Privy Council Appeal No. 27 of 1988

Chase Securities Limited *Appellant*

v.

G.S.H. Finance Pty. Limited *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 31ST OCTOBER 1988

Present at the Hearing:

LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD OLIVER OF AYLMERTON
LORD GOFF OF CHIEVELEY
LORD LOWRY

*[Delivered by **Lord Lowry**]*

This is an appeal by Chase Securities Limited ("CSL") from a judgment of the Court of Appeal of New Zealand allowing the appeal of G.S.H. Finance Pty. Limited ("GSH") from the judgment of Doogue J. in an action in which CSL were plaintiffs and GSH were defendants. The appeal arises out of an agreement dated 21st October 1985 ("the October agreement") between CSL and others and GSH, and the point for decision is the effect of a provision in that agreement (commonly known as an escalation clause) the object of which, speaking generally, is to protect an owner of shares who, in advance of a public takeover bid (which will be regulated by law), sells his shares to a person seeking control of a company, by giving the seller a right to be paid a further amount equal to the difference in price per share, if the purchaser of his shares later acquires other shares in the company at a higher price.

CSL is a wholly owned subsidiary of Chase Corporation Limited ("Chase") and in June 1985 caused to be purchased 32,596,600 shares in Hooker Corporation Limited ("Hooker"), an Australian listed public company. The shares were held in separate parcels by two wholly owned subsidiaries of CSL,

namely, Seah Pty. Limited ("Seah") and Xylan Pty. Limited ("Xylan"). The shareholdings were subsequently increased to 35,042,946 by a placement of 1,440,000 shares and various on and off market purchases.

In August 1985 (the precise date was not in evidence) Hooker declared a final dividend for the year to 30th June 1985 of 6 cents per share, to which, apart from any specific agreement, shareholders who were on the register on 31st October 1985 would be legally entitled. Payment was expected at the end of November 1985 and was actually made on 29th November. In September 1985 Chase was approached with a view to its selling the Hooker shares. While not initially interested, Chase changed its mind on learning that the would-be purchaser (who had not then been identified) intended to make a bid for up to 50 per cent of the Hooker shares, since it feared that it might be locked into Hooker with a minority shareholding.

On 24th September 1985, after discussion, Chase agreed to sell CSL's shares in Hooker to GSH at a price of A$2.40 cum dividend per share. To confirm the agreement Mr. Francis, Deputy Chairman of Chase, wrote the following letter to Mr. Herscu, the owner and controller of GSH, who countersigned it:-

"Mr. G. Herscu, 24 September 1985
G.S.H. Investments Pty Ltd.,
520 Collins Street
Melbourne. 3000.

Dear Mr. Herscu,

I confirm our agreement to sell to G.S.H. Investments Pty Limited 35,042,946 50 cents stock units in Hooker Corporation Limited at a price of $2.40 cum dividend subject to the following:-

1. Settlement to take place within 21 days from today against delivery of the scrip. From the time the scrip is delivered and the monies are unpaid interest will accrue at the rate of 18 per cent per annum calculated daily.

2. Chase or any associated person will not purchase any further shares in Hooker for 18 months.

3. The purchase price will be subject to escalation of 100% if GSH pays more than $2.40 cum dividend for any offer made to

Hooker shareholders in the next 6 months and 50% if GSH sells within 6 months at a price greater than $2.40 cum dividend.

Yours sincerely,

P. FRANCIS
DIRECTOR

Agreed,

GEORGE HERSCU
24 September 1985"

The paragraph numbered "3" constituted an escalation clause of the kind mentioned above.

But this was not the final agreement. It occurred to CSL that, if it sold all the shares in Seah and Xylan to GSH instead of selling the Hooker shares, it could save about $11 million in tax. So a new agreement was reached, as outlined in the following letter dated 17th October 1985 from Mr. Carter, the Chief Executive of GSH, to Chase Corporation:-

"This confirms our new agreement reached today to vary our original agreement of 24 September 1985 as follows:-

1. We will purchase all the shares of Seah Pty Ltd and Xylan Pty Ltd instead of purchasing the Hooker scrip from these two companies and you will pay us $1.25 million for this variation.

2. Settlement will take place as soon as possible after satisfactory documentation has been prepared and signed.

3. Your and our rights in respect of interest are reserved.

4. If this new agreement does not materialise for any reason, then our original agreement of 24 September 1985 stands.

I understand that Paul Rainey of Corrs is drafting the warranties that we will require."

This in turn led to the October agreement, under which GSH was to buy the shares of the subsidiary companies for a price which corresponded exactly to the value of the 35,042,946 Hooker shares at $2.40 each less the sum of $1.25 million in consideration of GSH's consent to vary the binding agreement of 24th September ("the September agreement") by

substituting the October agreement and a further sum of $3,000 representing CSL's contribution to Mr. Carter's travelling expenses. Under this agreement the 6 per cent dividend would of course fall to be paid to the subsidiaries and GSH, as the new owner of the subsidiaries, would therefore reap the benefit. It then occurred to the parties that 1,440,000 of the shares did not qualify for the 1985 dividend, and accordingly $86,400 was deducted from the price to be paid by GSH because the value of Seah and Xylan was seen to have been overestimated by that amount, which represented 6 cents per non-qualifying share. This deduction from the consideration payable by GSH was mentioned in an addendum dated 22nd October and signed on behalf of GSH by Mr. R.W. Nicholson and Mr. Carter, whereby GSH acknowledged the deduction and undertook to "refund" the sum of $86,400 if the 1,440,000 shares qualified for the final dividend of Hooker's 1984/85 fiscal year.

It will be helpful at this point to set out the figures which illustrate the precise correspondence between the September agreement and the October agreement and thereby show that the sale price of Seah and Xylan was directly based on the price which was to have been paid for the Hooker shares under the September agreement.

(A) September agreement

35,042,946 Hooker shares at $2.40	$84,103,070
less payment to GSH for giving consent to vary the September agreement.	1,250,000
	82,853,070

(B) October agreement

Price of shares in Seah	47,192,818
Price of shares in Xylan	13,818,010
CSL loan to Seah paid off	16,381,682
CSL loan to Xylan paid off	5,460,560
	82,853,070
Less Mr. Carter's travelling expenses	3,000
	82,850,070
Sale price reduced by 6 cents in respect of 1,440,000 non-qualifying shares	86,400
	82,763,670
Add interest due to CSL	15,320
Total payment to CSL	82,778,990

The October agreement also contained escalation provisions in the shape of clause 18, which reads as follows:-

"18.1 GSH further covenants and agrees that, if at any time within 6 months after the day hereof;

(a) GSH or any of its associates acquire any further ordinary stock units in Hooker for a price greater than $2.40 per unit, GSH shall (within 5 business days after such acquisition) pay to CSL a cash amount equal to such excess; and

(b) GSH or any of its associates dispose of any stock units in Hooker (whether or not included within the stock units referred to herein) in consideration of a price greater than $2.40 per unit, GSH shall (within 5 business days after such disposal) pay to CSL a cash amount equal to 50% of such excess.

18.2 Terms used in clause 18.1 which are defined in the Companies (Acquisition of Shares) Act shall respectively bear a corresponding meaning in this clause 18.

18.3 Reference to a price in clause 18.1 includes all forms of non-cash consideration to which fair market value shall be attributed for the purposes of this clause."

On 26th October 1985 GSH, having in effect acquired CSL's Hooker shares, launched its takeover bid by an offer to all Hooker shareholders to purchase 93,470,537 stock units for $2.20 cash cum dividend for each unit. This offer was increased on 11th November to $2.40 cum dividend (the same price - and this is the way in which Casey J. put it in his judgment on appeal - as that which had been paid to CSL) and on 21st November the offer was further increased to $2.44 ex dividend, which was accepted by James Hardie Industries Limited ("Hardie") which sold Hooker shares to GSH on 27th November at this figure. Accordingly clause 18.1 of the October agreement came into play. At first GSH disputed its liability to pay any sum whatever, to the extent of suffering summary judgment in the High Court, but subsequently accepted liability to pay CSL an additional 4 cents per unit, being the difference between the figures of $2.40 and $2.44 without taking account of any difference between cum dividend and ex dividend payment.

The fate of this appeal depends on the true construction of clause 18, and in particular clause 18.1(a). CSL argue that the expression "$2.40" means, or must be interpreted to mean, "$2.40 cum dividend" and that accordingly GSH is liable to pay 10 cents per share, having bought Hardie's Hooker shares on 26th November 1985 at $2.44 ex dividend, exactly as it would have been liable if the September agreement had remained in place: the figure of $2.40 is said to be the touch-stone of value for calculating the escalation, but it has no meaning, and thus cannot be resorted to for this purpose, until one sees whether it is "cum dividend" or "ex dividend". CSL submits that the expression "$2.40" must be given a pecuniary value in order to operate the escalation and thereby to carry out the intention of the parties to the October agreement: *verba ita sunt intelligenda ut res magis valeat quam pereat*. Thus, the argument goes, so far as may be necessary, the words "cum dividend" must be supplied after "$2.40".

GSH, on the other hand, submits that "$2.40" means simply that and contrasts the figure found in clause 18.1(a) and ~~(b)~~ with the expression "$2.40 cum dividend" in the September agreement. The proper differential, on this basis, is said to be 4 cents per share. Reliance is also placed on clause 6 of the October agreement which, subject to clause 7 (which preserves the parties' rights with regard to payment of interest), provides that, if the transactions set out in the October agreement are duly completed, that agreement:-

> "... shall constitute the entire agreement between the parties in relation to the transactions contemplated herein ..."

Their Lordships have been reminded by counsel of a number of helpful authorities on the construction of documents, with a view to what the court may or may not do to give effect to the intention or supposed intention of the parties. In *Gwyn v. The Neath Canal Navigation Co.* (1868) L.R. 3 Ex. 209 Kelly C.B. said (at p. 215):-

> "The result of all the authorities is, that when a court of law can clearly collect from the language within the four corners of a deed, or instrument in writing, the real intentions of the parties, they are bound to give effect to it by supplying anything necessarily to be inferred from the terms used, and by rejecting as superfluous whatever is repugnant to the intention so discerned."

In *Mourmand v. Le Clair* [1903] 2 K.B. 216, in which the statutory validity of a bill of sale was challenged, the court (admittedly with considerable

help from the terms of the bill as to interest) supplied the missing word "pounds". The report is noteworthy for the judicial observation at p. 217:-

> "... there is nothing in the Act to prevent a business document like a bill of sale being construed in a business sense."

Charrington & Co. Limited v. Wooder [1914] A.C. 71 was concerned with the interpretation of a covenant in the lease of a tied house. Viscount Haldane, L.C. observed (at p. 77):-

> "My Lords, we have to construe the covenant in the present case, not abstractly, but in the light of the circumstances to which it applied. If the language of a written contract has a definite and unambiguous meaning, parol evidence is not admissible to shew that the parties meant something different from what they have said. But if the description of the subject-matter is susceptible of more than one interpretation, evidence is admissible to shew what were the facts to which the contract relates. If there are circumstances which the parties must be taken to have had in view when entering into the contract, it is necessary that the Court which construes the contract should have these circumstances before it."

The appellant has relied throughout on the approach to construction which is found in *Prenn v. Simmonds* [1971] 1 W.L.R. 1381 and *Reardon Smith Line Ltd. v. Hansen Tangen and Others* [1976] 1 W.L.R. 989. In *Prenn* Lord Wilberforce observed (at p. 1383H):-

> "The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations. There is no need to appeal here to any modern, anti-literal, tendencies. Lord Blackburn's well known judgment in *River Wear Commissioners v. Adamson* (1877) 2 App. Cas. 743, 763 provides ample warrant for a liberal approach. We must, as he said, inquire beyond the language and see what the circumstances were with reference to which the words were used and the object, appearing from those circumstances, which the person using them had in view."

In *Reardon Smith* again Lord Wilberforce stated (at p. 995 and 996):-

> "In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating."

His speech also made reference at p. 997 to an apt quotation from the speech of Lord Dunedin in *Charrington supra* (at p. 82):-

> "... in order to construe a contract the court is always entitled to be so far instructed by evidence as to be able to place itself in thought in the same position as the parties to the contract were placed, in fact, when they made it - or, as it is sometimes phrased, to be informed as to the surrounding circumstances."

It is worth pointing out that the principles enunciated in *Prenn* and *Reardon Smith* have been applied by the New Zealand Courts on numerous occasions (see e.g. *National Bank of New Zealand Limited v. West* [1978] 2 NZLR 451, 455 (CA); *Buckley & Young Limited v. Commissioner of Inland Revenue* [1978] 2 NZLR 485, 490 (CA); *Henderson v. Ross* [1981] 1 NZLR 417, 429 (CA)) and have never been questioned. Finally, the observation of Lord Reid in *Schuler A.G. v. Wickman Machine Tool Sales* [1974] A.C. 235 at p. 251E may provide significant guidance:-

> "The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear."

Turning now to clause 18.1, their Lordships have no hesitation in concluding that the appellant's construction is the right one. In the first place, when the price of a share in a public company is mentioned, that price, in the absence of express words or necessary implication to the contrary, is ordinarily understood to be cum dividend. But, because the words "cum dividend" appear in the September agreement, yet are not found in clause 18, their Lordships consider it right to treat "$2.40" as an ambiguous expression calling for interpretation in the light of the principles already mentioned. The September agreement was already in force and therefore the October agreement was not the first example of consensus on the escalation point. Secondly, the GSH letter of 17th October refers to the agreement to vary the September agreement in consideration of a payment of $1.25 million, but does not mention the price or the escalation clause which is already in place. As between the parties, the substance of the bargain has not changed, but simply the form. Both in this letter and in the October agreement a reversion to the September agreement is contemplated if the new agreement is not carried out. And, CSL having already agreed to pay $1.25 million (no doubt a negotiated amount) in order to change the form of the agreement, there is no reason to think

that it has accepted escalation rights inferior to those which were conferred by the September agreement and are regarded as normal both contractually and under the general law, namely, to receive ultimately the same price per share as later vendors. These are the surrounding circumstances, as Lord Dunedin put it, about which a court construing this contract "is entitled to be informed".

But their Lordships would also observe, without the necessity of going outside the October agreement, that under it, as the figures already tabulated and the terms of the contract will show, CSL, while technically not selling the Hooker shares, has handed over control of those shares to GSH at a valuation of $2.40 in circumstances in whch GSH will own the companies receiving the dividend. If GSH (as it did) were subsequently to buy Hooker shares at a higher price than $2.40 cum dividend, CSL would have parted with its Hooker shares too cheaply just as if it had sold them in the ordinary way. Why then should the escalation clause be construed so as to deprive CSL of the usual compensation in this eventuality? The fact that the October agreement contains an escalation clause at all also involves accepting the proposition that, although CSL was not selling the Hooker shares, it was for practical purposes treated by clause 18 as doing so. Therefore a subsequent purchase of Hooker shares by GSH necessitated a comparison with the valuation of CSL's Hooker shares which had been adopted as the basis (less $1.25 million) of the sale price of the subsidiaries which held those shares.

After the declaration of dividend in August 1985 every vendor and every purchaser of a unit knew that Hooker would on 29th November 1985 pay to the shareholder on the register on 31st October 1985 a dividend of 6 cents. When, at any time after the declaration of dividend and before actual payment of the dividend, there was a sale at $2.40 per unit, the sale must have been intended to be either cum dividend or ex dividend. In any written agreement the expression $2.40 per unit simpliciter was ambiguous. It might mean that the purchaser was to receive the dividend from Hooker if he was registered before 31st October or from the vendor if the vendor was registered on 31st October; in this event the expression $2.40 per unit meant cum dividend. Alternatively, the expression $2.40 per unit simpliciter might mean that the vendor was to retain the dividend if he was paid by Hooker or was to be entitled to claim the amount of the dividend from the purchaser if the purchaser received payment; the expression $2.40 per unit would then mean ex dividend.

Clause 18.1 of the October agreement contained an ambiguity: CSL was to receive an additional sum if GSH subsequently purchased shares for more than $2.40 per unit, but whether that meant more than $2.40 cum dividend or more than $2.40 ex dividend was not expressly stated. This latent ambiguity arises because the October agreement was entered into after the declaration of dividend and before payment of the dividend. That ambiguity can and must be resolved by examining the surrounding circumstances including the circumstance that the October agreement was intended to give effect to the September agreement as modified by the October agreement. Once the surrounding circumstances are examined, it becomes clear that the price $2.40 per unit in the October agreement means $2.40 cum dividend. The argument put forward by GSH invites the court to construe the October agreement as though the expression "$2.40 per unit" means either $2.40 ex dividend or $2.40 if GSH choose to purchase ex dividend.

Such a conclusion is quite inconsistent with the object of the clause, which clearly appears on examination of the documents and the surrounding circumstances.

Their Lordships' view of the case makes it unnecessary to consider any of the arguments which were directed in the courts below to the meaning and effect of clause 18.3 and which, however persuasive in themselves, were inevitably based on an erroneous interpretation of clause 18.1.

A few other points may be briefly mentioned, since they do not in the result make a significant contribution to their Lordships' conclusions. The respondent laid stress on clause 6 of the October agreement, as disposing of any support which the appellant might have looked for in the September agreement. But, as their Lordships have been at pains to show, the October agreement, properly understood, brings the appellant home. The currency of six months given to the October agreement was to some extent relied on as introducing possible complications which might militate against the construction put forward by the appellant. But the six month period was also a feature of the September agreement, and the possible difficulties which were envisaged in the course of argument ought not to be allowed to obscure the simplicity of the position in the events which actually occurred.

The respondent's argument, already briefly summarised above, was well and attractively presented, but seemed to their Lordships to be somewhat divorced from reality in its complete disregard of the incidence of the dividend; taken to its logical conclusion the argument amounted to

saying that "$2.40" meant "$2.40 ex dividend", since it would be completely unrealistic for a vendor or purchaser of shares to leave in the air the dividend, which was at all material times essential to the calculation of value.

The following extract from the judgment of Casey J. in the Court of Appeal helps to put this case in its true perspective:-

> "It can be accepted at once that the background of the transaction leading to the agreement of 21 October was the contemplated takeover of Hooker by GSH, and that the substantial holding to be acquired from the Chase Group would form the platform for that bid, to be undertaken in accordance with the appropriate Australian company takeover provisions. Once an 'official' takeover is launched, it was conceded that those who accepted earlier and lesser offers thereunder for their units are entitled to an increase in the price bringing it up to that paid to later sellers. As the deal with the Chase Group had been negotiated before the takeover was launched, it did not enjoy this statutory advantage; hence the provision of the escalation clause. I have no doubt it was intended to ensure that Chase would be treated in the same way as subsequent sellers under the takeover, should GSH find it necessary to offer more.
>
> I am also satisfied that at the time of the negotiations for the October agreement, it was known to both sides that the dividend had been declared and would be payable to the persons registered as the holder (sic) of the units when the books closed on 31 October. The dividend was in fact paid on or about 29 November 1985. Entitlement to it would have been a factor in the price negotiations."

Their Lordships find no difficulty in equating this reality with the true legal situation.

For all these reasons their Lordships will humbly advise Her Majesty that this appeal should be allowed and that the respondent should pay the appellant's costs in the High Court and the Court of Appeal. The respondent must also pay the appellant's costs before this Board.