

FREDERICK J. FAIRHALL (DE- }  
FENDANT) . . . . . } APPELLANT;

1928  
\*May 16.  
\*May 28.

AND

WILLIAM V. BUTLER, ON BEHALF }  
OF THE WHITE STAR REFINING COM- } RESPONDENT.  
PANY, (PLAINTIFF) . . . . . }

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

*Company—Sale of common shares—Statement of company's assets and liabilities—Undeclared dividends on preference shares as constituting a liability of the company.*

F. gave an option to purchase a block of common shares of a company, which purchase would give the purchaser control of the company. The optionee required that F. furnish an accountant's statement showing the company's assets and liabilities and profit and loss to August 31, 1926, and an affidavit that the company's liabilities would not exceed the amount shown by such statement. A statement and affidavit were furnished, and the acceptance of the option was expressed to be based on said statement. Preference shares had been issued by the company, non-participating and non-assessable, entitling the holders thereof to a first, fixed, cumulative dividend of 8 per cent. per annum.

*Held*, that cumulative dividends on preference shares, to August 31, 1926, undeclared and unpaid, constituted a liability of the company within the meaning of the contract, and should have been included as such in the said statement; and that, therefore, upon a certain stated issue, the decision of which, on its proper construction, was held to depend on the determination of said question of law, the said liability should be borne by F.

Judgment of the Appellate Division, Ont., (61 Ont. L.R. 305, reversing judgment of Grant J., *ibid*) affirmed.

APPEAL by the defendant from the judgment of the Appellate Division of the Supreme Court of Ontario (1) which, reversing the judgment of Grant J. (1), held that a certain issue, directed to be tried between the parties, should be determined in favour of the plaintiff. The issue arose out of a dispute as to whether or not cumulative dividends on preference shares in a company, which had not been declared (and, therefore, had not been paid) should be taken

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\*PRESENT:—Duff, Mignault, Newcombe, Lamont and Smith JJ.

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into account in the adjustments in the carrying out of a certain contract for the sale, by the defendant to a purchaser represented in these proceedings by the plaintiff, of certain common shares in the company. The material facts of the case, and the issue to be determined, are sufficiently stated in the judgment now reported. The appeal was dismissed with costs.

*W. P. Harvie* for the appellant.

*Bernard Furlong* for the respondent.

The judgment of the court was delivered by

MIGNAULT J.—This is an appeal from the Second Appellate Division of Ontario (1) setting aside (Latchford, C.J., and Masten, J.A., dissenting) the judgment of Mr. Justice Grant (1) on an issue which Mr. Justice Logie had directed to be tried between the parties.

The facts giving rise to the controversy are not in dispute and may be briefly stated.

By a writing dated the 28th of August, 1926, the appellant gave White Star Refining Company (represented in these proceedings by the respondent) an option to purchase 1,352 shares of the common stock of Western Motor Corporation, Limited, the purpose of the optionee being, if it purchased, to secure the control of that corporation. White Star Company, on the 7th of September, 1926, accepted this option upon the following conditions (agreed to by the appellant): viz. that the appellant would furnish that company "certified public accountant's statement showing the assets and liabilities and profit and loss of Western Motor Corporation, Ltd., to and including August 31st, 1926," and that the appellant would "attach to certified public accountant's statement of assets and liabilities as above affidavit sworn to by yourself before a notary public to the effect that the liabilities of the company will not exceed the amount shown by said accountant's statement." There were further conditions which it will suffice to mention summarily, such as the right of the optionee to examine the confidential records of the corporation, and its right to withdraw if after investigation it was deemed imprudent or unwise to proceed further.

In pursuance of the condition above quoted, the appellant furnished White Star Refining Company the report and balance sheet prepared by Riddell, Stead, Graham and Hutchison, chartered accountants. This balance sheet shows certain liabilities of the Motor Corporation, and there is no criticism of this statement of liabilities as far as it goes. The point is that what is alleged to constitute a liability within the meaning of the contract was not disclosed.

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The appellant also furnished the White Star Company his affidavit in which he said:

That I have examined Auditors' Report and financial statements prepared by Riddell, Stead, Graham and Hutchison, Certified Accountants of Windsor, Ontario, attached, and that said statement correctly sets forth assets and liabilities of Western Motor Corporation Limited as of August 31, 1926. And I do further make oath and state that Western Motor Corporation Limited has no liabilities other than those shown in said Auditors' statement attached.

The Motor Corporation had a share capital of \$100,000, divided into 10,000 shares of \$10 each, of which 7,500 shares were to be preference shares, non-participating and non-assessable, entitling the holders thereof to a first, fixed, cumulative dividend of 8 p.c. per annum. The financial statement of Riddell & Co. shows that 2,981 preference shares, representing \$29,810, fully paid, had been issued. It also states that the sum of \$1,028.56 had been paid for dividends, which admittedly refers to dividends on preference shares. The White Star Company subsequently obtained a financial statement from its own auditors to which a note was appended stating that "at October 6, 1926, cumulative preferred stock dividends amounting to \$2,518.33 for the period from June 30, 1925, to September 30, 1926, had not been declared." It is therefore clear that the \$1,028.56 paid for dividends on preference shares were for dividends declared for some period anterior to June 30th, 1925.

What ensued between the parties after the receipt of the financial statement and affidavit may be briefly stated.

On October 6th, 1926, the White Star Company wrote to the appellant stating that it accepted the option and that its acceptance was based upon the statement of assets and liabilities as set forth in the statement of Riddell & Co. which he had furnished the Company. When the time

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for settlement arrived (all other conditions for placing the White Star Company in control and having its nominees elected as directors of the Motor Corporation having been fulfilled), a difficulty was encountered with regard to the undeclared and unpaid dividends on preference shares mentioned in the audit of the White Star Company's auditor. The appellant at the trial frankly admitted that the dispute arose as a result of the fact that Riddell and Co. did not show cumulative dividends outstanding against the preferred stock, while the White Star Company's auditors showed these dividends as being charges against the Motor Corporation. The amount in dispute was \$3,158.12 (it does not appear how it was made up), and the appellant admits that the money was paid into the Canadian Bank of Commerce in a trust account, with a letter stating that it was to be paid out on the determination of this question.

An application was then made to the court for judgment to declare and determine to whom the \$3,158.12 paid into the bank should be paid. On this application, Mr. Justice Logie directed that an issue should be tried between the applicant, Butler, plaintiff, and Fairhall, defendant, this issue to be as follows:

The plaintiff affirms and the defendant denies: That the cumulative dividends on the outstanding preferred stock of the Western Motor Corporation, Limited, from January 1, 1925, to August 31, 1926, undeclared and unpaid as of August 31, 1926, constitute a liability under the contract that is not disclosed in Riddell, Stead, Graham & Hutchison's report of the said company as of that date, and that this liability, in pursuance of the contract, is to be borne by the Respondent Fairhall.

It is clear that anything outside this issue is irrelevant, and therefore the appellant cannot be heard to contend, as he did in the courts below as well as on this appeal, that he had given notice to the officers of the White Star Company, before they finally accepted the option on October 6th, 1926, that these preference dividends had not been declared and that the acceptance was made with full knowledge of this fact. The only question with which we are concerned is that stated in the issue on which the parties proceeded to trial.

The learned trial judge (1) considered that the undeclared dividends were not a liability of the Motor Corpora-

tion and therefore did not require to be disclosed in the auditors' report furnished by the appellant. He also relied on the fact that the White Star Company had accepted the option with full knowledge that these dividends had not been declared.

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This judgment was reversed by the Second Appellate Divisional Court of Ontario, Latchford, C.J. and Masten, J.A. dissenting (1).

The majority of the learned judges were of the opinion that within the meaning of the option and its acceptance the undeclared dividends on preference shares were a liability of the Motor Corporation which the appellant should have disclosed in the report furnished by his auditors, and consequently that the issue should be determined in favour of the respondent.

The dissenting judges agreed with the trial judge that the undeclared dividends were not such a liability. But they also took another ground, fully explained by Mr. Justice Masten, and which, with all deference, appears to me to be based on a misconstruction of the issue. This ground, Mr. Justice Masten observes, was not presented by counsel for the respondent (the appellant here), and is that "the issue is as to whether the dividends in question 'constitute a liability *under the contract*'" (the italics are those of the learned judge). Mr. Justice Masten says that the real issue "is the liability of the plaintiff (Butler; possibly the learned judge meant the defendant Fairhall), not the liabilities of the Company (the Motor Corporation)". He adds:—

The form of the issue might at first sight suggest that the question is, "What is the meaning of the term 'liability'?" But the real question is, does the contract by its terms entitle the purchaser to a reduction of \$3,158.12 in the price which it had agreed to pay for the defendant's shares? I find no such term or condition anywhere in the agreement.

The conclusion of the learned judge on this question is that:

if the plaintiff has any claim it is not a claim in pursuance of the contract, but must be founded in tort on false and fraudulent misrepresentations anterior to the contract.

With respect, the issue states a proposition of law which the plaintiff (the respondent) affirms and the defendant (the appellant) denies. This proposition is that the un-

(1) (1927) 61 Ont. L.R. 305.

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declared dividends constitute a liability under the contract (i.e. the option and its acceptance under conditions agreed to by the appellant) not disclosed in the report of Riddell & Co. on the Motor Corporation, and that this liability, in pursuance of the contract, is to be borne by the appellant Fairhall.

I think it is unquestionable, as shewn by the admissions of Fairhall at the trial above referred to, that the intention of the parties was that if the court came to the conclusion that these undeclared dividends were a liability within the meaning of the contract, which should have been disclosed in the financial statement, this liability should be borne by Fairhall, and that, if the court so decided, the sum of \$3,158.12 paid into the bank to await the decision on the issue should go to the respondent.

This being the only point in the case, my opinion is that within the meaning of the contract, as understood by the parties, the undeclared dividends on preference shares were a liability which should have been disclosed in the report of the appellant's auditors.

It is *nihil ad rem* that until a dividend is declared no action on behalf of a shareholder lies to enforce its payment, and from that point of view it can no doubt be said that a company incurs no liability until a dividend is declared by it. But it was not in that sense that the White Star Company employed the word "liabilities" in its letter of October 7th. The purchase was of a block of common shares giving the control of the company to the purchaser. It was an essential condition of the respondent's acceptance that the assets and liabilities of the company should be truly shewn in the financial statement of a certified public accountant which the vendor undertook to furnish the purchaser. And for the additional protection of the latter, and so that it could determine whether it was imprudent or unwise to proceed further, the appellant was required to make an affidavit "to the effect that the liabilities of the company will not exceed the amount shown by said accountant's statement." For a purchaser of common stock of the Motor Corporation, undeclared but overdue dividends on its preference shares were certainly a liability of the company, in the sense that he could obtain no dividend on his common shares before the payment of all accrued

dividends on preference shares, whether in fact a dividend had or had not been declared. I would therefore, on this issue, say that these dividends constituted a liability under the contract that was not disclosed by the auditors' report. It follows that this liability must be borne by the appellant in pursuance of the contract.

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The appeal should be dismissed with costs.

*Appeal dismissed with costs.*

Solicitor for the appellant: *W. P. Harvie.*

Solicitors for the respondent: *Furlong, Furlong, Awrey,  
Whyte & St. Aubin.*

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