IN THE COURT OF APPEAL OF NEW ZEALAND

CA366/2016
[2017] NZCA 121

BETWEEN	ACTIVEDOCS LIMITED Appellant
AND	CADRE INVESTMENTS LIMITED, MICHAEL WILLIAM SCOTT STANBRIDGE AND TREASURY MERCHANT FINANCE LIMITED Respondents

Hearing:	21 March 2017
Court:	Randerson, Winkelmann and Asher JJ
Counsel:	G J Judd QC for Appellant A R B Barker and I F F Peters for Respondents
Judgment:	11 April 2017 at 2:30 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay costs to the respondents for a standard appeal on a band A basis with usual disbursements.

REASONS OF THE COURT

(Given by Randerson J)

Background

[1] The appellant (ADL) is a software development company. In 2002 it was in the process of developing its software products and was in urgent need of more working capital. It offered preference shares to its existing shareholders. The respondents were amongst the shareholders who subscribed for and were allocated preference shares.

[2] The key rights attaching to the preference shares were contained in a Short Form Prospectus and Investment Statement:

> Each Preference Share will carry the following rights and restrictions
>
> - The right to be paid a preferential dividend of 15% 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 Ordinary Shares in the Company [first bullet point]
>
> - The right on the liquidation of the Company to receive NZ$1.00 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 [second bullet point]
>
> - Subject to the exceptions specified below, each Preference Share will automatically convert to four Ordinary Shares in the Company on the date 2 years from the date of issue [third bullet point]
>
> The exceptions are
>
> - 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% of 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 [first exception]
>
> - 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 [second exception][1]

[1] The bracketed words have been added for convenience in later analysis.

> 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

[3] The Prospectus defined a number of terms. The only one material for present purposes is the definition of "Conversion Date" (a term used only in the second exception):

> **Conversion Date** means 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

[4] The preference shares were issued on 8 November 2002. The holders of the shares had the right to a preferential dividend of 15 per cent per annum payable at the time of conversion of the preference shares to ordinary shares. This was to occur automatically two years from the date of issue, that is, by 8 November 2004, but subject to the first and second exceptions. These permitted ADL to accelerate or postpone the time of conversion in defined circumstances. Upon conversion, each preference share was to convert to four ordinary shares.

[5] As matters transpired, ADL was unable to pay the preferential dividend at 8 November 2004. Shareholders were informed. ADL treated the preference shares as continuing to accrue dividends at 15 per cent per annum. The preference shares were shown in ADL's share register as such and were not treated as having been converted to ordinary shares. On 20 March 2007 the Board resolved to pay dividends in respect of the years ending 31 March 2003 and 31 March 2004 each of $193,852.[2] The first of these dividend payments was paid in May 2007 and the second in April 2008.

[6] ADL's financial statements continued to show a liability to pay 15 per cent on the preference shares accumulating each year. By the end of the 2012 financial year, the provision for the preference share dividend shown in the financial statements had risen to $1,421,581. However, after a legal opinion obtained by ADL, the Board

---

[2] There is some confusion in the materials as to the exact figures but any slight differences are not material.

resolved on 17 December 2013 to correct the share register to reflect the conversion of the preference shares to ordinary shares; to adjust the balance sheet to reflect that change; and to reverse the provision made for preference share dividends.

[7] It was this change in stance by ADL that gave rise to the current litigation. The central issue between the parties is the time of conversion of the shares and the related issue of whether ADL's liability to pay dividends on the preference shares extends beyond its acknowledged liability for the initial two-year period. In this respect, ADL contends that the preference shares would convert on ADL paying dividends calculated at 15 per cent per annum for a period of two years from the date of issue. Since the dividends for the first two years have been paid, ADL submits there is no further dividend liability. In contrast, the respondents' position is that the preference shares do not convert unless and until the company has paid dividends calculated at 15 per cent per annum from the date of issue until the date of payment, whenever that might be.

[8] In the High Court, Courtney J found in favour of the respondents.[3] She made formal declarations that:[4]

> (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 [ADL's] share register.

[9] In reaching her conclusions, Courtney J found the authorities established that preference shares are presumed to be cumulative as to dividend unless the contrary is shown. ADL submits the Judge ought to have determined the case on orthodox principles of contractual interpretation without reference to any presumption. If those principles had been applied ADL submits its contention would have been upheld.

---

3 *Cadre Investments Ltd v ActiveDocs Ltd* [2016] NZHC 1489 [High Court judgment].

4 At [96].

The facts in more detail

[10] ADL (formerly known as Keylogix) was founded in 1992. Initially, the company operated as a contract software developer with specialised expertise in a number of Microsoft technologies. By the year 2000 ADL had developed a close working relationship with Microsoft but needed further capital in order to continue development and marketing of its product. In August of that year ADL raised $2 million through a private placement of shares, but by the end of the year ended 31 March 2001 the funds had largely been expended. It was evident further funding was required.

[11] In November 2001 further funding of $3.5 million was raised through an offer of six million new shares in ADL. A research paper prepared at that time by ADL's financial advisers ABN-AMRO Craigs described the company's product in favourable terms with the expectation that substantial sales would occur after the completion of a pilot installation. The paper described the offer as a rare opportunity to invest in a young growth company but also warned that:

> This opportunity does come with substantial investment risk, the risk of loss of capital, as the capital will be used for marketing, and sales force salaries. Being an IT company, the balance sheet consists substantially of intangible assets, meaning there will be little tangible asset backing for investor security.

[12] By June 2002, despite the additional capital raised, ADL was critically short of cash. One of the company's directors, Mr B W Roulston, deposed that despite high expectations in 2001 based on the company's prospects with Microsoft:

> … by June 2002, Active Docs was in a relatively precarious financial position. The company's cash reserves had almost been exhausted and yet ActiveDocs had an urgent need for cash and faced having to close its doors in the absence of greatly increased revenue because sales were grossly below budget and not yet covering costs.

[13] Mr Judd QC for ADL did not dispute the accuracy of Courtney J's conclusion that, at this time, ADL was "in desperate need of more working capital".[5]

---

[5] At [1].

[14] An annual shareholders' meeting for ADL took place on 2 September 2002. One of the items of special business was the consideration of a resolution authorising the Board to issue the preference shares to existing shareholders in order to raise up to $1.4 million in capital on terms to be determined by the Board. These were to include terms that each holder of ordinary shares would have the right to acquire one preference share for every 20 ordinary shares held, the price for each preference share being $1. Otherwise, the preference shares were to have the rights and restrictions in the terms we have set out at [2] above. Explanatory notes to the notice of the meeting stated:

> Current revenue and cost projections indicate that [ADL] 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 one $1.00 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.

[15] The resolution relating to the issue of preference shares was duly passed. ADL's optimism that the company would soon be cash positive was reflected in the Short Form Prospectus and Investment Statement and in an accompanying letter from ADL's then-chairman, Mr Chris Gedye. The proceeds of the offer were to be used to meet ongoing cash requirements until ADL became cash positive. Mr Gedye stated that, with the increasing level of sales now being achieved, it was projected ADL would reach that state by January 2003.

[16] However, further material in the Prospectus cautioned that sales cycles could not be predicted with absolute accuracy. As a result, the directors had recommended the rights issue to shareholders to ensure a sufficient cash buffer if any key sales were delayed beyond current projections. The Prospectus made it clear that ADL gave no assurance it would achieve or sustain profitability or reach its projected sales targets. In that event, it was said ADL might suffer operating losses. If ADL were unable to raise additional funding in such circumstances, it was said to be likely there would be a significant effect on the value of investments in the company.

[17] These risks were underlined by ADL's auditors in relation to the company's financial statements for the year ended 31 March 2002. The Prospectus stated that this report contained material under the heading "Fundamental Uncertainty". The Prospectus stated that, in general terms, the effect of the auditor's report was:

> … that the financial statements have been prepared on a going concern basis, the validity of which depends on the Company being able to raise capital or obtain continuing Shareholder support in the future or generate a sufficient level of profitability and cash flow to continue in operation.

[18] On 20 September 2002 ADL's Board resolved to proceed with the offer of preference shares in the terms already stated. The Board recorded its view that the proposed offer was the most appropriate means of raising the required capital in the current economic and investment climate and having regard to ADL's own particular circumstances. As well, the Board expressed the opinion that the consideration for the terms of issue of the shares were fair and reasonable to the company and to all existing shareholders. The Board resolved to give the necessary certificates under the Companies Act 1993 in connection with the issue of the shares.[6]

[19] The preference share issue raised a total of $1.27 million. The respondents were issued 50,000, 83,334 and 15,000 preference shares respectively. As Courtney J noted, ADL'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 following year there was a deficit of more than $600,000, again with negative shareholders' equity. As a result, ADL's Board was unable to authorise any dividends prior to the expected conversion date of 8 November 2004.

[20] The second exception to the rights attaching to the preference shares allowed for their conversion to be postponed in that event. ADL wrote to shareholders in February 2005 confirming that conversion would be postponed but stating specifically that:

> The preferential dividend right of 15% per annum will continue to accrue until [ADL] is in a position to carry out the conversion process by making payment of the accrued dividends.

---

[6] Companies Act 1993, s 47(2).

[21] This position continued to apply until the Board's resolution of 20 March 2007. As noted already, payment of the dividend at the 15 per cent rate for the years ending 31 March 2003 and 31 March 2004 was made in two tranches in 2007 and 2008 respectively.

[22] By 2012, the ever-increasing size of the provision in ADL's financial statements for accrued dividends was seen as a constraint on the company's growth and a barrier to the raising of further capital. After obtaining a second legal opinion in 2013, the Board resolved to make the corrections and adjustments we have already described. This effectively reversed the position ADL had taken over the previous eight years in respect of the conversion of the preference shares and the associated issue of ADL's liability to pay accumulating dividends.[7]

The High Court judgment

[23] In the High Court, ADL presented two alternative arguments. The first was that no dividends were payable even for the initial two-year period from the date of issue. That was because none had been declared during that period. This argument was not pursued before us. Rather, the focus of ADL's argument in this Court was on the alternative argument advanced in the High Court that the preferential dividend was payable only for the initial two years. Since the dividend for those two years had been declared and paid, it was submitted there was no further entitlement to ongoing dividends beyond the initial two-year period ending 8 November 2004.

[24] On the key issue of whether the dividends on the preference shares were cumulative, the Judge said that, where this is not specified:[8]

> [28] … the true nature of the rights 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.

---

7 We also record that in September 2012 the number of shares in ADL was reduced by consolidation. Both preference share numbers and ordinary share numbers were reduced to 10 per cent of their previous levels.

8 High Court judgment, above n 3 (footnote omitted).

[25] The Judge added:[9]

> [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. …

[26] Addressing the meaning of the term "accrued" in the second exception, the Judge noted Campbell J's observation in *Re Indalex*:[10]

> The use of 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.

[27] In his oral submissions Mr Judd did not dispute Courtney J's conclusion that the second exception was clearly focused on the shareholders' rights to be paid a dividend in the future.[11] She also found there was no principle requiring that such entitlement be determined by whether a dividend had been authorised. She considered that the wording of the Prospectus, particularly the reference to "accrued dividends", did not displace the presumption that the preference shares were cumulative as to dividend.

[28] Courtney J addressed three other aspects of the rights attaching to the preference shares which she considered made it clear the shares were cumulative. These were:

(a) Providing for conversion to be postponed was consistent with the preference shares being cumulative because no dividend may be declared once the shares have been converted.[12] Postponing conversion preserved the shareholders' right to have the dividend entitlement carried through to later years. Once a dividend is

---

9 The Judge cited *Henry v Great Northern Railway Co* (1857) 44 ER 858, 1 De G & J 606 (Ch), *Webb v Earle* (1875) LR 20 Eq 556 (Ch) and *Staples v Eastman Photographic Materials Co* [1896] 2 Ch 303 (CA) in support of the presumption.

10 *Re Indalex* [2010] ONSC 1114 at [36], cited in the High Court judgment, above n 3, at [45].

11 At [57].

12 At [59], citing *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd* (1992) 6 NZCLC 67,784 (HC) at 67,799.

authorised, it becomes payable as a debt whether or not the shares have been converted.

(b) The law was clear that when a cumulative dividend of an amount that reflects 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.[13] The fact that two years of dividends were expected to be declared at once and that payment of dividends could be delayed through postponement of conversion pointed to the shares being cumulative.[14] If they were not cumulative, the dividend entitlement would be lost at the end of each year. Postponing conversion would not prevent that.

(c) The provisions of the winding up clause were not considered to detract from the interpretation of the second exception.[15] That clause conferred 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 became payable if declared, arrears, even of cumulative dividends, are prima facie not payable on a winding up unless previously declared.

[29] Courtney J considered that, unlike the issue as to the cumulative or non-cumulative nature of the preference shares, the issue of ongoing entitlement to dividends fell to be determined on the usual principles of contractual interpretation without the aid of any particular presumption.[16] She considered the ongoing entitlement to cumulative dividends was supported by these features:

(a) The ability of the company to postpone the time of conversion under the second exception.[17]

---

13 At [60], citing *Mosgiel Ltd v Mutual Life and Citizens Assurance Co Ltd*, above n 12, and *Godfrey Phillips Ltd v Investment Trust Corp Ltd* [1953] 1 WLR 41 (Ch).
14 At [62].
15 At [63].
16 At [64].
17 At [72].

(b) The contrast between the terms of the first bullet point and the second exception.[18] Under the former, a single payment of dividend for the two-year period was contemplated, while under the latter the conversion would be postponed until either the company made payment of "all accrued dividends" or a holder of preference shares by notice in writing required that the preference shares held by that person be converted.[19] The use of "all" was 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" conveyed the possibility of further dividends accruing after November 2004.

[30] Addressing the commercial context, the Judge concluded:

> [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.

[31] Finally, the Judge rejected a submission that she should take into account ADL's subsequent conduct in interpreting the terms of the preference share issue.[20] It had been urged on her by the respondents that between 2005 and 2013 the company had made it very clear that it regarded the dividend entitlement on the preference shares as accumulating year by year even after the dividends for the initial two-year period were paid in 2007 and 2008. Effectively, it was argued this was evidence of mutual conduct since the shareholders had accepted ADL's advice to this effect and ADL had continued to reflect the liability each year in its financial statements.

---

18 At [70].
19 At [71].
20 At [89].

ADL's submissions

[32] Mr Judd presented careful and thorough submissions on ADL's behalf. In essence, counsel submitted:

(a) The Judge was wrong to adopt a presumptive approach to decide the issue of whether the preference share dividends were cumulative or non-cumulative.

(b) If there ever was such a presumption, it was no longer appropriate, particularly in the light of the solvency test introduced by the Companies Act 1993.

(c) The correct approach to determining the interpretation of the rights attaching to the preference shares was that adopted in the relevant Supreme Court authorities.[21]

(d) Objectively construed, the dividend was payable at the rate of 15 per cent per annum for the initial two-year period from the date of issue of the shares. However, if the company were unable to pay the dividend by that date, conversion of the shares to ordinary shares would be postponed until it had been paid in full, whereupon the shares would convert.

(e) ADL was unable to satisfy the solvency test for payment of the dividends until 2007–2008. Upon payment in full after the second tranche was paid, all shares converted to ordinary shares.

(f) The commercial context in which the shares were issued was important in the interpretation exercise. Declaration (a) made by the High Court[22] produced the result of a steadily accumulating dividend obligation which, absent achievement of profits of a magnitude the likelihood of which was belied by ADL's history, meant the company would soon be in a position where it would never be able to pay a

[21] Such as *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [19] per Tipping J, and *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432.

[22] See above at [8].

dividend. Counsel submitted it was unlikely reasonable persons in the position of the company and the subscribers for the shares would have intended a potential outcome of that nature.

(g) The Judge had wrongly treated the preference shares as if they were redeemable preference shares rather than convertible preference shares. This had led to the Judge wrongly treating the dividend in a manner akin to an obligation to pay interest on a loan.

Analysis

[33] We propose to commence our consideration of the interpretation of the respondents' rights as to dividend on the preference shares without reference to the presumption relied upon in the High Court. We do so because, in our view, the wording of the Prospectus is such that the issue of construction is resolved in favour of the respondents without reference to any presumption. On that footing, the existence or otherwise of the presumption does not need to be determined.

[34] We adopt the approach summarised by the Supreme Court in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*:[23]

> [60] Given the issues in the case, it is not necessary that we discuss the approach to contractual interpretation in any detail. It is sufficient to say that 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". This objective meaning is taken to be that which the parties intended. While there is no conceptual limit on what can be regarded as "background", it has to be background that a reasonable person would regard as relevant. Accordingly, the context provided by the contract as a whole and any relevant background informs meaning.

[35] We accept Mr Judd's point that the contractual terms are established by ADL's offer as contained in the Prospectus and the acceptance of that offer by the respondents when subscribing for the shares. In doing so, the respondents signed an acceptance form in which they agreed to be bound by ADL's constitution. Mr Judd drew our attention in particular to cl 12.1 of the constitution. This provides that the

---

[23] *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 21 (footnotes omitted).

Board may authorise a distribution if satisfied on reasonable grounds that the company will, immediately after the distribution, satisfy the solvency test.[24]

[36] There is no dispute that ADL's Board could not lawfully authorise payment of a dividend until it did so by the resolution in 2007. That was because ADL did not meet the solvency test until that date. It is also undisputed that ADL then relied on the second exception. Shareholders were informed that the preferential dividend of 15 per cent per annum would continue to accrue and that conversion to ordinary shares would be postponed until ADL was in a position to pay the accrued dividends.

[37] While ADL subsequently resiled from that approach in 2013 on the basis of legal advice then obtained, we are satisfied that the approach ADL adopted from 2005 until that time was entirely consistent with the terms of the rights attaching to the preference shares, as supported by the commercial context and the background knowledge reasonably available to the parties at the time of the contract.

Text of the Prospectus

[38] Our reasons largely echo those given by the Judge and may be shortly stated:

(a) The starting point is that expressed in the first bullet point. The right to the payment of dividend was expressed to be 15 per cent per annum. This is consistent with an ongoing or cumulative entitlement.

(b) Payment of the dividend at that rate was to be made "at the time of conversion". Although the term "Conversion Date" is not used in the first bullet point, it is clear from the definition of that term as used in the second exception that the "intended" date of conversion was to be two years after the date of issue of the shares, that is, by 8 November 2004.

(c) We agree with Mr Judd that this period was consistent with ADL's expectation that the company would be cash positive by January 2003.

---

24 Defined in the constitution as that prescribed by s 4 of the Companies Act 1993, such test to be applied in the manner prescribed by the Act.

(d) However, given ADL's fiscal history to that point, no guarantee was given that the company would be able to achieve its anticipated goal by that date. The second exception therefore allowed for the postponement of conversion if ADL was unable to pay dividends accrued as at the Conversion Date. Of course, this was also consistent with the requirement that ADL satisfy the solvency test immediately after the payment was made.

(e) Conversion was postponed under the second exception until either:

(i) ADL "makes payment of all accrued dividends"; or

(ii) a holder of the preference shares gives notice requiring that the shares held by that person be converted.

(f) No one exercised the second option under the second exception so the focus is on the first. We agree with the Judge that the postponement of the conversion until payment of "all accrued dividends" plainly means payment of all accrued dividends at the rate of 15 per cent per annum up to the date of payment.

(g) Mr Judd sought to persuade us there was no significance in the use of the term "dividends" (plural) in the second exception when contrasted with the expression "dividend" (singular) in the first line of the first bullet point. That was because the rights under the bullet points were expressed to apply to "Each Preference Share". We accept that is so but we disagree with the proposition that the use of "dividends" (plural) in the second exception has no significance. Rather, we consider it supports the respondents' argument, particularly when it forms part of the total expression "all accrued dividends".

[39] In summary, under the second exception, conversion was postponed until ADL could pay all accrued dividends. The natural and ordinary meaning of the rights of the preference shareholders as to dividend, objectively construed by an examination of the terms as a whole, means payment of all accrued dividends, accumulating at the rate of 15 per cent per annum.

Commercial context

[40] We agree with the Judge that the ordinary meaning of the terms in the Prospectus is supported by the commercial context and the background reasonably understood by the parties at the time of the contract.

[41] On the evidence, the shareholders were being invited to participate in an investment carrying significant risks. Funds obtained by two earlier capital raisings had been exhausted and ADL was in urgent need of funds. According to Mr Roulston, ADL was facing the prospect of having to close its doors. Anticipated revenue had still not been received, budget targets had not been met and costs were not being covered. It was recognised ADL had little in the way of tangible assets. Other methods of raising funds were considered but discounted. The issue of preference shares was therefore considered to be the means by which funds might best be raised. The surrounding circumstances led the Board to recognise that the terms of the offer would have to be sufficiently attractive to encourage existing shareholders to invest. No doubt these considerations were reflected in the offer to pay a dividend at the rate of 15 per cent per annum.

[42] At the time of the preference share issue, the Board expected ADL to be in a position to pay the dividend within the initial two-year period but it was clearly recognised this might not be achieved. We consider it most unlikely that the respondents or other preferential shareholders intended their rights to be limited in the way advanced on ADL's behalf. That would have left them in the position where the return on their investments would be limited to 15 per cent per annum for the initial two-year period, payable at some unspecified time in the future when ADL was in a position to pay and the Board elected to declare a dividend. Any return to shareholders on their investment in this risky venture stood to be delayed for many years, possibly indefinitely and, on ADL's approach, limited to 15 per cent per annum for the first two years. Although not referred to in argument, we note that cl 12.6 of ADL's constitution stipulates that dividends do not carry interest.

[43] We acknowledge Mr Judd's submission that, at the time of conversion, preference shareholders were also to receive ordinary shares on a 4:1 ratio, but we do

not consider this additional benefit was likely to render the investment more attractive to the extent that it is reasonable to infer the parties intended to limit their return to the first two years.

[44] As to ADL's point that the parties would not have contemplated the prospect of an indefinitely accumulating dividend of a substantial amount in the company's financial statements or the accompanying difficulties that would be likely to create in raising finance, we can do no better than to endorse the conclusion reached by the Judge we have quoted at [30] above.

[45] We add that, as Lord Neuberger has recently observed:[25]

> [17] … the reliance placed in some cases on commercial common sense and surrounding circumstances … should not be invoked to undervalue the importance of the language of the provision which is to be construed. …
>
> …
>
> [19] … commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. …

Post-contractual conduct

[46] As noted earlier, we have not found it necessary to consider the post-contractual conduct of the parties as an aid to interpretation. The Judge did not consider it was appropriate to do so. We have also taken into account Mr Judd's submission that ADL's approach after the first two years was guided by the views of its accounting and legal advisers, as it was when a different opinion was obtained in 2013. In these circumstances, the extent to which the subsequent conduct of the company may be taken as reflective of the views of those responsible for the conduct of the company's affairs at the relevant time may be limited. As well, there is no clear evidence that the respondents took any active steps to endorse the approach adopted by the company post-contract. At best, they acquiesced in the approach ADL took.

---

[25] *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619.

Remaining points

[47] There are two other related criticisms made by ADL of the judgment below. First, it is said the Judge approached the case as if the shares were redeemable preference shares rather than convertible preference shares. We see nothing to support that proposition. Secondly, ADL submitted the Judge had wrongly treated the dividends as if they were equivalent to interest on a debt. That approach was said to be wrong because dividends are not equivalent to interest and because no enforceable obligation to pay the dividends arose until the Board declared they were to be paid.

[48] We are not persuaded there was any error in the Judge's approach. As the authors of the most recent edition of *Gower* state:[26]

> The truth of the matter is that an enormous variety of different rights, relating to dividends, return of capital, voting, conversion into ordinary shares, redemption and other matters, may be attached to classes of shares, all of which are conventionally described as "preference" shares. What these rights are in any particular case and whether any particular issue of preference shares is located more at the debenture end or the ordinary share end of the spectrum will depend on the construction of the articles or other instrument creating them.

[49] Ultimately, the interpretation of the rights in question depends on the true construction of the language used in the context reasonably understood by the parties at the time of contract. On that approach, we are satisfied the conclusion reached by the Judge was correct.

Result

[50] The appeal is dismissed.

[51] The appellant must pay costs to the respondents for a standard appeal on a band A basis with usual disbursements.

Solicitors:
Wells & Co, Auckland for Appellant
Wackrow Williams & Davies, Auckland for Respondents

---

[26] Paul L Davies and Sarah Worthington *Gower's Principles of Modern Company Law* (10th ed, Sweet & Maxwell, London, 2016) at 793 (footnote omitted).