Privy Council Appeal No. 134 *of* 1936

E.B.M. Company, Limited - - - - - - - *Appellants*

v.

The Dominion Bank - - - - - - - - *Respondents*

FROM

THE COURT OF APPEAL FOR ONTARIO

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 11TH JUNE, 1937.

Present at the Hearing :

LORD BLANESBURGH.
LORD RUSSELL OF KILLOWEN.
LORD MACMILLAN.

[*Delivered by* LORD RUSSELL OF KILLOWEN.]

In this case E.B.M. Company, Limited (a company incorporated by Dominion Letters Patent dated the 8th May, 1922, and granted under the Dominion Companies Act) appeals from a judgment and order of the Court of Appeal for Ontario which affirmed a judgment or order of Kelly J. in favour of the respondents, the Dominion Bank.

The relevant facts which led up to the litigation in which this appeal arises must first be stated; the appellant Company being referred to as the old Company, and the respondent Bank being referred to as the Bank.

The old Company (whose name was originally " Carling Export Brewing and Malting Company, Limited," the change of name being effected by Supplementary Letters Patent dated the 24th October, 1930), was formed for the purpose and with the object of carrying on the business of brewers and maltsters in all its various branches, and for other purposes and objects enumerated in the Letters Patent. It also possessed all the powers conferred by section 32 of the Dominion Companies Act. The old Company carried on its business as brewers until June, 1927. Its shareholders at all relevant times were five in number, viz. Charles Burns, Marco Leon, his wife Freda Leon, Harry Low and his wife Norah Low. All five were also the directors of the Company. The ladies each held one share. The rest of the issued capital (over $726,000.00) belonged to the three men in equal shares. The old Company had banking accounts with the Bank at the latter's London (Ontario) and Windsor (Ontario) branches.

By an agreement dated the 14th June, 1927, the old Company sold its undertaking and assets to a company

called Carling Breweries, Limited, which may be conveniently referred to as the new Company. At that time a claim was pending against the old Company by the Dominion Government in respect of certain taxes under the Special War Revenue Act, 1915. The new Company was protected against liability in respect of this claim by the old Company depositing $400,000 Dominion of Canada Victory Loan Bonds with the Bank to meet any judgment which might be obtained against the old Company with respect to the taxes. The bonds were lodged with the Bank, and the terms upon which they held them are shown in a letter of the 26th October, 1927, from the old Company to the Bank's head office in Toronto, which runs thus: —

> "Messrs. Roadhouse and McTague have handed you to-day $400,000 of Dominion of Canada Victory Loan 5½ per cent. Bonds, due 1st November, 1934.
>
> "These are to be held by you to meet any final judgment that may be obtained by the Dominion Government against Carling Export Brewing and Malting Company, Limited, in respect to action now pending with reference to sales and gallonage tax on export sales.
>
> "In view of the fact that this Company and Messrs. Low, Leon and Burns have agreed to indemnify Carling Breweries, Limited, in respect to such arrears of gallonage and sales tax, we would ask you to write a letter to Carling Breweries, Limited, advising them that you hold the sum of $400,000 to meet any judgment that may be obtained against this Company with respect to such taxes.
>
> "It is understood that you are to hold said bonds until any action by the Government with respect to sales and gallonage tax on export is finally disposed of by judicial decision or settlement.
>
> "The coupons on the bonds are to be clipped by you and cheque for interest payments is to be remitted to this Company from time to time during the period the bonds are held by you."

As from the date of the sale to the new Company, the old Company ceased to carry on any business; its only assets consisted of shares in the new Company, cash produced by sales of such shares, and its interest in the Victory Loan Bonds. In May, 1928, the Bank, being duly authorised in that behalf, sold $300,000 worth of the said bonds, and credited the proceeds ($313,250.69) to a special savings account in the name of the old Company. The Bank continued to hold the remaining $100,000 worth of the said bonds.

In addition to their interests as shareholders in and directors of the old Company, Messrs, Burns, Leon and Low carried on other activities in partnership together. With prohibition prevailing in the United States of America, they carried on in partnership a business (referred to in the judgments as the boot-legging business) of exporting beer and spirits to the United States, the beer being in large measure, if not wholly, purchased by them from the old Company while the old Company was still carrying on business, the spirits being purchased elsewhere. They also embarked upon a real estate business, making large purchases of land in Windsor, Toronto and Montreal. They each had separate personal accounts with the Bank at

different branches, and also an account in their joint names, all separate and distinct from the accounts of the old Company.

On the 3rd July, 1928, the Bank made an advance to Messrs. Burns, Leon and Low of $1,500,000 in connection with certain land which they had purchased in Dominion Square, Montreal, taking as security (among other securities) a hypothecation by the old Company of 59,500 shares of the capital stock of the new Company which stood in the name of the old Company. This hypothecation was the subject of a resolution of the old Company passed at a general meeting of the old Company, at which all the shareholders were present in person or by proxy, in the following terms:—

> "That resolution respecting hypothecation of 59,500 shares of the stock of Carling Breweries, Limited, held by this Company to the Dominion Bank as set forth in resolution passed at a meeting of the directors this date, be, and the same is hereby approved, ratified and confirmed. Carried unanimously."

At that date there was apparently a sixth shareholder, Mrs. Burns, but she died shortly afterwards.

This loan was to be repaid by the three partners as to $500,000 by 21st December, 1928, and as to $1,000,000 by 21st June, 1929. The old Company had no concern or interest in the Dominion Square venture. It is, however, true to say that large sums had at different times, after the sale to the new Company, been paid out of the old Company's assets to each of the three partners, no doubt (though erroneously) upon the footing that so long as sufficient assets remained undistributed to answer the paid up capital, those who held substantially all the shares might properly take payments on account of the moneys which would ultimately be receivable by them on a winding-up. The moneys so received by Messrs. Burns, Low and Leon respectively were no doubt applied in whole or in part in financing their partnership venture in real estate.

The partners failed to pay off the Bank's loan; and on the 12th July, 1929, a meeting took place at the head office of the Bank at Toronto, at which there were present the three partners, Mr. MacAgy (the Bank's chief inspector), Mr. Milliken (the Bank's solicitor) and Mr. Ashforth (a supervisor at the Bank's head office). There is some dispute whether a Mr. Springsteen (who is said to be a solicitor who acted for the partners, or for the old Company, or for both) was present or not, but in their Lordships' view it matters not whether he was present or absent. The object of the meeting was to discuss the position in regard to the debt which was due by the three partners to the Bank, and for which the Bank held the securities above referred to. The partners (as appears from a letter of the 8th July, 1929, from the Bank's Windsor branch to the head office) had already agreed to give further security by mortgaging to the Bank certain properties (described as Border Cities Properties) which they owned in Windsor and in Toronto. Two mortgages had in fact been prepared by the Bank's solicitors

in Windsor and were actually dated the 20th June, 1929, although they had not then been executed by any of the persons made parties thereto, viz. the three partners, Mrs. Leon and Mrs. Low, the ladies joining to bar their dower. On the occasion of the meeting of the 12th July, 1929, according to the evidence, the two mortgages were signed by the three partners; but the Bank, desiring further security, required that they should be given a charge on the old Company's interest in the moneys and bonds held by the Bank to answer the Government's claim against the old Company. A document was accordingly prepared by Mr. Milliken upon information given to him by Mr. MacAgy. It was signed by the three partners and was taken away by Mr. Burns for the purpose of having the seal of the old Company affixed thereto. This is the document which has given rise to the present litigation, the old Company denying and the Bank asserting that it is an effective security binding upon the old Company. In this connection it is important to observe that the evidence establishes that the Bank made no stipulation that the execution of the document should be approved by a resolution either of the directors or of the shareholders of the old Company, and made no inquiry as to the authority for its execution by the old Company.

The terms of the document must now be indicated. It recites the indebtedness of the partners to the Bank, and that they owned the total issued capital stock of the old Company; it recites the facts as to the deposit of the bonds, the sale of same and the deposit of the cash proceeds. It then proceeds as follows:—

> " AND WHEREAS the said Bank has required from the undersigned individuals further security for the payment of the said indebtedness of the said individuals to the Bank, as the consideration for which the Bank will refrain from immediately taking proceedings against the said undersigned individuals to recover the said indebtedness.
>
> " NOW THEREFORE in consideration of the premises, the undersigned Company and individuals do and each of them doth hereby assign, transfer and set over unto the said the Dominion Bank all the right, title and interest of them and each of them of in and to the said hereinbefore mentioned bonds and proceeds thereof, subject, however, to the payment thereout of the amount of any final judgment that may be obtained by the Dominion Government against the undersigned Company in respect to the action above mentioned.
>
> " IT IS UNDERSTOOD AND AGREED that the said Bank shall hold the said bonds and proceeds thereof to the extent to which the same are hereby assigned to the said Bank as further continuing additional security for the payment of the joint and several indebtedness from time to time of the undersigned individuals to the said Bank and interest thereon, and that in connection with the said bonds and proceeds thereof hereby assigned to the said Bank it shall have all the powers, rights and privileges contained in a certain agreement of even date herewith executed by the undersigned company and individuals.
>
> " DATED at Toronto this twelfth day of July, A.D. 1929."

In addition to the signatures of the three partners, there appears upon the document the old Company's seal accompanied by the signature of the president, Charles Burns and

that of Marco Leon as secretary. This is in conformity with number 10 of the old Company's by-laws which provides that the president " may execute bonds, mortgages and other contracts on behalf of the Company and affix the corporate seal to any instrument requiring the same, and the seal when so affixed and attested by his signature and the signature of the secretary shall be valid and binding on the Company." No resolution was ever passed either by the Company or by the directors authorising the creation of a charge upon the old Company's interest in the said bonds and cash to secure the indebtedness to the Bank of the three partners: but at some time shortly after the 12th July, 1929, the old Company's seal was in fact affixed to the document of charge. At that time the position of the litigation between the Dominion Government and the old Company was as follows:—By a judgment of the Exchequer Court, on the 29th April, 1929, the Crown had obtained judgment for a sum equal to about 17 per cent. of its claim. An appeal by the Crown and a cross-appeal by the old Company to the Supreme Court of Canada were pending. These eventually resulted in a judgment, on the 4th February, 1930, in favour of the Crown for the full amount claimed.

The rest of the story is soon told. In December, 1930, the Bank sold the balance of the $100,000 bonds for $103,904; and after crediting the old Company with the premium, carried the cash balance $100,000 to the special savings account. In February, 1931, the Judicial Committee advised His Majesty that the judgment of the Exchequer Court should be restored. On the 3rd June, 1931, the old Company's solicitors wrote to the Bank requesting them to pay the amount due to the Government and to return the balance to the old Company. In reply the Bank claimed that the balance was hypothecated to the Bank, and on the 30th June wrote a letter to the old Company stating that they had paid the Government's claim and had applied the balance in reduction of the indebtedness to the Bank for which it had been given as security. The old Company then commenced the present action (the writ being issued on the 21st October, 1931), claiming the balance of the cash proceeds of the bonds remaining in the Bank's hands after payment of the Government's claim.

The action was tried by Kelly J. who held that the Bank was entitled to apply the balance of the cash proceeds of the bonds in satisfaction of the indebtedness of Messrs. Burns, Leon and Low and made an order accordingly. The old Company's appeal from this judgment was dismissed with costs. It is, however, to be observed that the views expressed by the various Judges as the basis of their decisions differ widely, and are not in all respects consistent.

Their Lordships feel some uncertainty as to what was the real basis of the decision of the Trial Judge. He held that the three partners " were the owners of all of the shares of the capital stock of the plaintiff, but two of the said shares were held one each by two other parties as qualifying shares." By this he seems to mean that the beneficial

interest in the two shares was not in the two ladies, but in the partners or some of them, so that the three partners were the only persons beneficially interested in the stock of the old Company. All that can be said as to this is that such a view is founded upon no evidence in the case, and is irreconcilable with the fact that the ladies were directors, and with section 103 of R.S.C. 1927, c. 27 which provides that no person shall be elected as a director or appointed as a director to fill any vacancy unless he is a shareholder owning stock absolutely in his own right. Moreover the Bank were aware of the true position, for Mr. MacAgy in his evidence stated that the Bank's information was that the "wives owned the qualifying shares." The matter is of importance in connection with the judgment of Kelly J., because the greater part thereof rests upon the foundation that the three partners were the sole owners of all the shares in the old Company. He came to the conclusion that the business of manufacturing beer carried on by the old Company, and the "boot-legging" business carried on by the three partners constituted one business carried on for the benefit of the three individuals. This is what their Lordships understand the learned Judge to mean when he used the following language:—

> "Is it not a reasonable inference that these three persons were the sole owners of the shares of the plaintiff Company's capital stock, and carrying on business in connection with the Company in a sort of partnership or association in a common business enterprise, no longer needed, or in any event deemed they no longer needed, to keep a share register, no one but themselves being concerned therein. This appears to me to be one of the significant indications that there was a community of interest between, and of operation in the business carried on by, plaintiff and by Low, Leon and Burns the benefit resulting from each accruing to these three persons, whether carried on in the name of or by the plaintiff, or in the name of or by these three."

Having arrived at this conclusion he then proceeded to consider the position as he considered it existed on the 12th July, 1929. He states it thus:—

> "The benefit of any surplus of the bonds or the money so held by the defendant in excess of what would be necessary to pay this final judgment when delivered would enure to the plaintiff, and through it to these three persons who owned all the capital stock of the plaintiff, with which they were so intimately associated in the business in which they were both engaged."

The learned Judge, however, seems to have overlooked the all important facts, (1) that even if it were the fact (of which their Lordships can find no evidence) that the old Company was concerned in the "boot-legging" business of the three partners, that concern must have ceased when the old Company had ceased to manufacture beer in 1927, and (2) that the evidence clearly established that the old Company had never been in any way concerned in the only business of the partners which was relevant to the transaction of the 12th July, 1929, viz. the real estate business. Their Lordships feel unable to support the decision of the learned Trial Judge if and in so far as it is based upon the view that the old Company's business and

the business of the three partners was one business, the assets of which could be disposed of at the will of the three individuals. That appears to them to be a view which can not be supported either in law or upon the evidence in the case. Towards the end of his judgment the learned Judge appears to base his decision upon another and a different ground, for he says, "On the facts as I see them and on the authorities, my opinion is that the document attacked by the plaintiff was not *ultra vires*." By that their Lordships understand him to mean that the transaction was within the powers of the old Company, and also within the powers of the directors to carry out on their own initiative without the specific authority of the old Company conferred by a resolution of a general meeting. If this be the true ground of the decision, the previous consideration of the inter-relation of the businesses of the old Company and the three partners would appear to be unnecessary and irrelevant. Their Lordships, however, for reasons which will appear later, feel unable to support the judgment upon this ground either. The learned Judge refers also to the fact that the impeached document is correctly executed by the old Company in accordance with the provisions of the old Company's by-laws; but their Lordships do not understand him to hold that by reason of that fact alone, the document must be binding on the old Company; or to mean more than that the formalities required for the execution by the old Company of a document, which in other respects was a proper act of the old Company, had been duly observed.

In the Court of Appeal divergent views were expressed. Riddell J.A. would, their Lordships think, have allowed the appeal, but for the fact that he thought from the evidence "that the Company was a sham simulacrum or cloak and that its business must be regarded as the business of these three," meaning thereby the three partners. He thought that the true position was that the old Company, although a separate legal entity, was acting as the agent of the three partners, and was carrying on as such agent not the business of the old Company, but the business of the three partners. If this view were correct in fact or in law, the result would undoubtedly be clear; the business and its assets (including the bonds) would belong to the three partners, who could charge them to secure their indebtedness. Indeed no execution of the charge by the old Company would be required at all, for the purpose of passing the beneficial title to the bonds. But such a view (although Riddell J.A. seems to have thought otherwise) is directly opposed both to the evidence in the case, and to the principles and decision in *Salomon* v. *Salomon* ([1897] A.C. 22). It was never suggested, nor could it on the facts of this case ever have been suggested, that the business of brewing beer, which was carried on by the old Company and which in 1927 was sold by the old Company to the new Company, belonged to the three partners, or was carried on by the old Company as their agent. In point of fact at the crucial date (July, 1929), the old Company was not carrying on

any business at all. Neither was it ever suggested, nor could it on the facts of this case ever have been suggested, that the bonds were not in fact and in law the assets of the legal entity the old Company, but were the assets of the three individuals who constituted three out of the five shareholders of the old Company. So to suggest or so to hold would be directly contrary to the views expressed in *Salomon* v. *Salomon*. Many citations from the speeches in that case might usefully be made. For the present one will suffice. Lord Halsbury puts his view in the form of a dilemma thus:—

> "Either the limited Company was a legal entity or it was not. If it was the business belonged to it and not to Mr. Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not."

In truth Riddell J.A. appears to have been misled by certain words used by Lord Cozens-Hardy M.R. in the *Gramophone* case ([1908] 2 K.B. 89 at p. 96) in which he states:—

> "I do not doubt that a person in that position [i.e., who owns all the shares in a company] . . . may cause such an arrangement to be entered into between himself and the company as will suffice to constitute the company his agent for the purpose of carrying on the business, and thereupon the business will become for all taxing purposes his business."

But this can only mean that on the facts of a case it may appear that the legal entity has not become the owner of a business, but is merely carrying on as agent for another person a business which is the property of that other person: just as on the facts of a case it might appear that an individual who was carrying on a business was not the owner thereof, but was carrying it on as agent for another person who was the owner thereof. Lord Cozens-Hardy did not mean, and in the face of the *Salomon* case could not mean, that notwithstanding that a business is in fact and in law the property of a separate legal entity, a limited Company, it could be held for taxation purposes that the business was the property of some other person, and that the Company was carrying on the business as agent for that other person. That this is so is made clear in another taxation case, viz. *C.I.R.* v. *Sansom* ([1921] 2 K.B. 492). In that case all the shares in a limited company save one were owned by one man Mr. Sansom, who (as the phrase goes) had turned his timber business into a company. The company never distributed any dividends, but it made loans to Mr. Sansom at different times without security and without interest. The company went into voluntary liquidation. The loans were not repaid, but were taken into account when Mr. Sansom received his share of the assets in the liquidation. It was sought to charge Mr. Sansom with super-tax on the loans. The Special Commissioners in the case which they stated, found that the company was a properly constituted legal entity, that it had power to make loans to such persons and on such terms as it should think fit, and that it did make such loans to Mr. Sansom. They discharged the assessment. Rowlatt J. made an order remitting the case to the Com-

missioners to determine (*a*) whether the company in point of truth and fact carried on the business or whether Mr. Sansom carried it on; and (*b*) whether if the company carried on the business it did so as agent for Mr. Sansom, or whether it carried it on on its own behalf for the benefit of the corporators. On appeal this order was discharged and the decision of the Commissioners was affirmed, on the ground that the existing findings of the Commissioners involved the view that the business was the property of the company and therefore negatived the possibility that the company was carrying on as agent for Mr. Sansom a business which belonged to Mr. Sansom.

Their Lordships are unable to support the decision in favour of the Bank upon the grounds suggested by Riddell J.A. They believe it to be of supreme importance that the distinction should be clearly marked, observed and maintained between an incorporated company's legal entity and its actions, assets, rights and liabilities on the one hand, and the individual shareholders and their actions, assets, rights and liabilities on the other hand.

Masten J.A. (whose judgment was concurred in by Latchford C.J.A. and Fisher J.A.) was of opinion that the Company was not a sham or cloak for the three partners, and did not act as agent for them. He drew attention (and rightly as their Lordships think) to the grave risk of introducing confusion into the settled principles of company law. He held, however, that the impeached transaction was *intra vires* the Company upon the following grounds; that under its Letters Patent and the Dominion Companies Act the Company had power to join with the three partners as co-adventurers; that the evidence established that the Company and the three partners were co-adventurers in the " boot-legging " business; and that—(the words of the learned Judge must now be quoted) :—

> " In my opinion the co-adventure of Low, Burns, and Leon with the plaintiff Company still continued when exhibit 11 "—the impeached document—" was executed, and that document was executed and delivered as a part of the winding-up of the co-adventure and was within the powers of the plaintiff Company."

Their Lordships find it difficult to justify the view of the facts upon which this decision is based. As already stated there is no evidence that the old Company was concerned in the " boot-legging " business; the old Company had sold its business of manufacturing beer in 1927 (not in 1929 as the learned Judge mistakenly thought); the old Company had no kind of interest in the real estate business of the three partners; the impeached document was executed in relation to *that* business, and in no wise in relation to the liquor export business of the three partners. It seems impossible to support the foundation upon which the learned Judge based his opinion that the transaction was *intra vires* the old Company. Upon the assumption, however, that the transaction was *intra vires* the old Company, Masten J.A. proceeded to consider the objection that the transaction could not stand as being beyond the powers of the directors to

apply the old Company's assets for their personal benefit, without the sanction of the Company in general meeting duly obtained.

He held that the transaction could stand because it was a transaction which was "entirely proper and warrantable in the interests of the Company itself." He held it to be in the interests of the old Company on the ground that if the document had not been executed, the Bank could have taken in execution the shares in the old Company owned by the three partners, and could then have proceeded to wind up the old Company, a proceeding which, he said, it was desirable to avoid, in order that the old Company might dispute its liability to the Dominion Government if necessary by appeal to His Majesty in Council: and he pointed out that that appeal "proceeded to the Privy Council to the great advantage of the Company." These last words ring strangely, for upon the footing that the judgment which contains them is correct, it is difficult to see that anyone derived advantage from the result of the appeal except the Bank and the three partners whose personal indebtedness to the Bank was *pro tanto* discharged. Their Lordships are unable to appreciate how the Company by depriving itself of its main asset, could be helped in its litigation with the Dominion Government, and they are of opinion that the benefit to the Company upon which Masten J.A. based this part of his judgment is not only incapable of bearing the weight assigned to it but is in fact non-existent. But apart from this consideration, the judgment cannot be sustained on its second ground because, as will be pointed out later, if directors misuse their powers as directors for their own advantage, the transaction is as against the Company of no effect, and the Court will not inquire whether the Company derived any benefit from the transaction.

Davis J.A. held that the transaction was *intra vires* the old Company in view of "the wide specific powers set out in the Letters Patent together with the ancillary statutory powers possessed by it under the Act." Upon the question whether it was *ultra vires* the directors as an improper use of their powers, he was of opinion (1) that the Bank was entitled to rely upon the statement, which the old Company was precluded from disputing, in the document that Low, Leon and Burns owned the total issued capital stock of the old Company; (2) that a meeting of the shareholders to ratify the transaction was a mere formality; (3) that a Company is bound in a matter *intra vires* the Company, by the unanimous agreement of all its incorporators and (upon the authority of *Parker* v. *Reading* [1926] 1 Ch. 975) is so bound without any resolution of the Company in general meeting, and (4) that the plaintiff had not shown that the old Company had not derived benefit from the transaction. He therefore held that the appeal should be dismissed. Their Lordships understand this judgment to be based upon an estoppel which reduced the number of shareholders in the old Company to the three partners, whose unanimous agreement, without any resolution in general

meeting, operated as a ratification by the old Company of the disposal of its property for the benefit of some of its directors. Their Lordships find it unnecessary to express any view as to the correctness of the decision in *Parker* v. *Reading*, or as to the view that the unanimous agreement of all the shareholders of a Company, ascertained otherwise than in general meeting, is capable of operating in law as a ratification by the Company, because in their opinion no ground exists for the alleged estoppel. The statement as to the ownership of the stock which is contained in the document was, as has already been pointed out, not only untrue but was known by the Bank to be untrue. With the disappearance of the estoppel, the foundation of this judgment fails.

In the argument before their Lordships' Board the case for the Bank was argued in one respect on somewhat different lines from those indicated by the judgments in the Ontario Courts.

So far as concerns the question whether the impeached transaction was one which was *intra vires* or *ultra vires* the old Company, their Lordships had the privilege of listening to close and careful arguments from each side. They do not, however, feel called upon to decide this point; because without in any way expressing a view that such a transaction as is here in question, was *intra vires* the old Company, they are prepared to tender their advice to His Majesty upon the assumption in favour of the Bank that the transaction was one within the powers of the old Company.

That leaves for consideration the question whether the transaction was one which it was within the powers of the directors to carry out, and if not, whether their unauthorised act had in some way been ratified, so as to become binding upon the old Company.

Counsel for the Bank did not suggest that the old Company was in any sense a sham. His argument was that the hypothecation by the old Company of its property to secure the debt of its directors, was an act done by the old Company in its own interest in order to protect its shareholding in the new Company which by resolution of the shareholders in general meeting had already been given to the Bank as security for that debt; and that any defect occasioned by the incapacity of the three interested directors to be the means through which the old Company acted in the matter, was cured by the fact that all the shareholders approved and authorised the transaction. The Bank, he added, had no notice that anything out of the ordinary was involved. In these circumstances he contended that the document was binding on the old Company.

Their Lordships cannot accede to this argument.

In the first place it would seem that this suggestion that the motive which influenced the hypothecation by the old Company was a desire to protect its shareholding in the new Company, was advanced for the first time before their

Lordships' Board; there is no trace of it in any of the Ontario judgments. That, however, need not be a fatal objection to the argument. What is fatal is the fact that the evidence points all the other way. The old Company's shares in the new Company were in no way protected; these remained in the same jeopardy. W. C. MacAgy's evidence is to the following effect:—

> " Q. Was any promise made to anyone upon the faith of this document exhibit 11, or in consideration of its being given, was any promise or undertaking given by the Bank to anyone?—A. I think the understanding was that we agreed not to unduly press for repayment of our advance at once if they gave us this security.
>
> " Q. From whom?—A. From Low, Leon and Burns.
>
> " Q. Have you any recollection of anything being said about it?—A. No, I have not.
>
> " Q. Was there at any time any arrangement or agreement—I do not mean necessarily in writing, but an agreement binding the Bank——
>
> " Mr. TILLEY: There are two things there.
>
> " HIS LORDSHIP: Leave out the binding of the Bank part of it.
>
> " Mr. ROBERTSON: Very well.
>
> " Q. Was there any agreement or arrangement that the Bank would give any extension of time?—A. No, I do not think so.
>
> " Q. Was there any enquiry made by you or anyone on behalf of the Bank as to the authority of anyone to give this document on behalf of the Company?—A. No.
>
> " Q. Were any representations made as to the authority of anyone to give this document on behalf of the Company?—A. No.
>
> " Q. Was there any request that the Bank should pass by-laws in connection with it?—A. No.
>
> " Q. Was there any request that a meeting, either of directors or shareholders, should be held in connection with it?—A. No.
>
> " Q. Was any information given to the Bank as to whether a meeting of shareholders or a meeting of directors was held in connection with it?—A. No.
>
> " Q. Had the transaction, that is the giving of this document exhibit 11, any other purpose than to further secure the Bank in respect of the indebtedness of Low, Leon and Burns?—A. No, I do not think so."

Nor was any attempt made in the cross-examination on behalf of the Bank of this friendly witness, to show that the question of protecting the old Company's shareholding in the new Company had ever entered the mind of anyone. Nor can it, in their Lordships' opinion, be truthfully said that all the shareholders approved or authorised the transaction, even assuming that such approval or authorisation not given in general meeting would constitute the equivalent of a ratification by the old Company. As already indicated their Lordships cannot, in the face of section 103 of the Dominion Companies Act, and of the fact that Mrs. Leon and Mrs. Low were directors, accept the view that these ladies were not the beneficial owners of the shares which they held. Neither the pleadings nor the evidence establishes that they were not such beneficial owners, or that they approved or authorised the transaction in question. Nor should any such inferences be drawn in a case in which

the corporators could have been subpoenaed to give evidence, but have not been called.

But, further, their Lordships are of opinion that it is impossible by the application of any proper test to affirm that this transaction was for the old Company's advantage or benefit. Its interest in the bonds was its principal, if not its only free asset, available for the purpose of raising funds which would enable it to conduct to its end the litigation with the Crown. The suggestion that it was beneficial to the old Company, to deprive itself of its means of securing to itself the surplus value of that asset, in order that that surplus value should be applied for the purpose of discharging the private debts of its directors, is a suggestion to which their Lordships cannot accede. They view the transaction as one wholly detrimental to the interests of the old Company.

Moreover, even if (contrary to their Lordships' opinion) some benefit did accrue to the old Company from the transaction, the overriding fact remains that the old Company (acting through its directors and not by its shareholders in general meeting) purported to apply its property for the benefit of those directors. In such a case it is well settled that the Court will treat the transaction as unenforceable, and refuse even to inquire whether the Company has derived any benefit from it: and that on the ground that the Company has not received the protection to which it is entitled.

In the case of *Aberdeen Railway Company* v. *Blaikie* (I. Macqueen 461) Lord Cranworth L.C. used the following language which seems appropriate to the present case:—

> " This, therefore, brings us to the general question, whether a director of a railway company is or is not precluded from dealing on behalf of the company with himself, or with a firm in which he is a partner.
>
> " The directors are a body to whom is delegated the duty of managing the general affairs of the company.
>
> " A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.
>
> " So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.
>
> " It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the interest of the cestui que trust, which it was possible to obtain.
>
> " It may sometimes happens that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee, have been as good as could have been obtained from any other person—they may even at the time have been better.

"But still so inflexible is the rule that no inquiry on that subject is permitted. The English authorities on this head are numerous and uniform."

Their Lordships are conscious that in the result the Bank will be deprived of a security which will revert to the old Company, and that the Bank will only benefit from the old Company's success against the Dominion Government in its appeal to His Majesty in Council, to the extent to which the interests of the three partners in the old Company can be made available in execution proceedings or otherwise for the purpose of liquidating their indebtedness to the Bank. For this they have only to thank themselves for taking as security for the personal indebtedness of three directors of a limited Company, a charge on property of that Company without any inquiry and without satisfying themselves that the seal of the Company had been affixed to the security in such circumstances as to make the security a charge binding on the Company. This was not a case, as was suggested in argument, in which the Bank had no notice of anything extraordinary being done. It was a plain case of directors using their powers as directors to cause a limited Company to apply its property for the benefit of those directors as debtors to the Bank.

The language used by Atkin L.J. in the case of *Underwood* v. *Bank of Liverpool* ([1929] 1 K.B. 775 at p. 796) may well be cited in this connection:—

"The first question is: Had Underwood actual authority to deal with the cheques as he did? . . . . He was using the proceeds of the cheques in question to pay his own private debts. Under ordinary circumstances actual authority appears to be clearly negatived. Nevertheless it was contended that the fact that Underwood was the sole director, and practically the sole shareholder, gave him, in pursuance of the articles, actual authority. He was entrusted with all the powers of the company, the company can only act through its directors, and the directors, or director if only one, could do what they willed with the company's assets. If this means anything it means that a board of directors acting as such have actual authority to defraud the company by using the company's assets to pay debts due to butchers or moneylenders by the individual directors. Such an act is quite outside the class of acts—management of the company's business—authorised to be done by the board. The directors, whether collectively or singly, have not actual authority to steal the company's goods."

In the circumstances of this case the Bank were not entitled to rely upon the document as one sealed by the old Company in the presence of its proper officers, and as such binding upon the old Company.

Their Lordships think it right to add that although no other registered shareholders were shown to exist beyond the three partners and Mrs. Leon and Mrs. Low, the evidence did establish that other persons were equitably interested in and had acquired shares of the old Company. For some reason the Trial Judge refused to accept the evidence that certain other persons, though not shown to have been

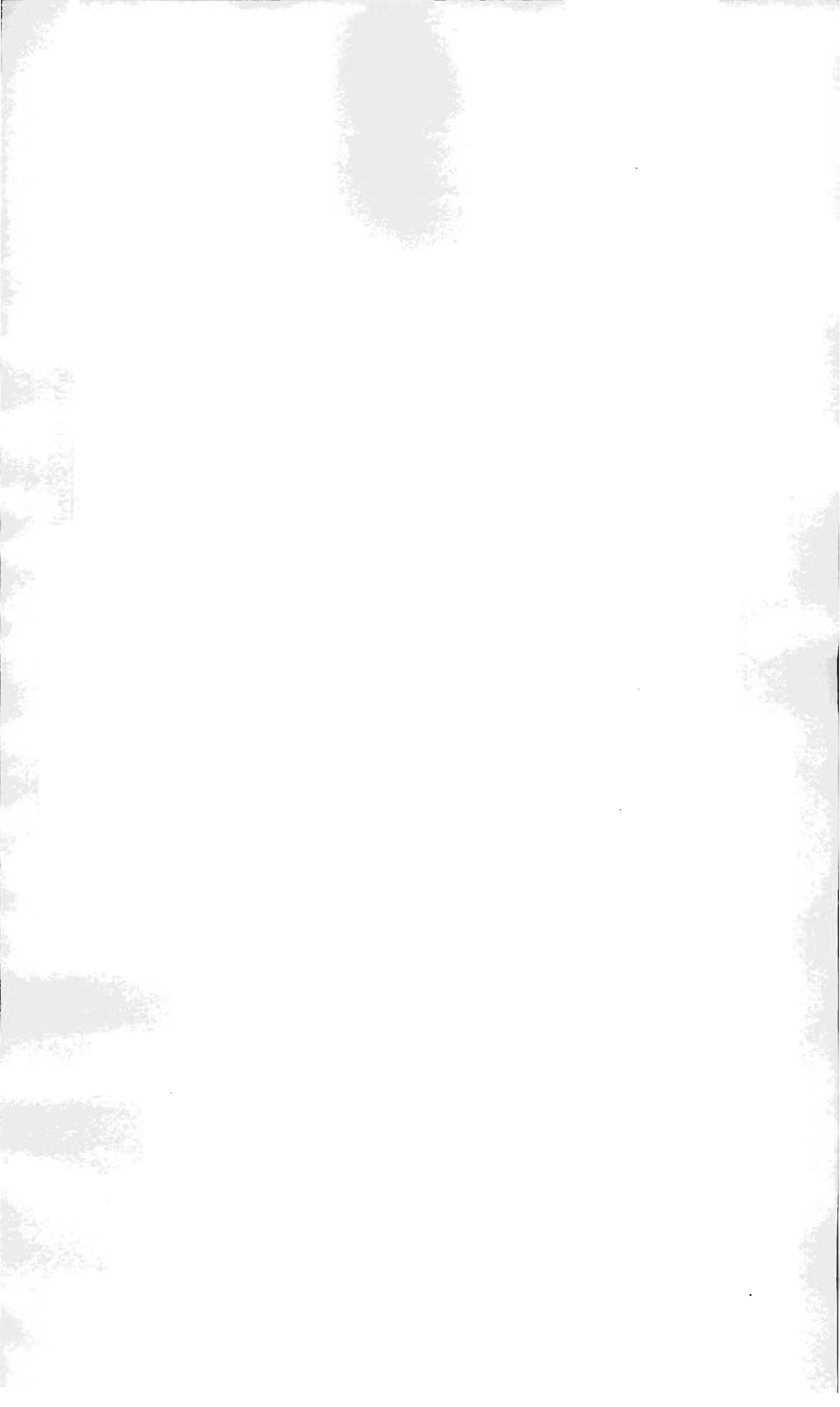
registered shareholders, had acquired or become owners of shares. The evidence, if accepted, however, seems clear. To take as one instance, the case of the witness Magid. He claimed to have been given in 1929 two blocks of shares (both common and preferred) in the old Company registered in the name of Burns, as security for liabilities to him by Burns, and to have received two certificates in the name of Burns, endorsed in blank. He produced a letter of the 23rd January, 1929, written to him by Burns confirming the transaction and enclosing the two certificates endorsed in blank, one for 7,543 preferred shares, and the other for 16,666 common shares. He produced further correspondence relating to the matter and consistent with his evidence. Throughout his cross-examination no suggestion was made that these letters were not genuine letters written at their respective dates, and containing truthful statements. Their Lordships find it difficult to understand how in the absence of even a suggestion against the authenticity of the letters, it was possible to reach a conclusion on the evidence that the witness Magid had not in 1929 (though not a registered shareholder) acquired shares in the old Company. The matter, however, is only of importance as indicating that in fact other beneficial interests were at stake which were capable of being affected by the improper disposition of the old Company's assets for the benefit of its directors which took place in July, 1929.

In the result their Lordships are of opinion that this appeal should succeed and that the Bank should account to the old Company for the balance of cash which remained to the credit of the old Company on the "savings account" (exhibit No. 8) at the Toronto branch on the 30th June, 1931, after payment thereout on that date to the Receiver-General of the sum of $88,073.17. It would appear from exhibit No. 8, that the said balance of cash was applied (1) in satisfying an indebtedness of the old Company to the Bank at the London branch amounting to $8,807.98 and (2) in satisfying three sums due to the Bank by the three partners, amounting in all to a total sum of $323,156.69. If the figures on this account are accepted by the parties, judgment should be entered for the old Company for this last mentioned sum with interest thereon at the proper commercial rate from the 30th June, 1931, until judgment. If the figures are not agreed, it must be referred to the Master to take an account to ascertain the amount of cash standing to the credit of the "savings account" on the 30th June, 1931, after the said payment to the Receiver-General had been made, and the Bank must be ordered to pay the amount so found, with interest thereon at the proper commercial rate until payment. The order of the Court of Appeal will be discharged, and the judgment of Kelly J., of the 4th January, 1934, varied by striking out the paragraphs numbered 2 and 4, by inserting therein either judgment for the old Company as above mentioned, or (as the case may be) an order for an account and payment as above mentioned, by ordering the Bank to pay the old Company's

costs of the action, and by omitting the numbers attached to the different paragraphs. If the judgment is varied by including therein an order for an account and payment as above mentioned, then the paragraph which at present bears the number 6, must be varied by substituting the word "references" for the word "reference," and the word "reports" for the word "report." Their Lordships will humbly advise His Majesty accordingly. The Bank will pay the old Company's costs of the appeals to the Court of Appeal and to His Majesty in Council.

It would be advisable that the parties, after considering this judgment should endeavour to agree to the appropriate form of minutes.

(42045—3A) Wt. 8151—17 130 6/37 P.St. G. 338



In the Privy Council

E.B.M. COMPANY LIMITED

v.

THE DOMINION BANK

DELIVERED BY LORD RUSSELL OF KILLOWEN

Printed by HIS MAJESTY'S STATIONERY OFFICE PRESS,
Pocock Street, S.E.1.

1937