Privy Council Appeal No. 3 of 1917

Pacific Coast Coal Mines (Limited) and Others *Appellants,*

v.

John Arbuthnot and Others - - - - *Respondents,*

FROM

THE COURT OF APPEAL OF BRITISH COLUMBIA.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 3RD AUGUST, 1917.

Present at the Hearing:

VISCOUNT HALDANE.
LORD DUNEDIN.
LORD SUMNER.

[*Delivered by* VISCOUNT HALDANE.]

This is an appeal from a judgment of the Court of Appeal of British Columbia, which reversed the judgment of Mr. Justice Clement, who tried the action. The proceedings were brought by the appellants as plaintiffs to set aside a trust-deed dated the 1st March, 1911, made between the appellants and the respondents, the British American Trust Company (Limited), for securing payment of 1,500 debentures of 1,000 dollars each, carrying interest at 6 per cent., and the debentures issued thereunder, and also to recover from certain of the respondents secret profits alleged to have been made by them as vendors to and promoters of the appellant Company.

As to the last claim, it was abandoned in this appeal, it being admitted that at the time when the properties were acquired by the vendors it could not be shown that they had become promoters, and further that rescission had become impossible. To that extent, at any rate, the judgment which allowed this claim at the trial cannot stand. The real question which remains is one on the answer to which the validity of the trust-deed depends, viz., whether an agreement can stand which was made on the 11th February, 1911, between certain of the respondents, the appellant Company and other persons. This agreement was undoubtedly *ultra vires* of the appellant Company unless it was validated by a Private Act of the Legis-

lature of British Columbia passed subsequently to its date on the 1st March, 1911. Under this Act the agreement was validated, but only subject to its adoption by resolution passed by a specified majority of the shareholders called for the purpose of adopting it, and of issuing the debentures already referred to. The decision on the appeal really turns on the single question whether the provision thus required by the validating statute was one of internal management only, the non-observance of which could be cured by the acquiescence of the shareholders, or whether it laid down a condition of the agreement becoming *intra vires*. In the latter alternative, and if it was not observed, it is not in serious controversy that no amount of acquiescence by the appellant Company and its shareholders should cure the defect.

In order, however, to state intelligibly how the point has arisen, it is necessary to refer to the transactions which led up to the agreement and to the passing of the Private Act.

The appellant Company was incorporated under the Provincial Companies Acts on the 21st March, 1908, for the purpose of acquiring and working mining properties and selling the produce. The first directors were the respondents, Arbuthnot, Savage, McGavin, Moran, Reynolds, and two defendants, Wishard and Hodgson, who are not parties to the appeal. The capital of the Company was 3,000,000 dollars, divided into 30,000 shares of 100 dollars each. The property which the Company was incorporated to purchase belonged to the promoters, who were also directors, and remained directors until March 1911, the date of the agreement in controversy. This property consisted of various blocks of land and Government licences for coal prospecting, carrying with them mining rights. These licences had been secured by the defendant Hodgson, and by the time the appellant Company was incorporated, Arbuthnot and others of the directors had become interested in them along with him. One of the blocks of land had originally belonged to Hodgson, for a term under a lease with an option to purchase. He had assigned it to Arbuthnot, who had incorporated a Company, the South Wellington Coal Mines (Limited), to which he sold it. This Company was under Arbuthnot's control. On the incorporation of the appellant Company he transferred to it 3,800 shares which he held in the South Wellington Company, as well as his interest in one of the blocks of land for 350,000 dollars. Two of the other blocks and the licences were at the time of the incorporation of the appellant Company held by a Company called the Vancouver Island Timber Company in trust for the persons interested in them respectively. These persons included Arbuthnot, Hodgson, and others of the directors who are respondents. The promoting vendors appear to have been desirous of so arranging their voting power in the appellant Company that they should be able to exercise a steady control. They accordingly transferred a large number of their shares in it to a holding Company,

incorporated in the Province of Manitoba, by Arbuthnot, who became its president and obtained its proxy. It was named the Pacific Securities Company (Limited). The result of this was to place the controlling power in the hands of the British Columbia group of shareholders, and to leave a body of shareholders in New York, who were represented by the defendant Wishard, in a minority. Hodgson, who was no longer on the Board of the appellant Company, at this point became dissatisfied. His shares were in the pool and in the hands of the Pacific Securities Company, and he could no longer make his influence felt. He, therefore, in June 1910, began an action, the purpose of which was to break up the new pooling arrangement. In this action grave charges were launched against Arbuthnot and his associates, in connection not only with the formation of the Pacific Securities Company, but with the promotion of the appellant Company. Wishard and two others named Kimball and Michener, who also belonged to the group of New York shareholders, were in sympathy with Hodgson, who relied on their co-operation in dethroning the British Columbia group. The latter became alarmed, and the suggestion appears to have emanated from them that the New York group should buy out the British Columbia group by letting them have debentures of the appellant Company in place of their shares and, in addition, for the amount due to them under their contracts with the appellant Company. One Hartman, a lawyer practising in Seattle, was then instructed to act for the New York group in negotiating and preparing an agreement on these lines. This was finally done, with the result that Hodgson's action was dismissed by consent.

The agreement was finally adjusted and entered into on the 11th February, 1911. The parties to it were the respondents Arbuthnot, Savage, and McGavin, of the first part, representing the British Columbia group; Hartman and Michener, of the second part, who were defendants in the present action but did not appear in this appeal, and who represented the New York shareholders; the appellant Company of the third part; Hodgson and an associate, who had an interest in his shares, called Spencer, of the fourth part; and the respondent Reynolds, of the fifth part. The agreement recited the circumstances of the incorporation of the appellant Company and the purchase of its properties, the transfer of shares held in it to the Pacific Securities Company in accordance with a pooling agreement made in 1908; the indebtedness of the appellant Company to the Merchants Bank of Canada and a guarantee for this indebtedness given by certain of the directors; the institution of the Hodgson action; and the holding of shares in the appellant Company by Reynolds. The agreement then provided, among other things, for the dismissal of the Hodgson action without costs; for the execution of a trust-deed to secure debentures; for the issue of 1,500,000 dollars of such debentures, out of which the members of the British Columbia group,

and others whom they represented, were to receive amounts equal to the par value of their respective shares; for the surrender and extinction of such shares, an order of the Court to be obtained if necessary for the purpose; for the consequential reduction of the appellant Company's capital to 2,000,000 dollars; for the holding of the meeting or meetings of shareholders necessary for the ratification and adoption of the agreement and for carrying out its terms; for the ratification and adoption of all the acts of the Vancouver Island Timber Company and of the promoters of the appellant Company, and for a complete release to the latter of all claims against them in connection with such promotion; for the parties making such use of their votes in respect not only of their own shares but of shares which they represented by proxy, as would give effect to the agreement; for an application to the Legislature of British Columbia for an Act to authorise the reduction of capital, the surrender of shares, and the issue of debentures as provided by the agreement, and the agreement itself; and for the resignation of their directorships of the appellant Company by Arbuthnot, Savage, Moran, and Reynolds. The agreement contained other provisions less germane to the questions now raised and which need not be referred to specifically.

The Provincial Legislature was then in session at Victoria, and on the 14th February, three days after the agreement was signed, a petition for a Private Act was presented. A Bill was introduced which became law on the 1st March. In anticipation of the passing of the Act, the directors sent out notices from the appellant Company's office, calling a meeting of shareholders for that day.

But for this statute the directors, had they desired to obtain the reduction of capital contemplated, must have applied to the Court under the Companies Act, 1910, of British Columbia. The application must have been founded on a special resolution which would have required two meetings, and the Court must have satisfied itself that it was cognisant of all possible claims from creditors, and that these creditors had consented or had had their claims satisfied. It is probable that, having regard to the nature of the story of the Hodgson action, and to other matters referred to on the face of the agreement, the Court, had it been applied to, would have made enquiry and looked carefully before pronouncing the order asked for. It was an advantage which would accrue to the directors if they could obtain a Private Act that they would be dispensed both from delay and further scrutiny.

The provisions of the Act which was passed on the 1st March were substantially as follows: After reciting in the preamble the petition for legislative sanction for the reduction of capital, the power to issue debentures, and the validation of the agreement which had been filed with the Registrar of Joint Stock Companies at Victoria, the surrender of shares provided for in the agreement and the reduction of capital to 2,000,000

dollars were authorised. The Company was then empowered, subject to obtaining the sanction of a resolution of 75 per cent. of the shareholders present, personally or by proxy, to issue debentures and execute a trust-deed as provided by the agreement. The agreement itself and all its terms were then—

"validated, ratified, and confirmed, subject to the same being adopted by a resolution passed by 75 per cent. of the shareholders of the Company present, personally or by proxy, at any meeting of the shareholders of the said Company called for that purpose, and for the purpose of authorising the issue of the said debentures after the 14th day of February, 1911, and upon a copy of the said resolutions being filed with the Registrar of Joint Stock Companies at Victoria."

The first question which arises upon these, the words on the construction of which the appeal, in their Lordships' opinion, turns, is whether they make the adoption of this agreement by resolutions passed by the specified majority at a meeting called for the purpose, a condition without the fulfilment of which the agreement would remain *ultra vires* and therefore incapable of being made the act of the Corporation, even if every shareholder joined in attempting to make it so. In their Lordships' opinion this question must be answered in the affirmative. It was argued for the respondents that the procedure directed by the Act was only one of internal management, which had been put within the power of the Corporation, and which the members of the Corporation could therefore effectively unite, in terms or by implication from subsequent action, to treat as in reality performed, notwithstanding the absence of formalities which were necessary only if a minority was sought to be bound by the decision of a majority. It was said that four years had elapsed since the agreement was made and carried out, and that the conduct of the shareholders had shown general and complete acquiescence. The Court of Appeal proceeded on this view of the law. In their Lordships' opinion, it is fallacious. No doubt where some act, such as the granting of an obligation in the course of its business, is put by the constitution of a Company within its power, and certain formalities of administration are prescribed by the Articles of Association which for domestic purposes regulate the duties of the directors to the shareholders, the mere failure to comply with a formality such as a proper appointment or the presence of a quorum of directors, will not affect a person dealing with the Company from outside and without knowledge of the irregularity. He is presumed to know the constitution of the Company, but not what may or may not have taken place within doors that are closed to him. Lord Hatherley's judgment in *Mahony* v. *The East Holyford Mining Company* (7 E. and I. Ap. 869) is for practitioners in Company law the classical exposition of this principle. But the case stands quite otherwise when the act is one which has not, by the constitution of the Corporation, been put within its

power excepting on the fulfilment of a condition. In that event the persons dealing with the Corporation are bound to ascertain whether the condition has been fulfilled. The question which alternative applies is of course one of construction of the statute authorising the act. Their Lordships are compelled to dissent from the view taken by the Judges of the Court of Appeal on this point, and to hold, with Mr. Justice Clement, who tried the action, that unless the condition prescribed by the words cited from the Private Act was literally and in reality fulfilled the agreement remained, what it undoubtedly was apart from the Act, *ultra vires* of the appellant Company.

The question that follows is whether, on the footing of this interpretation, the condition imposed was complied with. To answer this question it is necessary to consider the purpose for which the meeting was directed to be called, the terms of the notice by which this was done, and the circumstances in which the meeting took place.

The trust-deed to secure the debentures was executed on the day the Act passed and was duly registered. It recites that all necessary resolutions of the directors and shareholders had been passed at meetings called to consider them. The shareholders' meeting took place at 3·30 on the 1st March, just half-an-hour after the Act had passed. A shareholder who has to receive notice of a general meeting is entitled, under the 55th of the Company's Articles of Association, to have sent to him a seven days' notice, stating, in the case of special business such as this, the general nature of the business. The notice actually sent was despatched on the 20th February, before the Act had passed. Having regard to the language of the Private Act, their Lordships think that this anticipation of the passing of the statute was competent to the directors, but what remains to be seen is whether the notice gave the necessary information of the purpose of the meeting, and of the general nature of the special business for which it was called. The notice was to the effect that resolutions would be proposed that the Company should ratify and adopt the agreement of the 11th February, and empower the directors to do all things that the Act authorised; that the debentures should be issued and the trust-deed be executed; and tha the capital should be reduced by cancellation of shares. Now the agreement had not been seen by the shareholders generally before the meeting. It is stated to have been filed with the Registrar of Joint Stock Companies at Victoria. Doubtless it could have been inspected there by shareholders who had hurried from Eastern Canada or the United States. But why should they think that it contained the serious matters it did contain? The resolutions of which notice was given to them merely said that an agreement dated 11th February had been entered into and filed with the Registrar. The statement did not inform the shareholders that the debentures proposed to be issued were to be issued to shareholders, some of whom were directors, in exchange for

their shares, nor did they refer to the fact, set out in the agreement itself, that Hodgson had brought an action against the directors and the Company which was being compromised, and that the agreement contained a release by the Company of all claims in respect of promotion which it might have against the directors. If the shareholders were to release possible claims, they ought to have been told of the grave character which Hodgson had attributed to the circumstances out of which he had alleged that they had arisen. Nor was there anything to tell them that as the result of the settlement Arbuthnot in particular would, under the terms of the agreement, cease to be a director and shareholder and would quit the Company with large profits in his pocket. The absence of full notice was particularly inappropriate in the case of those shareholders who had given proxies at dates prior to the agreement, when they could have known nothing of what it was to contain —proxies which were not the less on that account used by the directors at the meeting.

Their Lordships are of opinion that to render the notice a compliance with the Act under which it was given it ought to have told the shareholders, including those who gave proxies, more than it did. It ought to have put them in a position in which each of them could have judged for himself whether he would consent, not only to buying out the shares of directors, but to releasing possible claims against them. Now, this is just what it did not do, and therefore, quite apart from the fact that the meeting was held in half an hour from the time the Act passed and before the shareholders could have had a proper opportunity of learning the particulars of what the Legislature had authorised, their Lordships are of opinion that the notice was bad, and that what was done was consequently *ultra vires*.

This disposes of the controversy. The judgment of the Court of Appeal must be reversed, excepting so far as it dismisses the claim for profits made by promotion, a claim which was given up at the Bar on this appeal. The judgement of Mr. Justice Clement will be restored so far as relates to the first part of its declarations, except that the name of Reynolds will be omitted from the second and third of them, and that the words " pay to the plaintiff Company the amount thereof or " will be struck out of the third. The fifth, sixth, seventh, and eighth declarations, which relate to profits made by promotion, disappear. Declarations 9 to 14 inclusive will be restored, as well as the reservation of further consideration.

Their Lordships do not intend by their judgment to prejudice rights competent to anyone whose rights do not purport to be dealt with by their decision.

As to the costs, their Lordships think that the appellant Company should have the general costs of the action up to and including the trial, excepting that they must pay to the

respondents the costs of the issues on which the latter succeeded at the trial. In the Court of Appeal neither party should have any costs. The appellant Company will have the general costs of the appeal to the King in Council, less half the costs of printing and perusing the record. There will be liberty to apply to the Court of First Instance to give effect to this judgment.

Their Lordships will humbly advise His Majesty accordingly.

In the Privy Council.

PACIFIC COAST COAL MINES (LIMITED) AND OTHERS

v.

JOHN ARBUTHNOT AND OTHERS.

DELIVERED BY
VISCOUNT HALDANE.

PRINTED AT THE FOREIGN OFFICE BY C. R. HARRISON.

1917.