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*June 10, 11, 12, 15
*Nov. 17

F. HOMER ZWICKER, on behalf of himself and all shareholders of Lord Nelson Hotel Co. Ltd. other than the individual Defendants (*Plaintiff*) .... APPELLANT;

AND

H. NORMAN STANBURY, SYDNEY C. OLAND, MELVIN S. CLARKE, GEORGE E. GRAHAM, J. H. WINFIELD, C. B. SMITH, EDITH TURNBULL HOPE and THE EASTERN TRUST COMPANY as Executors of and under the Last Will of D. R. Turnbull, deceased, and LORD NELSON HOTEL COMPANY LIMITED (*Defendants*) ..... RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF NOVA SCOTIA IN BANCO

Companies—Directors—Fiduciary Position—Liability to account—Shares, surrender of, no reduction of capital involved—validity.

The Lord Nelson Hotel Co. Ltd. was incorporated under the Nova Scotia Companies Act with an authorized capital of 6,400 preference shares, par value $100, and 2,285 common shares, n.p.v. Of the preferred shares issued the Canadian Pacific Ry. Co. held 3,500 and others 2,883. Of the common issued the C.P.R. held 1,600 and others 685. All shares issued were fully paid up. The hotel property was subject to a 1st mortgage to secure $600,000, 6½ per cent sinking fund bonds maturing Nov. 1, 1947. In 1932 the interest rate was reduced to 4 per cent upon the C.P.R. undertaking to guarantee the interest at the new rate until the maturity of the bonds. In consideration thereof a 2nd mortgage was given the C.P.R. on which at the time this action was brought there was outstanding $241,500. At the 1946 shareholders' annual meeting the question of providing for payment or refinancing of the maturing bonds was referred to the directors. The latter authorized C. B. Smith, the president, to discuss the matter with the C.P.R. which took the position that upon the expiration of its guarantee it would take no further part in financing the hotel. Subsequently, at the suggestion of Smith, it transferred all its shares to him for himself and his fellow directors, he undertaking to return the stock if his plan for re-financing failed. The directors, other than one Graham, then purchased on their own behalf $115,000 of the hotel bonds and the stock was divided among them. Subsequently as a result of negotiations with the C.P.R. the directors purchased the 2nd mortgage for $120,000.

*PRESENT: Rand, Estey, Kellock, Cartwright and Fauteux JJ.

Held: 1. That the action was properly brought within the principle of *Menier* v. *Hooper* L.R. 9 Ch. 350.

2. That the respondent directors both in their acquisition of the shares and the 2nd mortgage became trustees for the hotel company and, except as to 200 preferred shares disposed of to one Guptill, liable as such to account therefor. *Regal (Hastings) Ltd.* v. *Gulliver* [1942] 1 All E.R. 379; *Pearson's* case 5 Ch. D. 336 at 341 followed.

3. That the said shares, other than those held by Guptill, be surrendered to the hotel company, the share certificates to be delivered up for cancellation. *Rowell* v. *John Rowell & Sons Ltd.* [1912] 2 Ch. 609, applied.

4. That the 2nd mortgage be declared to be security for the sum of $120,000 only, with interest at 5 per cent per annum, the said respondents to be accountable for any additional amount received or which may be received by them.

APPEAL from the judgment of the Supreme Court of Nova Scotia *in banco* (1), affirming subject to variation, the judgment of the trial judge, Ilsley C.J. (2).

John Jennings, Q.C. and *A. G. Cooper* for the appellants.

A. S. Patillo, Q.C. and *A. J. MacIntosh* for the respondents.

RAND J.:—I agree with the reasons and conclusions of my brother Kellock, and have only a few words to add.

Shares in a company exist by the fact of incorporation with a capital structure; they are simply fractions of potential interest in the assets and active life of the company, whatever it may be, into which the capital is divided. Their issue gives rise to a title to property which is of the nature of a *chose in action.* Such a title is always susceptible of release. But a company cannot purchase its own shares both because of the underlying obligation to use the funds of the company for the objects for which the company was created, of which the purchase of its own shares is not one; and because it would mean an abstraction of assets of the Company on the strength of which creditors deal with it.

But where shares are fully paid up and are released by way of voluntary surrender, none of these considerations applies. The assets are not affected and the balance sheet position in relation to the payment of dividends would be a matter of accounting accommodation. This latter feature is, in fact, present whenever a share is forfeited and its

(1) (1952) 30 M.P.R. 106. (2) [1952] 3 D.L.R. 273.

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effect cannot be taken to be converted into an ultra vires character according to the number of paid up shares surrendered.

The remaining question is that of the mechanics of surrender. The case must be treated as if the Canadian Pacific Company had itself made a surrender with the intention of extinguishing its title; and the authorities cited show that such a delivery over and cancellation of the certificate effects that result, leaving the shares available for re-issue. This is the practical means for a practical situation with which the principles of company law and the provisions of the Nova Scotia Companies Act are entirely consistent.

The judgment of Kellock and Fauteux, JJ, was delivered by:—

KELLOCK J.:—I agree with the courts below that this action was properly brought by the appellant within the principle of *Menier* v. *Hooper's Telegraph Works* (1), approved by the Judicial Committee in *Burland* v. *Earle* (2).

So far as the shares acquired from the Canadian Pacific Railway are concerned, the only question which need be considered is as to the remedy to which the appellant is entitled, as in my view, in the circumstances of this case, it cannot be successfully maintained that the individual respondents acquired the shares formerly held by the Canadian Pacific Railway, otherwise than under a liability to account for them to the respondent company.

The law is clearly laid down by Viscount Sankey in *Regal (Hastings)* v. *Gulliver* (3), as follows:—

> The respondents were in a fiduciary position and their liability to account does not depend upon proof of *mala fides*. The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect. If he holds *any property* so acquired as trustee, he is bound to account for *it* to his *cestui que trust*.

With respect, the learned trial judge and the full court have failed to appreciate the effect of the above, holding as they do, that the respondents are not liable to account for the property itself, i.e., the shares, but only for any profit which they have made or may make out of the

(1) (1874) L.R. 9 Ch. 350. (2) [1902] A.C. 83.
(3) [1942] 1 All E.R. 378 at 381.

shares. Such a view is quite erroneous. In *Pearson's case*, (1), the Master of the Rolls, Sir George Jessel, had held with respect to a person in the position of the individual respondents, that he is liable

> at the option of the *cestuis* (*sic*) *que trust*, to account either for the value at the time of the present he was receiving, or to account for *the thing itself* and its proceeds if it had increased in the value.

In that case, the learned Master of the Rolls was also dealing with the shares of the actual company there concerned. Mellish L.J., also, in *McKay's case* (2), had stated the principle in similar terms as did Lord Esher M.R., in *Eden* v. *Ridsdales* (3).

Had the property which the respondents received been of a nature other than shares of the respondent company there would have been no difficulty in directing the individual respondents to transfer such property to the company, or at the option of the company, to pay to the company its value. In none of the cases above referred to did any question other than the value of the shares arise.

It is quite plain that there would be no difficulty in directing that the respondents transfer the shares here in question to a trustee for the company. In *Cree* v. *Somervail* (4), Lord Hatherley at p. 661 and Lord Blackburn at 667, were of that opinion. The point was the subject of express decision by Romer J., as he then was, in *Kirby* v. *Wilkins* (5). The learned trial judge in the case at bar considered the judgment of Romer J. of doubtful authority but, with respect, I am of opinion the case, so far as is here relevant, was well decided in accordance with principle and authority.

In *Black* v. *Carson* (6), (7), a company had acquired certain assets in consideration of the issue of the whole of its shares. The vendors, subscribers to a syndicate, had agreed among themselves that part of the shares, after their receipt by them, should be transferred to the directors of the company "for the purpose of providing funds for the organizing of the said company, and for working capital, as the said directors may deem prudent from time to time" (article 7). The shares were accordingly transferred to the

(1) (1877) 5 Ch.D. 336 at 341.
(2) (1875) 2 Ch.D. 1 at 5.
(3) (1889) 23 Q.B.D. 368 at 371.
(4) (1879) 4 App. Cas. 648.
(5) (1929) 2 Ch. 444.
(6) (1912) 7 D.L.R. 484.
(7) (1914) 36 D.L.R. 772.

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president and secretary of the company, their successors and assigns. An action brought by or on behalf of the original subscribers for a declaration that the shares undisposed of were held in their interest and not in the interest of the company, failed. Their Lordships, agreeing with the view taken in the court below, held that the company was not subject to any trust in favour of the appellants and that there was no limitation placed upon the beneficial interest which was transferred. The Court of King's Bench (Appeal Side) had adopted the reasons for judgment of Demers J. at trial who had held that the plaintiffs had "transferred the property in the said disputed shares, absolutely to the company". In the view of the Court of King's Bench the agreement did not

> constitute the company the owner of its own shares, but simply postpones their sale or disposition to a later date, under such sale conditions as it may deem advisable and in the interest of the company . . . Clause 7 . . . has no other effect in our view than that of a by-law of the directors and the shareholders regulating in the interests of the company the distribution of the shares in question.

In the case at bar, while I do not think the court should direct cancellation of the shares here in question, as the appellant asks, I am of opinion that, in the circumstances which obtain, unless there be valid ground of objection in law, the court ought to direct that they be surrendered to the company rather than that they should be left to be held in trust for the company.

In considering the question of the propriety in law of such an order, it is not without relevance to observe that even if held in trust for the company, any profits available for dividend can only enure to the benefit of the shareholders without regard to the shares held in trust. The same would be true in any distribution of the assets of the company on a winding-up. Any objection to an order directing the surrender of the shares to the company itself must therefore be purely technical, resting upon some supposed incapacity on the part of the company. For reasons which follow I am of opinion there is no such incapacity in the case of the company with which we are here concerned.

In *Trevor* v. *Whitworth* (1), in which it was held that a company may not purchase its own shares, Lord Herschell, after differentiating purchase from forfeiture, for which the

(1) (1887) 12 App. Cas. 409.

statute there in question provided, as does the Nova Scotia Companies Act, went on to speak of surrender, at p. 418, as follows:

> Surrender no doubt stands on a different footing. But it also does not involve any payment out of the funds of the company. If the surrender were made in consideration of any such payment it would be neither more nor less than a sale, and open to the same objections. If it were accepted in a case when the company were in a position to forfeit the shares, the transaction would seem to me perfectly valid. There may be other cases in which a surrender would be legitimate. As to these I would repeat what was said by the late Master of the Rolls in *In re Dronfield & Co.* (1). "It is not for me to say what the limits of surrender are which are allowable under the Act, because each case as it arises must be decided upon its own merits".

Similarly, Lord Watson at p. 424 said:

> When a share is forfeited or surrendered, the amount which has been paid upon it remains with the company, the shareholder being relieved of liability for future calls, while the share itself reverts to the company, bears no dividend, and may be re-issued.

At a later point in his judgment, Lord Watson said at p. 429:

> There is no reference in the Acts to surrenders of shares; but these have been admitted by the Courts upon the principle, as I understand it, that they have practically the same effect as forfeiture, the main difference being that the one is a proceeding in invitum, and the other a proceeding taken with the assent of the shareholder, who is unable to retain and pay future calls on his shares.

In *Rowell* v. *John Rowell & Sons Limited* (2), Warrington J., as he then was, had to consider the situation with respect to certain 6 per cent fully paid preference shares which had been surrendered, following upon which the company had issued other 5 per cent preference shares. The surrendered shares had not been cancelled but were held by the company, subject to re-issue. At p. 614 the learned judge said:

> Now the case with which I have to deal is the surrender of shares fully paid up and therefore not involving the release of the shareholder from any liability.

At p. 620, he said:

> that while a surrender of fully-paid shares means, of course, a reduction of capital if the shares are surrendered upon terms which do not permit their re-issue, in the present case the shares are surrendered upon terms which do permit their re-issue, and, with all respect, I really fail to see how in that case there is any reduction of capital at all . . . The shares are there ready to be issued, still forming part of the capital, and it would not require any resolution of the company to increase its capital

(1) 17 Ch. D. 76.

(2) [1912] 2 Ch. 609.

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in order to enable them to re-issue those shares. It seems to me, therefore, that, if the re-issue of these shares would not require any resolution for an increase of capital, there was in fact no reduction of capital in accepting the surrender coupled with the power of re-issuing these shares.

The above decision was referred to in this court with approval in *Alberta Rolling Mills Co.* v. *Christie* (1).

It is quite true that in *Rowell's* case the articles of association empowered the directors to accept surrenders on such terms as they saw fit. Articles of association, however, are merely internal regulations of the company, and cannot empower a company to do anything to which the memorandum of association does not extend.

In my opinion, therefore, the proper order to make is that the shares formerly held by the railway, except 200 preferred shares now held by Guptill, be surrendered by the individual respondents to respondent company, the share certificates to be delivered up for cancellation. It appears that certain of these shares are held in the name of Stanbury and Company Limited as trustees for Oland and Stanbury or either of them. Stanbury & Company Limited should, therefore, be added as a party and if it desires to raise any issue as to the shares so held by it, such issue shall be referred to the trial court to be dealt with according to the rules of that court. In default the said added party shall be bound by this judgment. With respect to the Guptill shares, the evidence indicates that these were applied by Smith in the interests of the respondent company in bringing about the reorganization and therefore do not form any part of the profit acquired by the other directors in breach of their fiduciary obligation.

It should be added, as to Stanbury, that he became a director on June 19, 1947, and his proportion of the railway company shares was transferred to him on July 15. It is, however, immaterial that he was not a director at the time Smith arranged originally for the shares to be given him. He nevertheless received the shares knowing the circumstances and is in no better position than the other directors who participated. *Cookson* v. *Lee* (2).

In considering the question as to the second mortgage, it is necessary to review the relevant circumstances. At a meeting of directors of May 31, 1946, the question of pro-

(1) (1918) 58 Can. S.C.R. 208 at 220. (2) (1854) 23 L.J. Ch. 473.

viding for the retirement or refunding of the company's bonded indebtedness, which had been referred to the directors by the shareholders, was discussed. The directors were unanimously of opinion that before formulating any plan the matter should be discussed with the Railway Company "as the party most directly interested both as being the largest shareholder and also being the second mortgagee". Accordingly, the respondent Smith was directed to take up the matter with the railway "with a view to ascertaining the wishes of that company in the premises".

At this time the respondent company had outstanding $600,000 4 per cent first mortgage bonds, maturing November 1, 1947, the interest being guaranteed by the railway company to that date but not thereafter. The railway company was also the holder of the second mortgage on which $241,500 principal was outstanding. The interest on the bonds and the second mortgage was then in current shape.

In the course of the negotiations with the railway company conducted by Smith, the latter says that it was made very clear to him that

> with the expiration of their guarantee of interest on the First Mortgage bonds, Canadian Pacific had no further interest in the Lord Nelson.

They were "not interested in protecting their investment, most of which had been written off". Their "investment" included the shares and the mortgage.

Ultimately, the bondholders exchanged the existing bonds for new bonds maturing November 1, 1967, and the railway company on its part agreed to reduce the rate of interest on its second mortgage to 3 per cent, payable only if earned, and that, so long as any of the bonds should be outstanding, the mortgage should not be enforceable. These arrangements were concluded in or about October 1947.

During the period that the guarantee of the railway company of the interest on the original First Mortgage bonds had been in operation the respondent company had experienced considerable difficulty in financing. At the end of December 1940, the amount outstanding for principal on the second mortgage had risen to $266,500 principal with $100,901.85 arrears of interest, a total of $367,401.85. Subsequently, however, the business of the hotel improved so

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that by the end of 1943 the arrears of interest had been paid and in July 1944, $25,000 was paid on account of principal.

Within a few months of the conclusion of the arrangements in October 1947, namely in April 1948, the provincial legislature enacted liquor control legislation following upon an earlier plebiscite. From the resulting situation it would undoubtedly be expected that the hotel would benefit.

In a letter written by the respondent Smith on January 10, 1951, the latter stated that

> since the reorganization, the company, through its directors . . . have all along been of the opinion that it would be in the best interest of the shareholders to effect a sale if a favourable opportunity presented itself.
>
> To this end they have, over the past three years, endeavoured to interest various persons or organizations in the purchase of assets and undertaking of the company . . ."

These efforts culminated in December 1950 in the receipt of an offer to purchase from a well known company operating a large chain of hotels.

In the meantime, in September 1949, Smith and a number of the other respondents had entered into negotiations with the Canadian Pacific Railway for an assignment to them personally of that company's second mortgage and this was duly carried out in November 1949, the railway company assigning the mortgage to Oland and Stanbury as trustees for themselves, Clarke, Smith and a company called Delta Securities Limited, in which J. H. Wingate, formerly a director of the respondent company, was interested as a shareholder, he having previously resigned in 1948. The consideration for the assignment of the mortgage was $120,000. It is in these circumstances the appellant claims that the interested respondents are entitled to claim against the hotel company only the amount actually paid by them for the assignment with interest on that sum from its date.

In my view the position of these respondents with respect to the mortgage is governed by the principle already cited from the judgment of Viscount Sankey in the *Regal* case at p. 381. Lower down on the same page, Viscount Sankey

referred to the headnote to the decision of the House of Lords in *Hamilton* v. *Wright* (1), as follows:

A trustee is bound not to do anything which can place him in a position inconsistent with the interests of his trust, or which *can have a tendency to interfere* with his duty in discharging it. Neither the trustee nor his representative can be allowed to retain an advantage acquired in violation of this rule.

His Lordship also cited the following passage from the judgment of Lord Brougham in that case, at p. 124:

the knowledge which he acquires as trustee is of itself sufficient ground of disqualification, and of requiring that such knowledge shall not be capable of being used for his own benefit to injure the trust. The ground of the disqualification is not merely because such knowledge may enable him actually to obtain an undue advantage over others.

In the case cited, a trustee had acquired by assignment a bond of annuity which had been granted by his *cestui que trust*. It was held by the Lord Ordinary that the trustee could not sue upon the bond but was bound to give to the *cestui que trust* "any advantage that may have accrued or may yet accrue", from the transaction. This decision was reversed on appeal but was restored in the House of Lords. At p. 124, Lord Brougham said:—

In *Ex Parte Lacey* (2), Lord Eldon denied the doctrine supposed to have been delivered by Lord Loughborough in *Whichcote* v. *Lawrence* (3), that a trustee must make some advantage of his purchase before it can be set aside; because in ninety-nine cases out of every hundred, he held that it might be impossible for the Court to examine into this matter. So the conduct of the trustee not being blameable in the purchase, is nothing to the purpose; . . .

In *Keech* v. *Sandford* (4), a lease of the profits of a market was devised to a trustee in trust for an infant. Before the expiration of the term the lessor refused to renew an dthe trustee thereupon took a lease for his own benefit. It was however decreed that the trustee should assign the lease to the infant, the trustee to be indemnified from the covenants in the lease and to account for the profits since the renewal. Lord Chancellor King said that "the trustee should rather have let it run out than to have ha dthe lease to himself: that it may seem hard that the trusee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly pursued, and not in the least relaxed."

(1) (1842) 9 Cl. & Fin. 111.
(2) 6 Ves. 626.
(3) 3 Ves. 740.
(4) (1726) Sel. Cas. Ch. 61.

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In the present case the individual respondents participating in the purchase of the mortgage did not acquire it simply as members of the public but "by reason and in course of their office of directors", to employ the language of Lord Russell in the *Regal* case at p. 386. In my opinion the acquisition of the mortgage was due to and prompted by the information which they, as directors, had acquired as to the small value placed by the former mortgagee upon its security, a knowledge they were in duty bound to employ for the advantage of the company and not for themselves. I do not consider that when the adjustments in the affairs of the respondent company with respect to its outstanding bonds and this mortgage were concluded in 1947, the directors ceased to have any duty toward the respondent company with respect to the mortgage. There was in my opinion a continuing duty to manage the affairs of the company, in the interests of the shareholders, including the bringing about of the most advantageous sale possible. This involved giving to the company the benefit of any additional favourable adjustment in the terms of the mortgage which subsequently might prove obtainable.

No attempt appears to have been made to this end. These respondents considered only their own advantage. In acquiring the mortgage for their personal benefit they placed themselves in a position where they had a personal interest conflicting with the interest of the company. The best substantiation of that fact is their subsequent conduct.

As already mentioned, the efforts to sell resulted, on the 11th December, 1950, in the offer presented by the respondent Smith to a meeting of directors of that date at which were present in addition to himself, the respondents Graham, Oland and Clarke. The offer which was then presented, while it provided for the purchase of the asests of the hotel and the assumption of the outstanding first mortgage bonds, stipulated that the sum of $241,500, the face value of the mortgage in question, was to be paid by purchasing or causing the second mortgage to be purchased from its holders at its face amount, in six equal half-yearly instalments. This offer, however, was not accepted, but another offer put forward at the meeting by the respondent Oland was accepted. The only difference

between the Oland offer and the other was that the purchase price of the second mortgage in the Oland offer was to be paid within 2 years instead of 3, the only persons benefiting being the holders of the second mortgage. This action of the directors was subsequently approved at a general meeting of shareholders, on December 29, at which the directors voted the shares acquired from the railway company in favour of the Oland offer.

Subsequently, on January 15, 1951, at a general meeting of shareholders called to confirm this sale and the consequent winding-up of the company, another offer was presented to the directors from an outside party. This offer did not provide for payment of the second mortgage as did the former offers, but only for its assumption. It did, however, provide for an increase of $100,000 cash in the purchase price.

In the result, although this last offer was much more favourable to the shareholders, and although the directors protested that in their opinion a sale and winding-up were in "the best interests of the shareholders", this course was not followed. Oland and Stanbury appear to have determined to acquire control of the undertaking by purchase of shares rather than by direct purchase of the assets. The minutes of the meeting contain the following illuminating entry:

> The Chairman (Smith) then addressed the meeting stating that the directors in recommending to the shareholders the acceptance of the offer made by Col. S. C. Oland and his Associates and in voting for the Special Resolution to wind up the company (at the former meeting) had believed that it was in the best interest of the company and the shareholders generally to do so. He stated that while *they had not changed their opinion in this respect* they had come to the conclusion that in the circumstances that had developed it was not advisable to proceed with the winding-up of the company and they had consequently determined to vote the shares owned or represented by them against confirmation of the Special Resolution. He added that the directors, however, proposed to sell their controlling interest in the company to Colonel Oland and his Associates for the price of $25 per preference share with the common thrown in, that being the estimated amount that they would have received if the company had been wound-up.

The "controlling interest" above referred to was of course that of the directors themselves derived by reason of the shares which they had acquired from the Canadian Pacific Railway.

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It is transparent in the above resolution that Oland and his "Associates", while quite prepared to dispose of the undertaking to one of themselves on terms which would have yielded the holders the full profit involved in the acquisition of the second mortgage at approximately 50 per cent of its face value, were equally prepared to prevent the shareholders, other than themselves, from participating in any purchase of the assets of the hotel by an outside party even at an enhanced price. A sale and winding-up of the respondent company which was in the best interests of the shareholders generally on the 29th December, became something quite different on the 15th January following by reason of the emergence of a third person desiring to purchase.

In the court below the decision with respect to the mortgage was influenced by the fact that there was no money in the hands of the respondent hotel available to pay off the mortgage at the time when it was acquired by the individual respondents. The decision in *Regal's* case indicates such a question is quite irrelevant. Lord Russell, at p. 389, after referring to *Keech* v. *Sandford* (*supra*) and *Ex Parte James* (1), said:

> It was contended that these cases were distinguishable by reason of the fact that it was impossible for Regal to get the shares owing to lack of funds, and that the directors in taking the shares were really acting as members of the public. I cannot accept this argument. It was impossible for the *cestui que trust* in *Keech* v. *Sandford* to obtain the lease, nevertheless the trustee was accountable. The suggestion that the directors were applying simply as members of the public is a travesty of the facts. They could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting. In default of such approval, the liability to account must remain.

Every word of the above applies, in my judgment, in the case at bar.

It is also suggested in the judgment below that the situation might have been differently regarded had the respondent company been insolvent. Again, the decision in *Regal's* case is a complete answer to any such distinction as are the other authorities discussed above. It is quite true that in *Larking's* case (2), where Malins, V.C., acted upon the principle here in question, the company there

(1) (1803) 8 Ves. 337.

(2) (1876) 4 Ch. D. 566.

concerned was in liquidation and the learned Vice Chancellor expressed himself to the effect that the situation might well be otherwise in the case of a solvent company. The mere existence of solvency or insolvency, however, is not the test.

In the case at bar the individual respondents, both in their acquisition of the shares and the second mortgage were arrogating to themselves a secret profit which, as stated by Lord Wright in *Regal's* case, at p. 393, is "nothing more than a profit without the consent of the shareholders". They did not obtain the consent of the shareholders and both transactions, therefore, for the reasons stated, cannot stand.

With respect to the mortgage, there should be judgment declaring that the mortgage is security only for the respective amounts paid by each in respect of its acquisition, with interest thereon at 5 per cent per annum, as asked by appellants, the said respondents to be accountable to the respondent company for any amount or amounts which may have been received or which may be received beyond such amounts and such interest. This order is, of course, subject to the provisions of the deed of trust securing the bonds by which the company may not repay any part of the principal of the second mortgage so long as any of the bonds are outstanding.

As the mortgage is held by the respondents Oland and Stanbury not only for themselves and the respondents Clarke and Smith but also for Delta Securities Limited, the statement of claim should be amended so as to claim against Delta, and that company should be added as a party. If Delta conceives its rights under the said mortgage as differing in any respects from the rights of the other parties as hereby declared, it will be at liberty to raise such issue, in which event the said issue will stand referred to the trial court for disposition according to the practice of that court, the costs to be in the discretion of that court. In default the said added party shall be bound by this judgment.

The appeal should be allowed: the appellant should have his costs throughout.

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ESTEY, J.:—I agree with the reasons and conclusions of my brothers Kellock and Cartwright and, therefore, this appeal should be allowed with costs to the appellant throughout against all the original defendants except the Hotel Company.

CARTWRIGHT J.:—For the reasons given by my brother Kellock, I agree with his conclusions that the respondents, other than Lord Nelson Hotel Company Limited, obtained both the shares and the mortgage referred to under circumstances which render them liable to account to Lord Nelson Hotel Company Limited, hereinafter referred to as "the Company".

As to the shares I agree with the order proposed by my brother Kellock that the shares, other than the 200 preferred shares transferred to Guptill, be surrendered to the Company to be dealt with as unissued shares. Such surrender is in no sense a purchase by the Company of its own shares as it involves neither payment by the Company nor (the shares being fully paid up) the release by the Company of any liability to it. No reduction in capital is brought about as the Company parts with nothing and its authorized capital will remain unaltered, although the number of issued shares will be reduced and the number of unissued shares will be correspondingly increased. In my opinion the authorities referred to by my brother Kellock show that in the circumstances of the case at bar there is no legal objection to such a course but I wish to make it clear that I express no opinion as to whether or not such an order could have been made if the shares in question had not been fully paid up. I see no necessity to order the cancellation of the shares. The Company if it sees fit can take the necessary steps under the Companies Act to effect such cancellation.

The question of the proper order as to the mortgage is a difficult one. The respondents, on November 30, 1949, paid $120,000 in cash for an assignment of a second mortgage dated June 14, 1932 made by the Company on its hotel property and other assets, to the Canadian Pacific Railway Company which, as varied by the terms of an indenture of October 20, 1947, secured $241,500 principal with interest at a rate up to but not exceeding 3 per cent per annum (but not cumulative) payable exclusively out of profits. The

last mentioned indenture contained provisions for calculating the annual profits of the mortgagor for the twelve month period ending on October 31 in each year and for payment of the interest if earned, or so much thereof as might be earned, on the 15th of December following. The indenture further provided that so long as any of the bonds of the Company therein mentioned remained outstanding the mortgagee would not take any steps to foreclose the mortgage or otherwise realize its security or any part thereof. Apart from this provision the principal secured by the mortgage would have been due on May 2, 1947, but as the bonds refererd to do not mature until November 1, 1967 the principal will not be payable before the latter date unless all the bonds should be earlier redeemed.

By an Indenture dated November 1, 1947, made between the Company and The Eastern Trust Company, the Deed of Trust securing the bonds of the Company was amended. Subclause (*s*) of Clause 18 of Article V of the Deed of Trust, as amended, provides:—

> (*s*) That so long as any of the Bonds hereby secured remain outstanding the Company will not declare or pay any dividends in respect of its preference or common shares, and will not repay to Canadian Pacific Railway Company any part of the principal secured by the Mortgage made by the Company in favour of Canadian Pacific Railway Company dated the 14th day of June, 1932.

It will thus be seen that until all the first mortgage bonds have been redeemed not only is the mortgagee restrained from enforcing payment of the principal secured by the second mortgage but the Company, the mortgagor, is prevented from paying any part thereof. It is this circumstance which creates the difficulty as to the proper form of order which should be made in regard to the mortgage.

But for the circumstance just referred to I would have thought that the proper order would have been one similar to that made by the Lord Ordinary and approved by the House of Lords in *Hamilton* v. *Wright* (1), that is, that upon the Company paying to the respondents the price given by them for the mortgage with interest (less any sums received by them on account of the said mortgage) they should deal with the mortgage as directed by the Company. I would have thought, also, that it should be a

(1) (1842) 9 Cl. & Fin. 111.

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term of the order that the amount found due to the respondents should be promptly paid, because, as was said by Lord Eldon in *Ex Parte Bennett* (1), "the person who is to be delivered from the situation of purchaser shall be speedily delivered". It is obvious that the value in 1949 or at this date of a second mortgage the principal of which is not payable until November 1, 1967 and meanwhile bears non-cumulative interest at the rate of 3 per cent, only if earned, must be very much less than the amount of the principal secured. The Court does not proceed against an accounting trustee by way of punishment (see the observations of Lord Cranworth L.C. in *Attorney-General* v. *Alford* (2) and those of Lord Hatherley L.C. in *Burdick* v. *Garrick* (3)"; and the effect of an order that the respondents can not enforce the mortgage for more than $120,000 principal and must await payment of that sum until 1967 would be not merely to deprive them of all profit but to inflict a heavy loss upon them. It is eminently a case in which the order should provide that they be "speedily delivered" from this situation. This could be simply accomplished by limiting a reasonable time (perhaps the two months fixed by Lord Eldon in *Ex Parte Bennett* (*supra*)) in which the Company should pay the $120,000 and interest, but for the fact, which it is to be remembered was known to the respondents when they purchased the mortgage, that the Company is precluded by the terms of the indenture of November 1, 1947, quoted above, from making any payment on account of the principal of the mortgage while any bonds are outstanding. In such circumstances it is the duty of a Court of Equity to make the order best suited to the actual circumstances and in my opinion it should be directed that the Company do pay to the respondents the said sum of $120,000 as soon as it is able to do so consistently with the terms of the indenture of November 1, 1947, above refererd to, together with interest thereon at the rate of 5 per cent per annum from November 30, 1949, less any sums paid to them as interest under the said mortgage, that until payment of the said sum of $120,000 the interest thereon at 5 per cent be paid annually on the 15th day of December insofar as the terms of the said indenture of November 1, 1947 permit, and that upon payment of the said sum of $120,000 and interest as

(1) (1805) 10 Ves. 380 at 401. (2) (1855) 4 D.M.&G. 843 at 851.
(3) (1870) L.R. 5 Ch. 233 at 241.

aforesaid (including any interest which may be in arrears by reason of the earnings of the Company in any year or years having been insufficient to pay it) the respondents shall deal with the said mortgage as directed by the Company.

Counsel for the appellant, in the memorandum as to the order which he submitted should be made furnished by him at the request of the Court, suggests, very fairly as I venture to think, that the rate of interest on the $120,000 should be 5 per cent. Even if he had not done so I would have held that to be the proper rate. To fix a lesser rate would be to treat the respondents harshly. At such rate the interest accruing each year will amount to $6,000 and under the terms of the mortgage as varied by the indenture of October 20, 1947, the Company was entitled and obligated to pay interest in each year, if earned, of $7,245 (i.e. 3 per cent on $241,500). While the Company is in equity entitled to the benefit of the reduction of the principal of the mortgage by the sum of $121,500, it is the barest justice that it should pay interest at the legal rate of 5 per cent on the money expended by the respondents in securing this advantage. I agree that the order proposed by my brother Kellock adding Stanbury and Company Limited and Delta Securities Limited as parties defendant should be made.

I would allow the appeal and vary the judgments below in the manner indicated above. The appellant should have his costs throughout.

Appeal allowed with costs throughout against all the original defendants except the hotel company.

Solicitor for the appellants: *Russell McInnes.*

Solicitor for the respondents: *F. D. Smith.*