Wednesday, November 20.

SECOND DIVISION.

WAVERLEY HYDROPATHIC COMPANY *v.* BARROWMAN.

Company—Preference Shares—Issue of Preference Shares unauthorised by Articles of Association—Rights of Allottees.

Preference shares issued by a company in 1876 were in 1895 found to be invalid, because no provision for the issue of such shares was contained in the articles of association.

Held that the allottees of the preference shares were not to be dealt with as ordinary shareholders but as creditors of the company, and were thus entitled to receive back the amount paid for the shares, with interest from the date of the allotment, under deduction of the sums received in name of dividends on the shares.

The Waverley Hydropathic Company, Limited, was incorporated under the Companies Acts 1862 and 1867, upon 28th May 1869. By the memorandum of association it was provided as follows:—(Fourth) The liability of the members is limited; (Fifth) The capital of the company is £12,000 sterling, divided into 480 shares of £25 each. Along with the memorandum of association there were registered articles of association which contained provisions for the increase of the company's capital, but did not confer upon the company power to issue preference shares.

By special resolutions in 1871 and 1872, the nominal capital of the company was increased to £36,000, divided into 1440 shares of £25 each. Of these shares 880 were issued and fully paid up, making a paid-up capital of £22,000.

By special resolution agreed to at an extraordinary general meeting of the company held on 25th March 1874, certain additions to and alterations and amendments on the company's articles of association were approved of, and the amended articles of association were confirmed at a subsequent general meeting of the company on 9th April 1874. The amended articles of association provided, *inter alia*, that "new capital shall be subject to all the provisions herein contained, and when paid up shall participate in all the privileges pertaining to the pre-existing capital, or the new capital may be raised by preference stock bearing a fixed rate of dividend, as the company may then determine."

By special resolution dated 15th April, and confirmed 1st May 1876, it was resolved:—"That the remaining unissued 560 shares of the nominal capital of the company shall be preference shares; and that the directors may, from time to time, with the consent of a general meeting, issue such portions thereof as such meeting may authorise, subject always to the following conditions, viz., (1) That such preference shares shall be payable in full within one month after allotment; (2) That such preference shares shall bear a yearly rate of dividend, to be fixed by the general meeting at which such preference shares shall be authorised to be issued, and that such dividends shall be payable yearly out of the first annual profits of the company, to be expressly set apart for that purpose, before paying a dividend to the ordinary shareholders; (3) That in case the profits of any year shall not be sufficient for the payment of said preferential dividend, such profits shall be divided, so far as they will extend, among the holders of such preference shares, *pari passu*, and the deficiency shall be made good out of the profits of succeeding years; (4) That, for behoof of the company, the directors shall have a prior right to purchase at par, from the registered owner thereof, any of such preference shares, for which instrument of transfer may be presented for registration, or, at any time after ten years from the date of issue, the company shall have power to purchase or redeem at par any of such preference shares from the holder thereof, who shall be bound to transfer said shares to the company on being required to do so; (5) That, in the event of a winding up of the company before said preference shares shall be redeemed by the company, the holders thereof shall rank *pari passu* and be entitled to be repaid at par said preference shares out of the free assets of the company, with all deficiencies of dividends, should the profits in any year not be sufficient to pay the fixed rate of dividend at which such shares shall have been issued, and that in preference and priority to the holders of the ordinary shares of the company; but interest shall in no event be chargeable upon such deficiencies of dividend; (6) That such preference shares shall not entitle the holder thereof to any vote, or to be present at any meeting of the company, or to take any part in the management of the affairs of the company, or to participate in any of the rights or privileges pertaining to the ordinary shareholders under the articles of association; (7) That, should the whole of the preference shares authorised to be issued at any general meeting not be taken up, the remainder may, by a general meeting, be reconverted into and issued as ordinary shares; (8) That anything contained in the articles of association contrary to the foregoing conditions shall be held to be inapplicable to such preference shares, and to the holder thereof."

In terms of the foregoing resolution, 419 of the remaining unissued 560 shares of the nominal capital of the company were from time to time issued by the directors, with the consent of general meetings of the company, as preference shares, with a fixed rate of dividend at 5 per cent. per annum, producing a capital sum of £10,475. Of these shares, 234 were issued in 1876, 106 in 1877, and 79 in 1878. In the circulars issued to invite application for these shares, in the forms of application, and in the letters of

allotment and the share certificates, the shares were described as preference shares. On the back of each share certificate was printed a copy of the special resolution of 15th April 1879. The holders of these shares were paid a preferential dividend at 5 per cent. out of the profits of the company during the years 1876, 1877, and 1878, but nothing was paid thereafter until the year 1884, when a dividend of 7½ per cent. was paid to these shareholders to account of arrears due to them. In 1885 a dividend of 10 per cent. was paid to account of the arrears, and at Martinmas in that year, and in the year 1886, under agreement assented to by all the preference shareholders, the arrears of dividend upon the preference shares to 31st January 1886 were cleared off by compositions of 6s. 8d., making together 13s. 4d. per pound. At Martinmas 1887, the preferential dividend of 5 per cent. for the year to 31st January 1887 was paid. After the last-mentioned date no profits were divided among any of the shareholders. Dividends upon the ordinary shares were paid for the year ending 31st July 1876 at the rate of 10 per cent., for the year ending 31st July 1877 at the rate of 8 per cent., and for the year ending 31st July 1878 at the rate of 8 per cent. Thereafter no dividend was paid upon the ordinary shares of the company. During the period between 1876 and 1888, when dividends were from time to time paid upon the preference shares, the payment of these dividends was mentioned in each annual report. In all the annual reports of the company since the issue of preference shares, the shares were distinguished as preference and ordinary.

In 1895, when proposals were made for a scheme of reconstruction of the capital account of the company, questions were raised by the company's legal advisers whether the issue of preference shares was *ultra vires* of the company, and whether the same were valid in view of the fact that the original articles of association did not provide for the issue of preference shares. Questions were also raised as to the position of the preference shareholders in the event of it being determined that the issue of preference shares was invalid.

For the determination of these points a special case was presented to the Court by (1) the company; (2) two preference shareholders of the company, viz., David Barrowman, who had succeeded to four preference shares possessed by his father, Robert Borrowman, an original allottee of the shares, and Daniel Lamond, a *bona fide* onerous transferee of twelve preference shares; and (3) John Ferguson, an ordinary shareholder of the company.

The questions of law were:—"(1) Are the said preference shares valid to the effect of entitling the second parties, as the holders thereof, to a preference over the profits and assets of the company? (2) If the first question is answered in the negative, are the second parties ordinary shareholders of the company in respect of the said shares? or (3) Are they creditors of the company to the amount paid for said shares, with interest thereon at the rate of 5 per cent. per annum from the date of such payment, less the amount of sums received by them in name of dividends or composition for dividends upon said shares? (4) If the second question is answered in the affirmative, are the second parties, or either and which of them, entitled to rescind their agreement to become shareholders, and to have their names removed from the register of shareholders in respect of said shares, and to claim repayment from the company of the amount paid for said shares, with interest, and under deduction as aforesaid?"

When the case came before the Court all parties agreed that the first question must be answered in the negative.

On the remaining questions the second parties argued — (1) They were not ordinary shareholders but creditors of the company. There being no power under which the issue of preference shares could be effected, the resolution authorising their issue was entirely nugatory. No ordinary shares were issued under that resolution; the whole of the documents and the conditions subject to which these shares were issued dealt with them as preference shares. When this resolution had been decided to be nugatory, could it be held that the stock issued under it was good ordinary stock? The issue of these shares was beyond the power of the company, and all following on the resolution was void and of no effect—*Ashbury Railway Carriage and Iron Company* v. *Riche*, 1875, L.R., 7 English and Irish App. 653, *per* Lord Chancellor Cairns, p. 673. The second parties being creditors of the company, they are entitled to receive their money back, with interest, less the amount of sums received by them in name of dividends—*Guardian Permanent Benefit Building Society*, 1882, L.R., 23 Ch. D. 440, *per* Jessel, M.R., p. 460. (2) If it were held that the second parties were at present ordinary shareholders of the company, they were entitled to rescind the agreement and claim repayment of their money, the contract having been induced by misrepresentation or founded on mutual error.

Argued for the third party—(1) The second parties were ordinary shareholders of the company, The shares issued under the resolutions of 15th April 1876 were the remaining unissued nominal capital of the company, and although purporting to be preference shares were really ordinary shares. So far as within the power of the company the issue was good, but so far as the issue or the conditions, subject to which the shares were issued, were outside the power of the company, the issue was bad. The company had power to issue shares but not preference shares. The issue was coupled with an illegal condition, viz., that the shares were to be preference shares. This illegal condition must be held inoperative, and those who had been allotted preference shares simply became ordinary shareholders. At the time of the allotment all the facts were within the knowledge of both parties. There had been a mutual error on both sides as regards the law—

Ooregum Gold Mining Company of India v. *Roper*, 1892, L.R., App. Cas. 125; *Liquidator of Milford Haven Fishing Company, Limited* v. *Jones*, November 20, 1895, 22 R. 577. (2) If the second parties were held to be ordinary shareholders, they were not now entitled to rescind their agreement to become shareholders. They were prevented from doing so by reason of acquiescence and delay. All the facts were known to the preference shareholders as well as to the company at the date of allotment, and if the former had wished to exercise the right of repudiation they should have done so timeously. But after all these years, when matters were no longer entire, the second parties were barred by delay from seeking to be restored—*Lawrence's* case *in re Cachar Company*, 1867, L.R., 2 Ch. App. 412; *Kincaid's* case *in re Russian (Vyrsounsky) Iron Works Company*, 1867, L.R., 2 Ch. App. 420.

At advising—

LORD JUSTICE-CLERK—The second parties in this case bought some years ago from the Hydropathic Company certain shares on the footing that they were preference shares, and subject to various conditions. These conditions are peculiar. The fourth of these conditions is that the company has a right to purchase the shares at par, and at any time after 10 years they have power to redeem any of such shares at par. That is a privilege given to the company which is quite inconsistent with the idea that these shares are ordinary shares. Then again under the sixth condition the holders of these shares are not to be entitled to vote or to be present at the meetings of the company, or to take part in the management of the company's affairs, or to participate in any of the rights or privileges of the ordinary shareholders. Now, this is a restriction upon the rights of the purchasers of the preference shares, which puts them outside of the ordinary category of shareholders altogether. There is a further provision applicable to these preference shares, and to no others, viz., that they are to receive a certain fixed rate of dividend, and if the profits are not sufficient in any year to pay the dividend the deficiency is to be made good out of the profits of subsequent years. This again places these shares in a position as unlike that of ordinary shares as possible.

It has now turned out that the issue of preference shares was unauthorised by the articles of the company, and it is not now contended that these shares are preference shares.

In these circumstances the only question which arises is whether the contention of the ordinary shareholders is sound, viz., that as the persons who took these so-called preference shares cannot take them on the conditions in the special resolution, they must now be held to be ordinary shareholders liable to the obligations and entitled to the privileges of ordinary shareholders. I cannot see how this contention can be held to be sound. I do not see any ground for holding that persons who definitely bargained to become preference shareholders can now be held to be ordinary shareholders, when it is found that the company exceeded its powers in creating preference shares. I therefore am of opinion that the second question must be answered in the negative.

The only question remaining is that involved in the third question of law, what is the position of the persons who took the shares believing them to be preference shares? It appears to me that this question must be answered in the affirmative. These persons handed over their money to the company on conditions which the company had no power to make, and received certain privileges which the company could not give. The only course left is that the company must restore all the money they received from the persons with interest, *minus* the amount of the dividends paid on the so-called preference shares.

LORD YOUNG—The shares to which this case refers were applied for and allotted under a resolution of the company, passed on 15th April 1876. The question at the root of all the others is, whether this resolution was legal—whether it was within the power of the company. The parties are agreed that it was not, that it was invalid, and that the allotment of shares under the resolution was not good.

But the substantial question between the parties is not whether the allotment was good, but what was the position of parties after the allocation was made. If the first question is answered in the negative, are the holders of the shares ordinary shareholders, or in other words, is the allotment in terms of the resolution to be so altered as to make it an allotment of ordinary shares, contrary to the terms of the resolution. I have no hesitation in answering that question in the negative. It was *ultra vires* of the company to issue these shares, and that being so, the issue must be held to be of no effect at all. It is impossible to change the contract between the parties into an issue of shares of a totally different character from that specified in the contract.

The next question is, what is the position of a person who took these shares, believing them to be preference shares which the company was authorised to issue. I am of opinion that he is entitled to the remedy of restoration, the ordinary remedy under similar circumstances. There may be cases where an illegal term in a contract may be struck out, leaving the contract to stand without it. But this is not a case of that class. The company desire to change the bargain into something totally different from what it originally was. In such circumstances the proper remedy is restoration, the allottee getting back his money with ordinary interest, I do not say at such a high rate as 5 per cent., but that can be arranged.

LORD TRAYNER—I am of the same opinion. With the consent of all parties, the first question is to be answered in the nega-

tive. It appears to me that this answer, taken in conjunction with the facts before us, leads to a similar answer being given to the second question. If the second parties are not preference shareholders they are not shareholders at all. They applied for and received shares which the directors had no power to give, and when that has been shown, it follows that there is no contract between the parties. These shareholders never asked for ordinary shares and never got them, for the possession of ordinary shares would have entitled them to receive more than 5 per cent., if the company had earned sufficient to distribute a larger dividend, and would have empowered them to attend the meetings of the company, and to take part in the management of the company's affairs, privileges from which they were excluded. Looking at the clauses of the resolution, the two classes of shares are as separate and distinct as two things could possibly be. The preference shares being once held invalid, there is no reason for holding that their owners are ordinary shareholders in the company.

What, then, is the position of the original allottees of these shares? I think their position is that of creditors of the company, and that they are entitled to receive back the money which they paid to the company with interest, less any dividend which they have received. As to the rate of interest, if it cannot be made a matter of agreement between the parties, I should think that 5 per cent was too much, and should be inclined to award something less. As to the position of transferees, I express no opinion, as we have not before us the information necessary for forming one.

LORD RUTHERFURD CLARK was absent.

The Court pronounced the following interlocutor:—

"Answer the first and second questions therein stated in the negative, and in answer to the third question therein stated, find that the first of the second parties is a creditor to the amount paid for said shares, with interest thereon at the rate of 4 per centum per annum from the date of such payment, less the amount of sums received by him in name of dividends, or composition for dividends, upon said shares; and further, find that the facts stated in the case are not sufficient to enable the Court to answer the question so far as affecting the second of the second parties: *Quoad ultra*, find it unnecessary to answer the fourth question."

Counsel for the First Party—W. Campbell—Cullen. Agent—Andrew Tosh, S.S.C.

Counsel for the Second Parties—M'Clure. Agents—Russell & Dunlop, W.S.

Counsel for the Third Party — Cook. Agent—James Skinner, S.S.C.

Friday, November 22.

SECOND DIVISION.

[Lord Low, Ordinary.

CRUIKSHANK *v.* NORTHERN ACCIDENT INSURANCE COMPANY.

Insurance — Accident — Mis-statement in Proposal — Warranty — Construction — "Slight Lameness" — "Paralysis" — Knowledge of Agent Imputed to Company.

The proposal for an insurance against accident contained the question:—"Are there any circumstances which render you peculiarly liable to accident?" To this question the assured answered, "Slight lameness from birth." Annexed to the proposal was a declaration signed by the assured in the following terms:—"I hereby declare and warrant that the above statements are true; that I have not had paralysis, or a fit of any kind . . .; that I have no physical infirmity." The policy incorporated this declaration as the basis of the contract.

At the time when the assured signed the proposal he was lame, but the extent of his lameness was manifest to the agent of the company through whom the negotiations were conducted, and who saw the assured walk across a room.

In an action at the instance of the assured's executrix for payment of the sum insured, the company pleaded that the policy was void on the ground that the above answers and declaration were untrue.

Held (1) that the defenders were not entitled to found on the description "slight lameness" as inaccurate, the extent of the lameness being known to their agent, and he having concurred in so describing it; (2) that the warranty that the assured had not had "paralysis or a fit of any kind" was to be construed as referring to a shock of paralysis in the ordinary sense, and not to local paralysis, resulting in lameness, and caused by a fall in infancy; (3) that the warranty that the assured had "no physical infirmity" must be construed with reference to the specific statements in the proposal, and therefore as referring to physical infirmity other than the lameness which had been disclosed.

In December 1894 Mrs Cruikshank, widow of George Macaulay Cruikshank, patent agent, Glasgow, raised an action, as executrix-dative of her husband, against the Northern Accident Insurance Company, Limited, for £1000, being the amount which, by policy dated 20th February 1883, the defenders promised, subject to the conditions of the policy, to pay to Mr Cruikshank's representatives in the event of his death through accident. The negotiations for the policy had been conducted, on the part of the defenders, by Mr Black, then