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*Feb. 15.
*May 1.

ROBERT HOOD AND OTHERS (PLAINTIFFS) . APPELLANTS;

AND

A. C. CALDWELL AND OTHERS (DEFENDANTS) ..... } RESPONDENTS.

ON APPEAL FROM THE APPELLATE DIVISION OF THE SUPREME COURT OF ONTARIO

Action—Laches—Acquiescence—Company—Purchase from promoters—Consideration—Payment for services—Resolution of directors.

An action was brought by individual shareholders against a joint stock company and its president for recission of an agreement to purchase the assets of the business formerly carried on by the president (promoter), worth some $1,500, for 500 shares of the common stock (par value $50,000) of which 200 were to be held in trust and given to purchasers of the preferred; also to have struck from the minutes a resolution of the board of directors providing payments to the president for future services as manager and a return of the money received by him pursuant to said resolution.

Held, affirming the judgment of the Appellate Division (50 Ont. L.R. 387) Duff and Brodeur JJ. dissenting as to the first-mentioned cause of action, that whether or not the proceedings of the company are open to attack no fraud was proved and the plaintiffs are debarred, by laches and acquiescence in all that was done for several years, from maintaining the action.

Per Duff J.—It is clear that the 500 shares were alloted to the vendors of the assets at a discount and the allotment was *ultra vires*. The agreement should, therefore, be set aside.

Per Anglin J.—The appellants, suing as individuals, cannot have such allotment set aside. *Fullerton* v. *Crawford* (50 Can. S.C.R. 314) referred to.

Held also, Anglin and Mignault JJ. dissenting, that the respondents should not be given the costs of this appeal or of any proceedings below.

APPEAL from a decision of the Appellate Division of the Supreme Court of Ontario (1) affirming the judgment at the trial in favour of the defendants.

The material facts are stated in the head-note.

Woods K.C. and *Counsell K.C.* for the appellants. Acquiescence is not a bar to shareholders not fully aware of the matters complained of; *Denman* v. *Clover Bar Coal Co.* (2) at pages 326 and 329; nor in delay prior to discovery of fraud. *Farrel* v. *Manchester* (3).

McClemont for the respondents.

*PRESENT:—Sir Louis Davies C.J. and Duff, Anglin, Brodeur and Mignault JJ.

(1) 50 Ont. L.R. 387. (2) 48 Can. S.C.R. 318.
(3) 40 Can. S.C.R. 339.

THE CHIEF JUSTICE.—On the ground solely that the plaintiffs in this case had by their laches and acquiescence debarred themselves from the relief prayed for in this action, as found by the trial judge and confirmed by a majority of the Court of Appeal, I am of the opinion that this appeal should be dismissed, but without costs of appeal here, or in the trial court, or in the Divisional Court of Appeal, as on the merits apart from the acquiescence I would have allowed the appeal. In his judgment the trial judge stated that in his opinion the action was not one in which costs should be allowed.

DUFF J. (dissenting).—I concur in the view of Mr. Justice Ferguson that the agreement of the 8th March, 1912, by which the company professed to purchase the good will and assets of the Caldwell Company for five hundred fully paid-up shares, was *ultra vires*. I concur in his view that under the Ontario Act it is beyond the power of a company to allot fully paid-up shares at a discount. This, of course, does not necessarily mean that shares must be paid for to the amount of their nominal value in actual cash. It was long ago settled that shares might validly be paid for in "meal or malt," and where there is a real agreement by which the company agrees to accept in exchange for shares property which is treated as having a value equivalent to the amount of the shares, and where this agreement is made in circumstances in which the transaction itself is presumptive evidence of the value of the consideration, then the court will not inquire into that value, and the transaction is unimpeachable on the ground solely that the consideration appears to be inadequate.

But it does not follow that in no case will the court set aside an agreement on the ground that it is a virtual attempt to sell its shares at a discount. If it is established by the circumstances that the agreement is a mere sham—a mere façade to hide the real object of the donee of the shares and of the persons representing the company to do an *ultra vires* act, namely, to allot shares as fully paid-up which have not been paid for at all, or only paid for in part —then the court will treat the transaction in law as being

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what it is in fact. In *In re Wragge* (1) Vaughan Williams L.J. points out that in such circumstances the court will not limit itself to the question whether or not there is "no consideration whatever," but with regard either to the whole of the consideration or to any part of it will give effect to its conclusion that the whole or the part is a sham; that in respect to the whole or part "the transaction is a colourable one." As Lord Watson said, in *Ooregum* v. *Roper* (2):

> The court would doubtless refuse effect to a colourable transaction entered into for the purpose or with the obvious result of enabling the company to issue its shares at a discount.

The judgment of Lindley L.J. in *In re Wragge* (1) at pages 830-2, is to the same effect.

Now the case under consideration was one of those cases which have often been before the courts, such, for example, as *Erlanger* v. *New Sombrero* (3), in which promoters who own property get up a company to take the property and allot qualifying shares to themselves and nominees who are entirely under their control and appoint a board of directors entirely under their control, and then go through the form of an agreement between themselves and the company, taking the share capital of the company in consideration of the transfer of the property. In the economic sense, such a transaction is not a sale. It is not a transaction having any significance whatever as to the value of the property transferred. The price is fixed by the fiat of the vendors, and therefore the considerations which have led the courts to hold that where there is a real sale entered into between promoters and persons acting independently of them for the company, the price paid in shares is presumptive evidence of the value of the property which, in the absence of fraud or some kind of unfair dealing, the courts will not go behind, have no sort of application whatever. If in such circumstances it is made plain that the so-called consideration is merely nominal or patently derisory, I think the court should not be slow to draw the proper conclusion and to press that conclusion to its logical result.

(1) [1897] 1 Ch. 796 at 814. (2) [1892] A.C. 125, at page 136.
(3) 3 App. Cas. 1218, at page 1286.

I will not review the facts which have been fully reviewed in the judgments below, but I have no hesitation in concluding that the agreement had to use Lord Watson's language,

> the obvious result of enabling the company to issue its shares at a discount;

and moreover that it was entered into for that purpose and that it comes within the class of " colourable transactions " to which the court ought not to give effect.

What, then, should be the result? The agreement is one to which effect should not be given, and I agree with Ferguson J., that in the circumstances the allotment must be set aside, subject, however, to this qualification; the persons who acquired these shares subsequently, whether by purchase from Caldwell and Nicholson or as bonus shares, may have acquired them in such circumstances that the company, on the principle of *Burkinshaw* v. *Nicolls* (1); *Parberry's Case* (2); *Bloomenthal* v. *Ford* (3); is estopped from denying that the shares were fully paid-up and consequently that the allotment was lawful.

The next question which arises concerns the moneys received by Caldwell under his agreement of the 4th May, 1915. The general principle of law is that directors being trustees of their powers for the shareholders are incapacitated from retaining as against the company any profit arising from a contract made between themselves and the body of directors of which they are members, unless the company knows and assents. *Imperial Mercantile Credit Association* v. *Coleman* (4); *James* v. *Eve* (5), *Gluckstein* v. *Barnes* (6); *Boston Deep Sea Fishing Company* v. *Ansell* (7); *Fullerton* v. *Crawford* (8). The only provision of the Ontario Companies Act which appear in any way to affect this principle is section 92, which provides that no by-law for the payment of the president or any director shall be valid or acted upon unless passed at a general meeting or, if passed by the directors, until the same has been confirmed at a general meeting. This provision is negatively

(1) 2 App. Cas. 1004.
(2) [1896] 1 Ch. 100.
(3) [1897] A.C. 156.
(4) [1871] 6 Ch. App. 558, at page 566.
(5) L.R. 6 H.L. 335, at page 348.
(6) [1900] A.C. 240.
(7) 39 Ch. D. 339.
(8) [1919] 59 Can. S.C.R. 314, at page 330.

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expressed, but it no doubt implies authority in the shareholders and directors to pass a by-law having the object and effect indicated, provided the prescribed procedure is followed. It may be open to question, I think, whether or not this enactment does authorize such a by-law as by-law 15, which extends to profits made by any director in connection with any contracts made between him and the company. Assuming the arrangements of the 4th May, 1915, to come within section 92, then my conclusion is that the conditions of that section have not been fulfilled. By-law 15 professes to delegate to the directors the duty of exercising the authority reposed in the shareholders by section 92. I mean that by-law 15 does not in itself authorize the payment of the president or any director. It is not a "by-law for" such payment. In passing it the shareholders cannot be held either to have passed such a by-law or to have confirmed such a by-law; they have merely professed to delegate to the directors the authority to act in a certain way.

On the other hand if the arrangement falls outside of section 92, the question arises whether this by-law constitutes a sufficient assent by the company to the retention by a director of profits received from a contract made between himself and the company through the agency of the directors alone. That is a point which would, I think, require a somewhat careful examination of the provisions of the Ontario Companies Act respecting the authority of shareholders in ordinary general meetings; and without suggesting that the by-law was not competently enacted at the meeting of the 8th April, 1912, I prefer to express no opinion upon the point, in the absence of any argument upon it.

It is unnecessary to say more as to the validity of the arrangement of the 4th of May, 1915, because I am convinced that the view which was taken by the learned trial judge and by the majority of the judges of the Court of Appeal that there was, in fact, such acquiescence in the arrangement made by the directors with Caldwell as to amount to an assent by the company to that arrangement, is a view which has so much support in the evidence that

it would be quite out of the question for this court to decline to act upon it.

An observation is necessary upon the head-note in *Fullerton* v. *Crawford* (1). It is made to appear thereby that the court held that the payment to Doran in respect of commission was a lawful payment, and it is made also to appear that this court affirmed certain Ontario decisions as concerns section 92 of the Ontario Companies Act. In point of fact, of the three members of the court who expressed an opinion as to the legality of the payment to Doran, two, the Chief Justice and myself, held it to be wrongful and recoverable back. Two members of the court, Mr. Justice Idington and Mr. Justice Brodeur, held that Crawford was disentitled by his conduct to impeach the validity of the arrangement with Doran and expressed no opinion upon the point aforementioned, upon which the head-note represents the court as giving a decision.

ANGLIN J.—Two distinct claims are made in this action, first, the setting aside of an agreement whereby the defendants Caldwell and Nicholson (The Caldwell Orchard Company) sold their business to their co-defendant, The Wentworth Orchard Company, of which they were promoters, for the entire common stock of that company, having a par value of $50,000, and secondly, the repayment by the defendant Caldwell to the Wentworth Orchard Company of $18,700, paid to him as compensation for services as its manager.

On both branches of the case the learned trial judge found the plaintiffs debarred from relief by laches and acquiescence, and in that conclusion, affirmed by a majority of the learned Appellate judges, I agree, and would consequently dismiss this appeal with costs.

As to the claim for repayment by Caldwell, the trial judge, in my opinion, properly found that the resolution providing for his remuneration as manager was passed by the directors. I agree with the learned Chief Justice of Ontario, and Magee and Ferguson JJ.A. that the by-law of the 8th April, 1912, confirmed by the shareholders, was a sufficient compliance with section 92 of the Ontario Com-

(1) 59 Can. S.C.R. 314.

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panies' Act, if indeed that provision applies to services not rendered *qua* president or director and usually performed by a salaried employee. I had occasion to discuss this aspect of the matter in *Fullerton* v. *Crawford* (1). I also agree that a repetition of the directors' resolution in each subsequent year was not necessary. The company would appear to have had in the increased volume of its business and the maintenance of its profit-earning character, at least a fair return for this expenditure. There is no suggestion of fraud or impropriety connected with it. This branch of the appeal, in my opinion, fails.

I am disposed to agree with most of what has been said by Mr. Justice Hodgins and Mr. Justice Ferguson in criticising the inadequacy of the consideration for the allotment to the defendants Caldwell and Nicholson of the 500 shares of common stock received by them. But whether or not the company or its creditors may be entitled to some other relief in respect of the allotment of this $50,000 of stock, rescission in this action of the agreement under which Caldwell and Nicholson acquired that stock is, I think, not possible. There is no suggestion that the business taken over should be restored to its vendors. On the contrary, the plaintiffs, who are at present a minority of the shareholders of the company, seek to have Caldwell's and Nicholson's holdings wiped out so that as holders of the preference stock thus left in a majority they may themselves control the company and the business which it acquired from Caldwell and Nicholson. They offer to relinquish a small amount of common stock received by them from Caldwell and Nicholson as a bonus on the acquisition of their preference shares, but they make no offer to repay dividends received on that stock. They sue as individual shareholders. They do not claim on behalf of the company or of all its shareholders other than the two individual defendants.

The appeal on this branch, in my opinion, also fails.

BRODEUR J. (dissenting).—The present action is instituted by the shareholders of a company for the purpose of setting aside the purchase of the business of Caldwell &

(1) 59 Can. S.C.R. 314, at pages 346-7.

Nicholson, and for the repayment by Caldwell of $18,700 given to him as manager without the sanction of the shareholders. It was dismissed by the courts below.

It is pretty evident to me that Caldwell & Nicholson conceived the idea of forming a joint stock company to take over a dying business which had no value, to keep the control of this company without putting in money and to induce some inexperienced people to subscribe stock in that enterprise. It is a fraudulent venture which was *ultra vires*.

Caldwell and Nicholson, who were in control of the new company, voted to themselves 50,000 of common stock for the price of a few barrels and ladders which had practically no value.

I entirely agree with the view expressed by Mr. Justice Ferguson in the dissenting opinion which he gave in the Appellate Division, and I could not add anything to what he said. For the reasons he gave, I would allow this appeal with costs of this court and of the courts below.

MIGNAULT J.—For the reasons stated by the learned Chief Justice of Ontario, in which I express my respectful concurrence, I would dismiss this appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellants: *Bruce & Counsell.*
Solicitors for the respondents: *McClemont & Dynes.*