

Yamashita Tetsuo v See Hup Seng Ltd
[2008] SGHC 21

Case Number : RAS 104/2007
Decision Date : 11 February 2008
Tribunal/Court : High Court
Coram : Chan Seng Onn J
Counsel Name(s) : Joseph Liow (Straits Law Practice LLC) for the defendant; Koh Swee Yen (WongPartnership) for the plaintiff
Parties : Yamashita Tetsuo — See Hup Seng Ltd

Deeds and Other Instruments – Deeds – Interpretation – Construction of deed of settlement – Option granted to convert company's convertible loan into shares in company – Whether outstanding convertible loan not converted to shares must be repaid in cash on repayment date – Whether parties could have intended less than 100% of outstanding unconverted loan to be repayable

11 February 2008

Chan Seng Onn J

Introduction

1 This was an appeal against the decision made by District Judge Miranda Yeo (“DJ Yeo”) in chambers. The appellants are See Hup Seng Limited (“SHSL”), a company incorporated in Singapore and listed on the main board of the Singapore Exchange. The respondent, Tetsuo Yamashita (“Tetsuo”), is a Japanese national who held rights derived from a deed of settlement (the “Deed”). The Deed was entered into on 29 September 2003 by SHSL and a company known as SHS Holdings (Pte) Ltd. (“SHSH”). SHSL acknowledged in the Deed that it owed SHSH a sum of S\$4,043,337.50 (the “SHSH Liability Amount”). In order to settle this, clause 2.2 of the Deed provided that the SHSH Liability Amount be split into two amounts:

(a) **Warrant Liability Amount** -- The sum of \$1,773,337.50 was to be constituted and deemed as a loan owing by SHSL on certain terms and conditions set out in clause 4 of the Deed; and

(b) **SHSH Convertible Loan** -- The remaining sum of \$2,270,000 was to be constituted and deemed as a loan owing by SHSL on certain terms and conditions set out in clause 5 of the Deed.

2 The Deed granted an option to SHSH to convert the SHSH Convertible Loan into shares in SHSL subject to certain conditions.

3 The proceedings in the District Court were commenced by Tetsuo, who was seeking a declaration that on a true construction of the Deed, he (as an assignee of some of the rights under the Deed) was entitled to be repaid a *further* sum of \$118,309.60. As there were no material facts in dispute, the parties agreed that the appeal could be decided solely by the proper interpretation to be given to the Deed.

4 The crucial issue before the court was how much of the outstanding SHSH Convertible Loan which was not converted to shares would have to be repaid in cash on the repayment date. Was the cash repayment to be 100% of the unconverted outstanding loan amount or only 75% of the

unconverted outstanding loan amount?

5 SHSL contended that under the Deed, Tetsuo was only entitled to cash repayment of 75% and not 100% of the unconverted loan amount that remained outstanding. Since SHSL had already paid 75% of the outstanding unconverted loan amount to Tetsuo, no further payments were owing to him. However, Tetsuo argued that 100% of the unconverted loan amount must be repaid in full in cash. Tetsuo thus claimed a further \$118,309.60 from SHSL, being the balance of 25% of the unconverted loan amount unpaid.

6 I noted that some three years before the dispute arose, SHSL had made clear their position publicly that it was obliged under the Deed to repay only 75% of the principal amount of any outstanding convertible loan in cash at the end of the tenor of the SHSH Convertible Loan. This can be seen at item 15 of the Notes to the Financial Statements in the Annual Report for the year 2003, in which SHSL specifically reported on the transaction relating to the Deed as follows:

"15. AMOUNTS DUE FROM/(TO) RELATED PARTIES (CONTINUED)

The loan from a corporate shareholder and the director are ***unsecured and interest free***. On 29 September 2003, the Company (SHSL) entered into separate deeds of settlement with a substantial shareholder SHS Holding (Pte) Ltd ("SHSH"), and the director, Lim Siok Kwee Thomas ("TL"), to settle their loans to the Company as follows:

SHSH

Under the deed between SHSH and the Company, SHSH will settle the loan of S\$4,043,337 to the Company as follows:

- (i) Apply an amount of S\$1,773,337 towards the exercise of the 16,121,250 warrants of the Company held by it within 7 months from the date of the deed (or such later dates as the parties thereto may agree), failing which this amount shall be deemed to be settled; and
- (ii) Convert the balance of S\$2,270,000 into a three-year (with effect from the date of the deed) interest free loan which may be converted into new shares of the Company at the option of SHSH at any time during its tenor at a conversion S\$0.15 per new share (the "Conversion Feature").

The Conversion Feature is subject to, *inter alia*, the approvals of the shareholders of the Company and the Singapore Exchange.

If SHSH is unable to exercise the Conversion Feature because the relevant approvals are not obtained or it is not valid or enforceable, the Company will repay SHSH the principal amount of the convertible loan in cash at the end of three-year tenor. ***In any other case, the Company is only obliged to repay 75% of the principal amount of any outstanding convertible loan in cash at the end of tenor as full settlement.*** [emphasis added]

7 SHSH, being the 4th largest shareholder of SHSL, should have received a copy of the 2003 Annual Report. I would imagine that if what was stated in Note 15 above was inaccurate or did not reflect the true intention of the parties when they negotiated and entered into the Deed, SHSH as a party to the Deed would have raised objections or sought an amendment to what was stated above in the Annual Report. I assumed that if there were any amendments, counsel would have placed the latest version of the 2003 Annual Report before me.

8 To avoid any doubt, I must add that what I noted above did not form any part of the considerations that went into my interpretation of the Deed.

The Deed and the assignments

9 As mentioned above, the Deed was entered into on 29 September 2003 between SHSH and SHSL. At the material time, one Thomas Lim Siok Kwee ("Thomas") owned 32% of the shares of SHSH and the remaining 68% was owned by Linguafranca Co. Ltd ("Linguafranca"), a company incorporated in the Cayman Islands. In March 2004, Thomas and Linguafranca entered into an agreement (the "TL Agreement") for SHSH to be placed in a members' voluntary liquidation and for the assets of SHSH to be distributed according to the terms of the TL Agreement. One of SHSH's assets was the SHSH Convertible Loan of \$2,270,000. As per clause 1.2(a)(iv) of the TL Agreement, Thomas and Linguafranca agreed to distribute the SHSH Convertible Loan such that Thomas would receive \$1,796,761.60 (approximately 79%) and Linguafranca would receive \$473,238.40 (approximately 21%) of the SHSH Convertible Loan. This arrangement was subsequently formalised by a deed of assignment dated 16 September 2005 whereby SHSH assigned and transferred to Linguafranca all of its rights, title and interest in \$473,238.40 of the SHSH Convertible Loan. Linguafranca subsequently assigned all of it to Tetsuo. Linguafranca thereafter informed SHSL of its assignment to Tetsuo by way of a Notice of Assignment dated 21 March 2006.

10 Unlike Thomas who chose to convert all of his interest in the SHSH Convertible Loan into the shares of SHSL, Tetsuo decided not to convert any part of his interest in the SHSH Convertible Loan. Tetsuo opted instead to receive cash for the repayment of \$473,238.40 of the SHSH Convertible Loan at the repayment date.

11 It was not disputed that on the repayment date, SHSL paid Tetsuo a sum of \$354,928.80 (amounting to 75% of the outstanding SHSH Convertible Loan amount of \$473,238.40). According to Tetsuo, there thus was a balance sum of \$118,309.60 (amounting to 25% of the SHSH Convertible Loan amount of \$473,238.40) still owing to him. SHSL disputed that such a balance sum was owed.

The Law on Interpretation of Documents

12 Counsel for SHSL submitted that where the terms of an agreement are clear and unambiguous, they should be given their plain ordinary meaning without the aid of extrinsic evidence. He referred me to the Court of Appeal decision in *Pacific Century Regional Development v Estate of Seow Khoon Seng* [1997] 3 SLR 761 where Karthigesu JA said at [17]:

17. The law on the construction of documents is clear. In the case of a contract, such as the agreement in question which is wholly in writing, the court is required to ascertain the mutual intention of the parties as expressed in the words of the agreement. The law is concerned with the objective appearance, rather than with the actual fact, of agreement. It is not concerned with the actual intentions of the parties, rather it is the court's task to decide what each party was reasonably entitled to conclude from the conduct of the other.

13 Counsel for Tetsuo cited the leading judgment of the House of Lords in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, where Lord Hoffmann summarised at pages 912 and 913 the general principles by which contractual documents are to be construed:

(1) Interpretation is the ascertainment of 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.

(2) The background was famously referred to by Lord Wilberforce as the “matrix of fact”, but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749.

(5) The “rule” that words should be given their “natural and ordinary meaning” reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania Naviera S.A. v. Salen Rederierna A.B.* [1985] A.C. 191, 201: “if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense.”

14 The above principles have been endorsed by the Court of Appeal, most recently in *Sandar Aung v Parkway Hospitals Singapore Pte Ltd (trading as Mount Elizabeth Hospital)* and another [2007] 2 SLR 891. In *Sandar Aung*, Phang JA stated that even if the plain language of the contract appears otherwise clear, the construction consequently placed on such language should not be inconsistent with the context in which the contract was entered into if this context is clear or even obvious, since the context and circumstances in which the contract was made would reflect the intention of the parties when they entered into the contract and utilised the (contractual) language they did. At paragraph 31, quoting from *Chitty on Contracts* Vol 1 (Sweet & Maxwell, 29th Ed, 2004) at para 12-115, Phang JA stated:

The more modern view, however, is that the words do not have to be vague, ambiguous or otherwise uncertain before extrinsic evidence will be admitted. Since the purpose of the inquiry is to ascertain the meaning which the words would convey to a reasonable man against the background of the transaction in question, the court is free (subject to certain exceptions) to look at all the relevant circumstances surrounding the transaction, not merely in order to choose between the possible meanings of words which are ambiguous but even to conclude that the parties must, for whatever reasons, have used the wrong words or syntax. So the court is entitled (and, indeed, bound) to enquire beyond the language of the document and see what the

circumstances were with reference to which words were used, and the object appearing from those circumstances which the person using them had in view. The court must place itself in the same "factual matrix" as that in which the parties were...

Phang JA added at [32]:

We are of the view that the "more modern view" referred to in the above quotation is to be preferred and that, as we have explained above, such a view is also consistent with what would be the practical reality in any event.

15 Counsel for Tetsuo also referred me to paragraph 6.13 in *The Interpretation of Contracts* (Sweet & Maxwell 1997) by Kim Lewison QC where it was stated that "*the reasonableness of the result of any particular construction is a relevant consideration in choosing between rival constructions.*"

16 In the Court of Appeal judgment delivered by Neill LJ in *The 'Fina Samco'* [1995] 2 Lloyd's Rep 344 (at 350), Neill LJ quoted the words of Lord Reid in *Wickman Tools v Schuler AG* [1973] Lloyd's Rep 53 at 57: "*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 their intention abundantly clear*".

17 In Singapore, in *MAE Engineering Ltd v Fire-Stop Marketing Services Pte Ltd* [2005] 1 SLR 379 at 388 the Court of Appeal noted that:

[T]he perceived 'common sense' of the court cannot be allowed to override the words of the contract where they are clear and unambiguous... the court's task is to ascertain what the parties mean by the words they use in a contract and to enforce it according to its terms; it should not rewrite the contract.

18 The Court of Appeal in *MAE Engineering Ltd v Fire-Stop Marketing Services Pte Ltd* quoted the words of Lord Mustill in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 at 388 with approval:

[T]o force upon the words a meaning which they cannot fairly bear is to substitute for the bargain actually made one which the court believes could better have been made. This is an illegitimate role for a court. Particularly in the field of commerce, where the parties need to know what they must do and what they can insist on not doing, it is essential for them to be confident that they can rely on the court to enforce their contract according to its terms.

19 Finally, there is another very important canon of construction to be borne in mind at all times which is to construe the document as a whole: Kim Lewison QC, *The Interpretation of Contracts* (2nd ed, 1997) at paragraph 6.02 at pages 156-161. In *Chamber Colliery Ltd v Twyrould* [1915] 1 Ch 268, Lord Watson opined as follows (at page 272):

I find nothing in this case to oust the application of the well-known rule that a deed ought to be read as a whole in order to ascertain the true meaning of its several clauses; and that the words of each clause should be so interpreted as to bring them into harmony with the other provisions of the deed, if that interpretation does no violence to the meaning of which they are naturally susceptible.

20 At this juncture, I would like to state that I am grateful to counsel for citing the above authorities in order to assist me on how the Deed and its clauses should be construed.

Interpretation of the Deed and the relevant clauses

21 Applying the legal principles above, I examined the entire Deed carefully to determine the nature of the SHSH Convertible Loan and the proper construction to be placed on the terms for repayment of the unconverted portion of the loan.

22 Essentially, a convertible loan is an agreement where the lender gives a loan to the borrower, with the borrower giving the lender an option to convert any part of the loan into shares in the borrower at an agreed fixed conversion or exercise price per share within a specified period of time. In this case, SHSL is the "borrower", and Tetsuo is the "lender" by virtue of the rights vested in him by SHSH through a series of assignments.

23 I will now set out the material clauses in the Deed governing the SHSH Convertible Loan.

24 Clause 1.1 defines the "SHSH Convertible Loan" as "the loan of principal amount of S\$2,270,000 referred to in clause 2.2(ii)."

25 Clause 2.2 (ii) then states "the remaining amount of \$2,270,000 out of the SHSH Liability Amount ("SHSH Convertible Loan") (which) shall be constituted and deemed as a loan owing by (SHSL) to SHSH with effect from the date of this Deed and on the terms and conditions set out in clause 5."

26 Clause 5 contains the mechanism for repayment in cash and the option to convert the loan into new ordinary shares of SHSL at a certain specified price per share.

27 Clause 5.1 of the Deed states that the SHSH Convertible Loan is interest free.

28 Clause 5.2 of the Deed, which is the most significant clause in relation to the issue at hand, states that:

Subject to Clause 5.3 below, **75%** of **the SHSH Convertible Loan** shall be repaid in cash on the Repayment Date.

29 Clause 5.3 of the Deed states that:

In the event (SHSL) is unable to obtain all relevant approvals for the Conversion Feature or SHSH is unable to exercise the Conversion Feature by reason of such Conversion Feature not being valid or enforceable or otherwise not in full force and effect for any reason whatsoever, the SHSH Convertible Loan, **100% of the SHSH Convertible Loan shall be repaid in cash on the Repayment Date.**

30 The repayment date is defined in Clause 1.1 of the Deed as:

"the third anniversary of the date of this Deed" which is 29 September 2006.

31 Clause 5.4 of the Deed provides that:

Notwithstanding anything in this Clause 5, the whole of the SHSH Convertible Loan shall become due and payable immediately in cash upon the occurrence of any one or more of the following events

32 None of the specified events (in relation to the winding-up of SHSL, execution against SHSL, unenforceability of the Deed or its breach by SHSL) took place. Hence, clause 5.4 was not triggered but counsel for Tetsuo had referred to this clause in his submissions on the interpretation to be placed on clause 5.2.

33 Clause 5.5 of the Deed provides that:

Subject to clause 5.6 below, the SHSH Convertible Loan shall have a conversion feature ("Conversion Feature") whereby SHSH may, but shall not be obliged to, at any time and from time to time from the date of this Deed up to and including the Repayment Date, convert the SHSH Convertible Loan **in whole or in part** into Shares subject to the following terms:

(a) the **conversion price will be S\$0.15 for each Share** and the relevant principal amount from the SHSH Convertible Loan shall be utilised and applied to meet such conversion price; **once so utilised and applied that relevant principal amount of the SHSH Convertible Loan shall be deemed fully and effectually repaid;**

(b) each exercise of such right will be by way of a Conversion Notice by SHSH to (SHSL), provided that:

(i) each Conversion Notice must be served between 9.00 am. and 5.00 pm. on any Market Day falling before (but not on) the Repayment Date; and

(ii) subject to paragraphs (iv) and (v) below, no Conversion Notice may be served in respect of any principal amount of the SHSH Convertible Loan which has been repaid or deemed repaid by (SHSL); and

(iii) except for a Conversion Notice which relates to all of the balance of the SHSH Convertible Loan which can be so converted, each Conversion Notice must relate to 150,000 Shares or an integral multiple thereof; and

(iv) In the event that **less than 25%** of the SHSH Convertible Loan has been converted into Shares as at the Repayment Date (**the difference between 25%** of the SHSH Convertible Loan **and the actual amount** of SHSH Convertible Loan **converted into Shares** to be referred to as "**Shortfall** Conversion Amount"), a Conversion Notice is deemed to be served on the Repayment Date to convert the **Shortfall** Conversion Amount into Shares on the terms of this clause 5.

34 Clause 5.6 of the Deed states that:

"The Conversion Feature shall be **conditional upon (SHSL) obtaining all approvals** for the Conversion Feature (including without limitation the approval of the Singapore Exchange Securities Trading Limited and, if necessary, approval of the shareholders of the (Defendant) in respect of such rights to convert and of the allotment, issuance and listing of the Shares arising from such conversion". [emphasis added to all clauses above are mine]

35 As is evident from above, the Deed grants the lender the option to convert any portion of the loan into shares in SHSL; however, clause 5.5(b)(iv) of the Deed requires a mandatory minimum conversion of 25% of the loan into shares. This mandatory minimum was fulfilled when Thomas converted his portion of the SHSH Convertible Loan, which amounted to some 79% of the total SHSH Convertible Loan. Hence, clause 5.5(b)(iv) need not concern us anymore. At this juncture, it is

important to note that the operative payment clause 5.2 is a standalone clause made subject only to clause 5.3. Clause 5.2 is thus independent of and has nothing to do with clause 5.5(b)(iv).

36 The next question is what is the relevant amount of the "SHSH Convertible Loan" referred to in clause 5.2 when part of it has been converted into shares.

37 Clause 5.5(a) makes it clear that once any portion of the principal amount from the SHS Convertible Loan has been utilised for the conversion into shares, that relevant principal amount shall be *deemed fully and effectually repaid*. This means that at the time of repayment, "the SHSH Convertible Loan" in clause 5.2 (which might have started off being defined as a loan of principal amount of \$2,270,000) is in fact, no longer the original loan amount but is now a smaller outstanding loan amount simply because the original quantum of the SHSH Convertible Loan has been diminished by the amount used for the conversion. Any reference to "the SHSH Convertible Loan" for the purpose of computing the amount to be repaid in cash on the repayment date in accordance with clause 5.2 must mean the quantum of the SHSH Convertible Loan remaining outstanding as at the time of repayment. It cannot, in my view, include any part of the SHSH Convertible Loan which has been extinguished upon their conversion into shares prior to the repayment in cash on the repayment date.

38 Once it is clear that the "SHSH Convertible Loan" referred to in clause 5.2 is not to be interpreted to mean the *original* principal amount of the loan (i.e \$2,270,000) but is to be interpreted to mean the *outstanding* principal amount remaining after the conversion, then it follows that 75% repayment of "the SHSH Convertible Loan" in cash must mean that 75% of the *outstanding* principal amount (as ascertained on the repayment date) shall be repaid in cash, and not 75% of the *original* principal amount of the loan (i.e \$2,270,000) which is to be repaid in cash on the repayment date.

39 If indeed the words "the SHSH Convertible Loan" in clause 5.2 are meant to refer to the *original* principal amount of \$2,270,000 as contended by Tetsuo (and not to the *outstanding* principal amount of the loan as at the repayment date), then the repayment term in clause 5.2 makes no sense and is wholly unworkable because it totally disregards any part of the loan that might have been earlier used for conversion into shares, and hence, extinguished from the principal amount still owing.

40 An example will show why Tetsuo's interpretation is both not sensible and not workable. If "the SHSH convertible Loan" in clause 5.2 means the *original* principal amount \$2,270,000, then clause 5.2 requires \$1,702,500 (or 75% of \$2,270,000) of the loan to be repaid in cash. This means that SHSL will invariably have to pay out a fixed sum of \$1,702,500 on the repayment date in accordance with clause 5.2. But what if SHSH had, prior to the repayment date, used \$1,500,000 of the Convertible Loan to convert to 10,000,000 SHSL shares at \$0.15 per share? Applying Tetsuo's interpretation for clause 5.2, SHSL will still have to repay SHSH the sum of \$1,702,500 in cash, being 75% of the original loan amount of \$2,270,000. If so, then the total amount effectively repaid by SHSL is \$1,500,000 plus \$1,702,500 making a total repayment of \$3,202,500 for a convertible loan which started off with only an *original* principal amount of \$2,270,000. This example not only illustrates the absurdity of interpreting the relevant amount of the "the SHSH Convertible Loan" in clause 5.2 to mean the *original* principal amount of \$2,270,000, but also demonstrates that clause 5.2 is never meant to operate on the *original* principal amount. In my view, it can only logically refer to the *outstanding* principal amount as at the date of repayment.

41 Tetsuo had a second interpretation for the Deed of Settlement (see paragraphs 31 and 33 of Carmen So's 1st affidavit and the letter from M/s Wong Partnership representing Tetsuo which is exhibited at pages 51 and 52 of the same affidavit) that only a *fixed* 25% of the SHSH Convertible Loan is to be converted into shares, while the remainder of a *fixed* 75% of the SHSH Convertible Loan

(amounting to \$1,702,500) must be repaid in cash on the repayment date. This plainly goes against the clear words of clause 5.5 of the Deed which provides that SHSH may convert the SHSH Convertible Loan in *whole or in part* into shares. I therefore rejected Tetsuo's interpretation that exactly 25% of the loan quantum of \$2,270,000 must be converted into shares and exactly 75% of the loan quantum of \$2,270,000 must be repaid in cash on the repayment date.

42 I also disagreed with the submission of Tetsuo's counsel that the effect of the restructuring was to guarantee SHSH a *fixed* return or repayment of \$1,702,500 (i.e 75% of the SHSH Convertible Loan of \$2,270,000) in cash on 29 September 2006, which was important to protect SHSH's interests against the possible depreciation of SHSL's shares. Once again, this contradicts the clear terms of the Deed which allow any part or the whole of the original principal loan amount of \$2,270,000 to be convertible to shares, subject to a mandatory minimum conversion of 25% of the original principal loan amount to shares. Hence, the actual repayment amount in cash on the repayment date cannot be a fixed amount of \$1,702,500 but must vary depending on the amount of the loan that has been earlier converted to shares.

43 I also rejected the third interpretation of Tetsuo that *no more than* 25% of the loan could be converted into shares. In my view, there is no set percentage ceiling for the amount of loan to be used for conversion. As there is a minimum of 25% to be converted under clause 5.5(b)(iv), SHSH could therefore convert anything between 25% to 100% of the original principal loan amount into shares.

44 The fourth interpretation of Tetsuo (see paragraph 32 of Carmen So's affidavit) is that once the threshold minimum of 25% of the SHSH Convertible Loan has been converted into shares, then the *remainder* of the loan must be repaid in full in cash. For instance if 40% of the loan has been applied in the conversion, then the balance of **60%** of the loan shall be repaid in full in cash according to Tetsuo. If so, then what is the purpose of the fixed percentage figure inserted in clause 5.2 that "**75%** of the SHSH Convertible Loan shall be repaid in cash"? Essentially, Tetsuo's interpretation requires me to delete the figure "75%" from clause 5.2 so that it would read that "the *remainder* of the SHSH Convertible Loan shall be repaid in cash". In determining the construction to be placed on clause 5.2, I am not minded to change or ignore the percentage figure of "**75%**" stipulated clearly in the operative clause for the cash repayment.

45 Tetsuo further contended that since the SHSH Convertible Loan was a singular loan owing to SHSH for the sum of S\$2,270,000, it could not be the intention of the parties to treat parts of the loan differently. According to Tetsuo, Thomas obtained full repayment for his part of the convertible loan but Tetsuo only got repayment of 75% for his part of the loan. This contention has no merits. Thomas chose to utilise all of his part of the convertible loan to convert into shares. On the repayment date, Thomas received basically everything in shares for the so called "repayment" and he received nothing in cash (except the sum of \$75.59cts for the 503.9 shares he was not allotted because the conversion was to the nearest 1000 shares). Furthermore, depending on the prevailing market price of the shares at the time of his conversion, the shares that Thomas received in "repayment" of his loan could have a total market value more than or less than the total amount of the loan used in the conversion. In my view, the so called "repayment" in shares is not equivalent to a repayment of the loan in cash.

46 If Tetsuo had taken the same action as Thomas to convert all \$473,238.40 of his loan to shares, he would get the same treatment as Thomas. Tetsuo would receive nothing in cash for the loan repayment, and everything in shares, which again might have a market value more than or less than the total amount of the loan "repaid" so to speak, depending on the prevailing market price of the shares at the time of his conversion.

47 Similarly, had Thomas decided not to convert, he would be treated no differently from Tetsuo in that he would also be entitled to be repaid only 75% of his loan in cash (i.e 75% of \$1,796,761.60) amounting to \$1,347,571.20.

48 It is wrong of Tetsuo to regard a repayment of a loan in cash as having the same effect as the so called "repayment" in shares when there is a predetermined conversion price per share. Listed shares in the stock exchange have a fluctuating market price. At the time of repayment, the market price of the share can be below or above the conversion or exercise price for the share. Hence, a repayment of a loan in cash is very different from a "repayment" of a loan in shares using a fixed conversion price. There is no guarantee that the market price of the share at the date of "repayment" or the date of conversion will be exactly the same as the exercise price of \$0.15cts per share. If the market price is lower than \$0.15cts, then the option holder choosing full "repayment" in shares will be receiving shares of a total value **less** than the face value of the loan used in the redemption, whereas a 100% cash redemption guarantees full repayment of the face value of the loan at all times.

49 Tetsuo should also not be complaining of any differential treatment because prior to the repayment date, SHSL had through its solicitors invited Tetsuo to consider converting the full value of his SHSH Convertible Loan entirely into shares at the predetermined price of \$0.15cts per share. SHSL's solicitors went further to advise Tetsuo that his realization of the shares might give him a better return compared to the repayment of 75% in cash under clause 5.2 for his convertible loan. However, Tetsuo declined the conversion and insisted on repayment of 100% of his portion of the SHSH Convertible Loan in cash. I cannot see how Tetsuo can now complain of unequal treatment.

50 Tetsuo's other argument that it is only rational that the lender expects to be fully repaid because the SHSH Convertible Loan was an *interest-free* loan also has no merits. I do not see how the fact of it being interest-free necessarily leads to an expectation of full repayment. If so, then what should the lender's expectation be when the loan is interest-bearing? If Tetsuo's argument is meant to suggest that the interest-free feature was the price the lender had to pay to obtain the benefit of loan convertibility such that there should be no discount on the cash repayment for the remaining unconverted loan at the maturity value, then the simple answer is that the original loan (even before its re-structuring into the new SHSH Convertible Loan for the same amount) was already interest-free to begin with. (The evidence that the original loan to SHSL was interest free can be found in Note 15 to the Financial Statements of SHSL's Annual Report for the year 2003.) It is not as if the original loan was interest-bearing, but upon its re-structuring into a convertible loan, it became interest-free. In other words, there is no benefit received by SHSL from the interest-free feature *per se* when the original interest-free loan was re-structured into another interest-free loan, which is now made convertible. Since no interest was payable even before the loan was made convertible, I am compelled to conclude that the interest-free feature in the convertible loan does not represent the consideration for the benefit of convertibility. In my view, the valuable consideration agreed to be given by the lender to the borrower under the Deed in exchange for the convertibility feature in the re-structured loan is effectively provided by the 25% discount on the cash repayment on the remainder of the unconverted loan.

51 Hence, reading clauses 1.1, 2.2(ii), 5.5(a) and 5.2 together, and having regard to the Deed as a whole, the most sensible interpretation that will give effect to the objective business intentions of the parties to the Deed is to construe clause 5.2 to mean that **75%** of the remaining or outstanding SHSH Convertible Loan shall be repaid in cash on the repayment date. Clause 5.2 is the singular operative clause specifying how the outstanding SHSH Convertible Loan is to be repaid.

Decision of DJ Yeo

52 DJ Yeo stated in the proceedings below that clauses 5.3 and 5.4 indicated that the parties had intended the loan to be repaid in full in the event that SHSH was unable to exercise the conversion feature or in the event of winding up, breach of contract or execution being issued against the property of SHSL. But if SHSL was obliged to pay 100% of the loan when things were not working out (i.e the conversion feature could not be exercised, or there was a winding up, execution or breach of contract), she asked if the parties could have reasonably concluded that SHSL was obliged to pay less than 100% of the convertible loan in the event that everything was working out fine. DJ Yeo then reasoned that SHSL's interpretation had the effect of extinguishing 25% of any unconverted outstanding loan, which she concluded would lead to a fairly unreasonable result. If the parties did intend that result, it would be necessary for them to make their intention abundantly clear. As there was no equivalent of clause 4 for the convertible loan deeming 25% of the outstanding loan to be satisfied and discharged, she concluded that looking at the contract as a whole, it was intended for the loan to be repaid in full: payment was to be made through a minimum of 25% in shares and a *maximum* of 75% in cash.

53 With respect, I believe that she is incorrect for five reasons (some of which may overlap). First of all, I am of the view that the intention to extinguish 25% of the outstanding loan on the date of repayment has been made abundantly clear in Clause 5.2 of the Deed where it states unequivocally that subject only to clause 5.3, exactly 75% (and not 100%) of the loan shall be repaid in cash on the repayment date. Furthermore, parties had made clear in the Deed that only in two situations would the convertible loan be repaid in full: the situation covered by clause 5.3 and the other situation covered by clause 5.4. Since these two situations never took place, clause 5.2 must become the **sole operative clause** specifying what amount of the loan shall be repaid in cash on the repayment date.

54 Second, unlike clause 5.5 b (iv) which makes clear (through the words "less than 25%", "the difference between 25% ... and the actual amount ...converted into Shares", and "Shortfall") that it is referring to a minimum of 25%, clause 5.2 on the other hand makes plain that it is exactly 75% that is to be repaid in cash. The words in clause 5.2 do not support any possible interpretation that it is to be a "**maximum** of 75%", or a range of percentages, or for that matter, any other fixed percentage apart from **75%** of the loan that "shall be repaid in cash on the Repayment Date".

55 Third, when the convertibility feature is available (hence, the term "convertible loan"), clause 5.2 of the Deed itself provides that "**75%** of the SHSH Convertible Loan shall be repaid in cash on the Repayment Date." This is in stark contrast with clause 5.3 of the Deed which provides that "**100%** of the SHSH Convertible Loan shall be repaid in cash on the Repayment Date" when the benefit of the convertibility feature is absent or not available. If I were to construe clause 5.2 of the Deed to mean that **100%** of the SHSH Convertible Loan shall be repaid on the repayment date when the commercially advantageous convertibility feature is available, not only will I be adopting a construction that is contrary to the clear words of clause 5.2, I will be effectively rewriting the Deed for the parties and changing their bargain, which I am not minded to do.

56 Fourth, it is precisely because the benefit of the convertibility feature is made available to the creditor under the new loan structure that he has to "pay" for that benefit by foregoing a part of the unconverted loan when he gets repayment on the loan in cash. In other words, the creditor takes a "hair cut" on the loan repayment in cash at the repayment date. Having a "hair cut" on the cash repayment in exchange for the valuable convertibility feature can hardly be said to be an unreasonable commercial result. In my view, it accords with the reasonable business expectations of the parties. And where there is no benefit of convertibility available to the creditor because of certain unforeseen circumstances specified in the Deed (e.g non-approval by the relevant authorities for the convertibility feature or winding up or defaults), then obviously, there is no reason for the creditor to

take any “hair cut” on the loan repayment in cash. Once convertibility is absent, the loan reverts to its original form of a simple straightforward loan, in which case clause 5.3 of the Deed provides that **100%** of the loan shall be repaid in cash on the repayment date. This again makes ample commercial sense and accordingly, the parties have rightly provided for it in the Deed.

57 Fifth, if indeed 100% of the unconverted SHSH Convertible Loan must be repaid in cash as is contended by Tetsuo, it essentially means that SHSH will be getting the valuable convertibility feature for free from SHSL. Giving away something valuable for free without receiving any consideration in return is certainly not the normal behaviour expected of businessmen or business entities dealing at arm’s length. Plainly, it is not SHSL’s interpretation but Tetsuo’s interpretation that does not make commercial sense. I would therefore construe this Deed as one entered into by parties at arm’s length such that SHSH (the creditor) must compensate SHSL (the borrower) for the additional benefit of convertibility given to SHSL as a result of the loan restructuring, and in this case, I reiterate that it is largely through the 25% discount on the cash repayment on the remaining unconverted loan (i.e a repayment in cash of only of 75% and not 100% of the balance of the loan at the repayment date.)

Convertibility Feature commands a premium

58 I shall now explain in more detail why the convertibility feature has an intrinsic commercial value and why a premium is normally paid to obtain the benefit of that convertibility feature. DJ Yeo might have thought that there is no difference in commercial value between a simple loan (without the convertibility feature) and a convertible loan for the same loan amount. This probably led to the error she made in concluding that the parties could not have reasonably concluded that SHSL was obliged to pay less than 100% of the convertible loan, which had the effect of extinguishing 25% of any unconverted outstanding loan, thereby leading to a fairly unreasonable result.

59 As explained previously, a convertible loan is essentially a simple loan coupled with an option to convert any part of that loan into shares at a fixed price per share before a certain date. This option to convert the loan into shares is very similar to a call option (or call warrant), except that the convertible loan holder may use the outstanding loan to set off against the amount that he has to pay for the shares, whereas the call warrant holder has to use his own cash to pay for the exercise price of the shares. In commercial terms, there is no material difference between converting a loan of \$100,000 into 100,000 shares at a fixed conversion price of \$1 per share in the case of a convertible loan, or exercising a warrant by using \$100,000 cash to pay for 100,000 shares at the same warrant exercise price of \$1 per share.

60 Generally, an option to purchase shares (call option/call warrant) or to sell shares (put option/put warrant) at an agreed fixed price per share exercisable before a specified date in the future are valuable commercial assets. Investors are prepared to pay money to acquire such valuable option rights because a “financial advantage” accrues to a call option holder arising from the right given to him at any time during the validity period of the option to compel the call option giver to sell the shares to him at a fixed exercise price, even when the prevailing market price of the shares at that time is **higher** than the exercise price. Similarly, a “financial advantage” accrues to the put option holder who may, at any time during the validity period of the option, compel the put option giver to buy the shares from the put option holder at a fixed exercise price even though the prevailing market price for the shares is **lower** than the exercise price. Since these option rights are intrinsically valuable, markets exist to buy and sell i.e trade those rights or warrants for valuable consideration. On the expiry of the validity period of the option, the option becomes worthless if the option is not exercised, which normally happens when the prevailing market price of the share is **above** the exercise price of the share for a put option, or is **below** the exercise price of the share in the case of

a call option. For the holder of a convertible loan, he will generally not want to exercise his right to convert his loan into shares if the prevailing market price of the shares at the time of conversion is **below** the exercise price of the shares for the conversion. Instead, he will be better off, demanding repayment of the loan in cash on the repayment date. With the money, he can go to the securities market and purchase the same shares at a cheaper price if he wants to. There is therefore no point in converting the loan directly into shares at an exercise price, which is **higher** than the prevailing market price for the shares. On the other hand, where the prevailing market price of the shares at the time of conversion is **above** the share exercise price, then the holder of a convertible loan will generally find it financially attractive and profitable to exercise the option and convert into the shares.

61 Since these options are intrinsically valuable, no businessman dealing at arm's length will give away such options for free. One therefore has to pay to obtain such options (regardless whether the person intends to or will find it financially attractive to exercise the option in the future). There can be many methods of payment for the option, for instance via payment by cash upfront by the buyer at the time the option is purchased, or via a set off against an existing loan given to the seller of the option.

62 For evidence that options and warrants are valuable assets, one need look no further than the warrant prices and the warrant transactions in the Stock Exchange of Singapore, where warrants and other such securities are traded daily in large volumes. I do not believe anyone can reasonably take the position that such options and warrants have zero value. If Tetsuo's argument is taken to its logical conclusion (i.e that there should be no "hair cut" at all on the loan repayment in cash because the convertibility feature does not have commercial value in the hands of the lender), then it must mean that all the call and put warrants presently traded in the Stock Exchange of Singapore should have a zero price because they are essentially valueless. If so, then there is no sense to all that pricing and trading in the warrant markets.

63 By now, it should be obvious that the convertibility feature itself has an intrinsic commercial value and that a convertible loan is *per se* therefore more valuable as an asset in the hands of the lender than a simple non-convertible loan for the same amount. Since the valuable convertibility feature cannot come free, it is not unreasonable for the lender to "pay" the borrower for the convertibility feature either by compensating the borrower through some form of cash payment, or through a reduction of the normal market rate of interest (if the loan is originally interest bearing) or through some set off from some part of the loan in some form. Indeed, there can be a variety of methods and all sorts of combinations are possible, limited only by the ingenuity of the parties structuring the convertible loan and the repayment terms. In this case, it was achieved mainly through a 25% reduction in the amount of the unconverted loan redeemable in cash at the repayment date. In my view, it accords with business common sense for the parties to treat the more valuable convertible loan differently from the simple non-convertible loan. How the repayment arrangements will be structured will depend on the valuation or pricing for that convertibility feature and what agreement has been reached by the parties to fairly compensate the borrower for giving the convertibility option to the lender.

Factors determining the price or value of the Convertibility Feature

64 There are many factors that affect the pricing or valuation of a call option or a convertibility feature in a convertible loan. I will cite some of them and indicate generally how the price or value might be affected. Much of which that is stated below can be derived from business common sense.

--

	Factors	Influence on the price of a call option or of a convertibility feature in a convertible loan
a.	Exercise Price	The higher the exercise price, the less valuable is the call option or convertibility feature ("Option").
b.	Validity period of the Option	The longer the validity period to exercise the Option, the more valuable is the Option.
c.	The volatility of the share in the market	The greater the volatility of the share, the more valuable is the Option because there is a higher probability of the market price of the share rising above the exercise price during the period of validity of the Option.
d.	The gearing	The higher the gearing of the Option, the more valuable is the Option.

e.	Other conversion features	<p>Where a greater amount of the loan can be used in the conversion, the more valuable will be the convertibility feature in a convertible loan. For instance, a loan where 100% of the amount of the loan may be used to convert into shares will be more valuable than one, where only 50% of the amount of the loan may be used to convert into shares. In this case, the lender has the option to convert up to 100% of the whole amount of the loan into shares.</p> <p>Where any part of the loan calls for a mandatory conversion at a price in the future which is higher than the prevailing market price of the share at the time of issue of the option/warrant, then I believe, the impact is not positive on the value of the convertibility feature because a part of the conversion flexibility that is initially available to the option holder is now denied to him. The option holder is obliged to convert even though the prevailing market price of the share at the time of conversion may be below the exercise price of the share. In this case, I note that there is a 25% mandatory minimum conversion feature in the convertible loan, which is probably to ensure that SHSH will inject at least 25% of the nominal value of the loan into the share capital of SHSL at the exercise price of \$0.15cts per share. Hence, this feature is generally beneficial to SHSL in increasing its share capital, and more particularly so, when the prevailing market price is below the exercise price of the share at the time of the mandatory conversion.</p>
----	---------------------------	--

65 As can be seen above, there are a multitude of factors that will affect the value of the convertible option. Not only do some factors impact on that value positively and others negatively, the magnitude of the impact of each factor may also be different. The fact that the original loan repayable on demand has been effectively converted to a term loan of 3 years, is also another factor to be taken into account.

66 After taking the impact of all the factors into account, parties to the Deed will have to (a) decide and quantify in monetary terms for themselves how much the convertibility with its own special features is worth; (b) negotiate the best bargain for themselves; and (c) come to an

agreement on the terms as set out in the Deed, including the manner in which the lender is to compensate the borrower when the original simple loan is converted into a convertible loan, which is generally more commercially advantageous to the lender than a simple loan as explained above.

Adequacy of Consideration for the Convertibility Feature

67 Looking at the Deed as a whole, I am of the view that the 25% extinguishment of the repayment sum in cash for the unconverted loan, forms a substantial part of the consideration to the borrower for providing the valuable call option to the lender to convert the loan into the shares of the borrower at a predetermined and fixed exercise price of \$0.15cts per share valid for a fairly long period of 3 years. I would imagine that such a long validity period makes the convertibility feature very valuable. Parties have not provided me with the publicly available information on the prevailing market price of SHSL at or about the time the Deed was signed, so that a comparison with the stipulated exercise price could be made to see how close the exercise price is to the prevailing market price, which in turn has an important bearing on the value of the convertibility option.

68 In any event, I do not think it is for the court to evaluate the adequacy or inadequacy of the consideration for the valuable convertibility option that the parties have agreed for the SHSH Convertible Loan. Their bargain has been negotiated and crystallised into the plain and unequivocal contractual provisions relating to the convertible loan that we now see in the Deed. It is not for me to disturb the commercial bargain of the parties particularly on the amount of premium they have placed on the new SHSH Convertible Loan structure, including the method they had chosen for the payment of that premium for convertibility. While that premium could well be paid up front by way of a cash payment by SHSH to SHSL, the parties have agreed instead to have a variable payment structure, i.e a 25% deduction from the balance of the loan amount that remains unconverted to shares at the repayment date, which is a structure that tends to incentivise SHSH to convert all or more of their outstanding loan into equity in SHSL and thus, discourage SHSH from taking the cash option when the loan is due for repayment.

Conclusion

69 In conclusion, I am of the view that the interpretation I have given to Clause 5.2 of the Deed not only accords with the natural and ordinary meaning of the clause when read together with other relevant clauses in the Deed, it is also consistent with commercial considerations and bears out the intentions of the parties for the convertible loan arrangement as expressed in the words they have used in the clauses in the Deed.

70 For the reasons stated above, I agree with counsel for SHSL that the Deed ought to be construed as follows:

- (a) That SHSL and SHSH had agreed to restructure loans owed by SHSL to SHSH which was referred to in the Deed as the "SHSH Liability Amount" and which then stood at \$4,043,337.50.
- (b) Part of that SHSH Liability Amount amounting to \$2,270,000 was redefined as the "SHSH Convertible Loan".
- (c) The SHSH Convertible Loan was wholly repayable if the conversion feature was not valid or unenforceable on the repayment date.
- (d) If the convertible feature was enforceable, only 75% of the outstanding amount under the SHSH Convertible Loan, which was not converted into shares, would be payable.

- (e) The whole or part of the SHSH Convertible Loan could be converted into shares.
- (f) A minimum of 25% of the SHSH Convertible Loan had to be converted into shares.
- (g) The term "SHSH Convertible Loan" being defined as the loan of principal amount of \$2,270,000 means a loan which starts off at the sum of \$2,270,000.
- (h) The "SHSH Convertible Loan" may be reduced at any time prior to the repayment date by SHSH or by its assignees in interest. Whenever any conversion is exercised, the "SHSH Convertible Loan" is reduced accordingly.
- (i) At the repayment date, only 75% of the remaining unconverted "SHSH Convertible Loan" is to be repaid in cash.
- (j) Since 79% of the "SHSH Convertible Loan" had been converted into shares prior to the repayment date, the minimum threshold for conversion has been met. Under clause 5.2, only 75% of the remaining 21% of the unconverted "SHSH Convertible Loan" is repayable in cash on the repayment date. As the remaining unconverted loan amounted to \$473,238.40 (being wholly Tetsuo's share of the "SHSH Convertible Loan"), Tetsuo would be entitled only to a repayment of 75% of \$473,238.40 = \$354,928.80. Since SHSL had paid this amount to Tetsuo, Tetsuo's claim for an additional amount of \$118,309.60 must fail.

71 I therefore allowed the appeal of SHSL and declared that Tetsuo was only entitled to repayment of 75% of the unconverted SHSH Convertible Loan at the repayment date and that no further payments need to be made to Tetsuo.

Copyright © Government of Singapore.