years from the date of the contract, the property and rights of the Company in the lines of railway, and all property belonging to the Company in the island.

The incorporation of the Company with proper provisions is stipulated for by paragraph 20 of the contract, and by a schedule attached to it; and by Section II. of the Act it is enacted that, for the purpose of incorporating the individuals described, and of granting to them the powers necessary to enable them to carry out the said contract according to the terms thereof, the schedule shall have force and effect as if it were an Act of the Legislature, and shall be an Act of Incorporation within the meaning of the contract.

On the 15th July 1882 the Company assigned to the other Plaintiffs the southern division of the railway and its entire plant and undertaking, constructed or to be constructed, being a distance of 100 miles, and all rights relating to that division or branches, including the grant of 5,000 acres of land for each mile of railway forming part of that division or branches, and also all interest of the Company in respect of the said division or branches in the subsidy of 180,000 dollars payable by the Government in accordance with the provisions of the said Act. The assignees were to hold the property assigned for the security of persons holding bonds which under the powers of the Act the Company were

about to issue to an extent not exceeding 400,000*l*. It appears that bonds have been issued to the full extent.

On the 20th April 1886 the railway should, according to the contract, have been completed. At that time the Company had only completed 85 miles, or 17 of the five-mile sections; and it must be taken for the purposes of the present questions that no more has been done, or ever will be done, by the Company. It does not appear when any five-mile section was completed, but as each has been completed the parties have considered that a proportionate part of the subsidy attached, and the Government has begun paying that proportion on the next half yearly day of payment. On this footing the amount due on the 1st of July 1886 was 17 sixty-eighth parts of the whole. But by that time the Company had failed to perform the contract, and the Government refused to pay any more.

Certain admissions have been made in the suit, by which it appears that the country through which the portions of the completed railway run are much more densely peopled than the country in which no work has been done.

Their Lordships now address themselves to the questions in the suit. As regards the grants of land, they feel little difficulty. It does not appear quite clearly what has been done with respect to these lands, but the argument has proceeded on the footing that in some cases grants have been completed; in some the Company has selected blocks (as by the contract it has a right to do), but no grants have been made; and in the rest there has been no selection of blocks.

In their Lordships' view the contract is not so framed as to make the grants of land

dependent in any way on the completion of the whole line, or upon anything but the completion of each five-mile section. As each of those sections was completed, the right to 25,000 acres of land became perfect. The Company has time allowed to select its blocks, but may if it pleases make the selection at once. There may, or rather must, be delays in selection, in negotiations after selection, and in the formalities of conveyance. But their Lordships think that it would not be in accordance either with the object for which grants of this kind are intended, viz., the immediate attraction of settlers, or with the frame of the contract, if they were to hold that the perfect right which the Company has gained on completion of each section is lessened by such delays. Indeed, the Appellants' Counsel agreed that it would be wrong to interfere with grants already completed, contending only that the Government is not bound to do anything more than has been done, or at all events that its counter claims may be enforced in incomplete transactions. Their Lordships hold that each claim to a grant must be treated as complete from the time when the section which has earned it was completed.

The questions relating to the subsidy are much more difficult. It is argued for the Government that the contract is for the whole railway as an entire thing; that it is to serve the travel and shipping interests of the whole tract of country in contemplation; that the provisions relating to plant and efficient operation refer always to the whole and never to a portion; that no part of the contract contemplates the completion of part and the abandonment of the remainder; that in fact the Company has only taken up the most lucrative portion; that, under the express words of paragraphs 13 and 14, the construction of the entire line is a condition

precedent to the payment of the subsidy, and the efficient operation of the line is a condition precedent to the payment of each instalment; that the subsidy also is treated as an entire thing; and that on the 20th April 1886 the condition was broken and nothing was payable.

Undoubtedly these arguments have great force. The contract assumes throughout that the railway will ultimately be completed; it nowhere contemplates partial completion and partial abandonment; and there is always much difficulty in applying the terms of a contract to a state of events which the parties have never had in their minds. But their Lordships think that the last provision of paragraph 14 requires more effect to be given it than the arguments for the Government allow. Indeed, if pushed to their logical conclusion, they would deprive that provision of all substantial effect. If the subsidy is so entire a thing that it cannot be severed, the whole must begin and end at the same time. No part of it could be payable till completion of the whole railway; and, as on the 20th April 1886 only part was completed, nothing would be payable at any time.

The Government certainly have not acted on this view, and their Counsel shrank from pressing it at the bar. They argued that, though it might be right to pay the amount of subsidy earned during the currency of the five years, yet when that term had expired, and the conditions precedent were irretrievably broken, the case was altered, and it became right to insist upon the entirety of the contract.

Upon this their Lordships think that the expression "to attach in proportionate parts and "to form part of the assets of the Company" imports a permanency of interest greater than would be satisfied by the currency of the subsidy for two or three years or a few months, as the case might be. Further, it is clear that the

theory now under consideration breaks up the unity of the subsidy. If, for example, a proportionate part commenced in 1883, it would end in 1918, whereas other parts would run on later up to the year 1921. But when once we abandon the unity of the subsidy, it is a question only of degree how far the contract requires it to be abandoned. To put the matter briefly, if nothing is payable immediately after the completion of a five-mile section, the last sentence of paragraph 14 is reduced practically to a nullity; if anything, the subsidy loses its unity, and becomes a number of subsidies payable for different periods.

Feeling as they do the impossibility of reconciling all parts of this contract, their Lordships give it the best construction they can, and they conclude that the provision with regard to five-mile sections has the effect of relaxing the extreme stringency with which the rest of the contract would bear upon the Company; and that, on the completion of each section, one 68th part of the whole subsidy became payable as a separate subsidy, beginning at the next day of payment and continuing for 35 years, though subject to the condition of continuous efficient operation.

Then comes the question of counter claim. Whether the Government can establish any has not been ascertained. But it is clearly conceivable that they may show damage arising from the non-construction of the railway, whether by the delay, or by being left to provide for the more sparsely peopled country while paying for the railway working among the more densely peopled a subsidy calculated on an estimate of the whole, or by having purchased land now rendered useless, or by the withdrawal of the 100,000 dollars security under circumstances which are not in evidence. If they have claims of this kind it would clearly be a great hardship on them to be

unable to relieve themselves *pro tanto* from the payment of the subsidy.

The Colonial Legislature has adopted the convenient and just rule introduced into England by the Judicature Act, so that damages unliquidated at the time of the action may be made the subject of counter claim. And the Plaintiffs do not deny that, as between the Government and the Company, such counter claims may be set up, but they contend that the assignment of July 1882 has altered the position of all parties, and that, as against the Plaintiff assignees, the counter claims cannot be set up.

As regards hardship on the Government, it is precisely the same in kind whether its claims are disallowed as between it and the Company or as between it and the assignees; though the extent of hardship might be less in the latter case, if the assignees find that the bonds are wholly or largely made good by the proceeds of the railway and of the 425,000 acres of land attached to it. But the question is to be decided, not on grounds of hardship, but on principles of law and the decisions which illustrate them.

The assignees indeed contend that the Act of 1881 and the Company's charter contain provisions which, in any controversy with the Government, place them in a better position than the Company. The charter contemplated that the Company will borrow money, and says that it may do so, and may issue bonds upon the faith of the corporate property. But their Lordships cannot find any indication throughout the whole of the documents which should lead a lender of money to think that the corporate property is anything more than what the Company may justly claim, or that he is in any other way to stand on higher ground than the borrower.

But then it is said that the rule of law deducible from the authorities is, that when a debt or claim under a contract has been assigned and notice given to the debtor, which may be assumed to have been done in this case, the debt or claim is so severed from the rest of the contract that the assignee may hold it free from any counter claim in respect of other terms of the same contract. So at least their Lordships understood the argument. And as such a limitation of the right to set off a counter claim is new to them, they are led to examine carefully the cases relied on to support it.

In Watson *v.* The Mid Wales Railway Company, 2, L. R. C. P., p. 593, the material facts were as follows. On the 18th March 1865 the Company gave bonds to Watson in consideration of "work and labour." Four days afterwards they demised to him their whole undertaking at a certain rent. He assigned his bonds to another Company, who gave notice to the Railway Company. After the assignment, rent accrued due to the Railway Company. An action was brought on the bonds in Watson's name against the Railway Company, who claimed to set off the rent. That claim was disallowed.

It was pointed out that Mr. Justice Willes examined the case to see whether there was any agreement that one debt should go in liquidation of the other, and that the balance only should be considered as the debt. And it was suggested that such an agreement was necessary to support counter claims against assignees. But Mr. Justice Willes only entered upon that examination because the two debts had no common origin, and, in default of such an agreement, no connection with one another. The true principle is shown by C. J. Bovill in the following terms:—
"No case has been cited to us where equity has
"allowed against the equitable chose in action

" a set off of a debt arising between the original " parties subsequently to the notice of assign- " ment, out of matters not connected with the " debt claimed, nor in any way referring to it."

It certainly cannot be said that the claim by the Government for non-construction of the railway arises out of matters not connected with the payment of the subsidy. On the contrary, the obligation to construct the whole is so intimately connected with the obligation to pay for a portion, as to give rise to a forcible argument that one is a condition precedent to the other; so intimately that their Lordships have serious difficulty in disengaging them, and can only do so by modifying the language of part of the contract.

The next case is that of the Milan Tramways Company, 22 Chan. Div. p. 122. Hutter was a Director of that Company, and in the year 1879 he purchased the claims of several of its creditors. On the 12th January 1880 an order was passed for winding up the Company. On the 5th February a charge was made against Hutter for misfeasances as a Director. On the 26th February he assigned to one Theys the claims against the Company which he had purchased. On the 31st May Theys took out a summons to be admitted as a creditor on those claims. On the 25th July Hutter was found guilty of misfeasance, and ordered to pay a sum of 2,000*l*. It was sought to set off this sum against Theys's claim. Mr. Justice Kay rejected the set off, and said that the case fell within Chief Justice Bovill's judgement in Watson's case. The Court of Appeal confirmed that decision. In their judgements, Lords Justices Cotton and Fry both point out that Theys was enforcing claims, not of Hutter, though the right to them was for a time vested in him, but of other creditors; and that there were no cross

demands between Theys and the Company. It is obvious indeed that the two demands were of totally different origin, and that no connection was ever established between them.

In the case of the Bradford Bank *v.* Briggs & Co. 12 App. Ca. p. 29, the Defendants Briggs & Co. had by their articles of association a first charge upon the shares of their shareholders for all debts due from them. Easby was a shareholder, and in November 1879 he gave to the Plaintiffs, the Bank, a charge for future advances. Notice of the charge was given to the Defendants, who did not give any notice to the Bank of their charge till June 1881. It was held that advances made by the Bank on the faith of their charge took priority of Easby's debts to the Company contracted after the notice given by the Bank.

The only difficulty in this case arose from the terms of the Joint Stock Companies Acts. Apart from that, the case exactly resembled the well known case of Hopkinson *v.* Rolt, 9 H. L. Cases 514, which settled the rules of priority as between a first mortgage for securing future advances and a second mortgage, in respect of advances made by the first mortgagee after notice of the second mortgage. Lord Campbell there says, "The first mortgagee is secure as to "past advances, and he is not under any obliga- "tion to make further advances. He has only "to hold his hand when asked for a further "loan." That was also the position of Briggs & Co. towards Easby.

The present case is entirely different from any of those cited by the Plaintiffs' Counsel. The two claims under consideration have their origin in the same portion of the same contract, where the obligations which give rise to them are intertwined in the closest manner. The claim of the Government does not arise from any

fresh transaction freely entered into by it after notice of assignment by the Company. It was utterly powerless to prevent the Company from inflicting injury on it by breaking the contract. It would be a lamentable thing if it were found to be the law that a party to a contract may assign a portion of it, perhaps a beneficial portion, so that the assignee shall take the benefit, wholly discharged of any counter claim by the other party in respect of the rest of the contract, which may be burdensome. There is no universal rule that claims arising out of the same contract may be set against one another in all circumstances. But their Lordships have no hesitation in saying that in this contract the claims for subsidy and for non-construction ought to be set against one another.

It is hardly necessary to cite authorities for a conclusion resting on such well known principles. Their Lordships will only refer to Smith *v.* Parkes, 16 Beav., p. 119, not so much on account of the decision as for the sake of quoting a concise statement by Lord Romilly of the principle which governed it. He says, "All "the debts sought to be set off against the "Defendant Parkes are debts either actually "due from him at the time of the execution of "the deed" (this was the deed by which the third party who resisted the set off was brought in) "or flowing out of and inseparably connected "with his previous dealings and transactions "with the firm." That was a case of equitable set off, and was decided in 1852, when unliquidated damages could not by law be the subject of set off. That law was not found conducive to justice, and has been altered. Unliquidated damages may now be set off as between the original parties, and also against an assignee if flowing out of and inseparably connected with the dealings and transactions which also give rise to the subject of the assignment.

It appears to their Lordships that in the cited case of Young *v.* Kitchin, 3 L. R., Exch. Div., p. 126, the decision to allow the counter claim was rested entirely on this principle.

In stating this conclusion their Lordships confine themselves to the claims on account of non-construction. Much of the foregoing reasoning does not apply to the claim on account of the withdrawal of the security. When the circumstances of that transaction are ascertained, they may show a fresh and voluntary dealing on the part of the Government raising wholly new obligations after notice of the assignment, and they may afford no ground for counter claim against the assignees, even if they afford any against the Company. That matter must be left for the Supreme Court to deal with when the facts are known.

It remains to say how the questions should be answered and the decree dealt with. Their Lordships propose to answer the questions as follows:—

(1.) In the negative.
(2.) In the negative.
(3.) They are entitled, subject to such counter claims pleaded in this action as may be established against them in fact and law.
(4.) In the affirmative.
(5.) They may counter claim damages, as mentioned in answer to Question 3.
(6.) Such counter claim may be made in these proceedings.
(7.) In the affirmative, so far as regards the non-construction of the railway.

Their Lordships think that the proper course will be to discharge so much of the decree below as directs payment of the subsidy, and instead thereof to direct an inquiry whether the Government is entitled to make any and what claim

against the Company in respect of any of the matters mentioned in the answer of the Attorney General. Such an inquiry will embrace the subject of the 100,000 dollars security, though it is impossible, or at least very inconvenient, to deal with that subject in answering the questions. The method of inquiry, whether by action or issue, or before the Court itself, should be left for the Court to determine. The rest of the decree should be affirmed.

The subject of costs in the Court below need not be mentioned. As regards the costs of this appeal, each party has lost and won on a substantial point, and each must be left to pay their own costs.

Their Lordships will humbly advise Her Majesty in accordance with the foregoing opinion.