

Friday, February 19.

FIRST DIVISION.

[Sheriff Court of Lanarkshire at Glasgow.]

LAUGHLAND v. MILLAR, LAUGHLAND, & COMPANY.

Contract—Pactum illicitum—Company—Director—Agreement by the Managers of a Company with a Director to Pay him a Share if Voted a Gratuity by the Shareholders.

A director of a company made a contract with the managers that in the event of the shareholders voting them a gratuity they were to pay him a specified share. The director attended a meeting of shareholders, at which he, without disclosing his personal interest, moved that the managers should be given a certain sum, and this motion was carried. He thereafter claimed his share, but being met with the plea that the contract was null and void, he dropped proceedings and disclosed the facts. The shareholders, at a meeting convened to consider the matter, resolved that no action should be taken by them.

Upon the director raising an action against the managers, held that the contract was a *pactum illicitum*, that it had not been affected or ratified by the subsequent knowledge and meeting of the shareholders, and that it could not be sued upon.

The Sunnyside Rivet Company, Limited, was a small limited liability company which carried on business from 1897 to March 1901. David Laughland, residing at 11 Newton Terrace, Glasgow, was a shareholder and a director of it, and Millar, Laughland, & Co., 65 West Regent Street, Glasgow, whose partners—Edward Millar and William Laughland—were also shareholders and directors, acted as managers.

In 1900 proposals were made for the sale of the company to a larger company about to be formed for the purpose of amalgamating several businesses of the same kind; and eventually the new company was constituted and the terms of the sale arranged, and at meetings of the shareholders of the Sunnyside Rivet Company, Limited, resolutions were passed for the winding-up of the company voluntarily and appointing a liquidator. The sale of the company was then carried through on terms which, after paying all debts and expenses and returning to the shareholders the paid-up cash capital, left a balance of about £1200. This sum was available for division amongst the shareholders, or as they might see fit. At a meeting of the shareholders, held on March 12, 1901, a resolution was passed, on the motion of David Laughland, who did not disclose any personal interest in the motion, that out of the balance there should be paid to the managers a bonus of £700 in cash or shares, in the same propor-

tions as the balance distributed to the shareholders. This resolution was confirmed upon March 27, 1901, and was afterwards carried out.

David Laughland then claimed from Millar, Laughland, & Co., a share of this commission, based upon an alleged contract, and having been met with the plea that the transaction was illegal, he wrote to the liquidator calling his attention to the proceedings upon which he based his claim. The liquidator summoned a meeting of the shareholders to consider the matter, and at that meeting, held on April 3, 1903, the shareholders decided to take no action.

David Laughland now presented a petition in the Sheriff Court at Glasgow for £200 against Miller, Laughland, & Company, and Edward Millar and William Laughland, the individual members of that firm. In it he made the following averments:—“(Cond. 6) The defenders maintained at meetings with the directors and shareholders that they were entitled to have the balance of the price handed over to them in consideration of the services they had rendered to the Sunnyside Rivet Company, Limited, and also as compensation for their giving assistance in the disposal of the business to their own detriment; and the pursuer claimed that he was entitled to participate in the division in respect of valuable services he had rendered to the company in raising capital and in guaranteeing the company's overdraft when it was in financial difficulties. (Cond. 7) On the 11th of March 1901 the defender Edward Millar had a meeting with the pursuer, when the matter of the destination of the balance of the price was discussed, and the respective claims of the pursuer and defenders were debated. There had been certain meetings prior to this at which the same matter had been discussed and resolutions come to, but subsequent investigations having shown that the state of affairs of The Sunnyside Rivet Company, Limited, on which the amalgamation had been arranged and the sale negotiated, had not been correctly made up, and that consequently the company had been obliged to accept a reduction of price, these resolutions were no longer applicable or binding. The defender Millar was acting for himself, and also for the other defenders, William Laughland and Millar, Laughland, & Company, when an arrangement was come to with the pursuer which was embodied in a memorandum in the following terms:—‘11 Newton Terrace, Glasgow, W., 11/3/01.

‘1st. If £1600 or thereabouts is divisible, D. L. gets £225 in cash from M. L. & Co.

‘2nd. If £1200 or thereabouts is divisible, D. L. gets £200 in cash from M. L. & Co.

‘The above in addition to what D. L. is entitled to in respect of his holding. If the first is moved, M. L. & Co. get 1000 shares or cash, less £225. If the second, M. L. & Co. get 700 shares, or cash less £200.

E. MILLAR.

‘To Messrs Millar, Laughland & Co.,
65 West Regent Street, Glasgow.’

This memorandum was written by the pursuer and addressed to Messrs Millar, Laughland, & Company, the defenders, and was signed by the defender Millar with his own signature. The D. L. mentioned in the memo. is the pursuer, and the M. L. & Co. are the defenders. (Cond. 9) The conditions of the arrangements between the pursuer and the defenders under which the pursuer became entitled to payment of the sum of £200 from the defenders as embodied in the said memorandum, *vide licet*, that £1200 or thereabouts had become divisible among the shareholders of The Sunnyside Rivet Company, Limited, and that the defenders got 700 shares or cash, having been purified, the pursuer claimed payment, and was met with the objection that the arrangement was null and void in consequence of its having been concealed from the shareholders of the company, whereupon the pursuer brought the matter under the notice of the liquidator, who convened a special general meeting of the shareholders on 3rd April 1902 to consider the agreement between the pursuer and the defenders, and the shareholders, in the full knowledge of all the circumstances and of the pursuer's claim, ratified and confirmed the proceedings at the meetings held on 12th and 27th March 1901. Copies of the minutes of these meetings are produced. (Cond. 10) If the whole balance of £1200 had been distributed among the shareholders (and the pursuer could have insisted on that being done), the share falling to the pursuer in proportion to his holding in the company would have been £120 or thereby, and but for the arrangement narrated in article 7th he would have insisted on the distribution of the entire balance among the shareholders."

Millar, Laughland, & Co. lodged answers, and pleaded:—“(1) The agreement founded on having been concealed from the shareholders, was an immoral contract and not binding in law.”

On 8th December 1902 the Sheriff-Substitute (STRACHAN) found that no relevant defence had been stated, and that the defenders were bound to make payment as craved.

Note.—“The only difference between this action and the one decided by me on 11th November 1901, and withdrawn by the pursuer when under appeal to the Sheriff, is that the pursuer now avers that on 3rd April 1902 a special general meeting of the shareholders was held to consider the agreement between the pursuer and the defenders, and that the shareholders in the full knowledge of the circumstances of the pursuer's claim ratified and confirmed the proceedings at the meetings held on 12th and 27th March 1901. If this has any bearing on the case it must strengthen the pursuer's claim and confirm the judgment pronounced by me in the previous action. I have heard nothing to lead me to think that the judgment referred to is erroneous, and I see no reason therefore why it should not be repeated in this case. For the ground of judgment I refer of course to the previous note ”

The previous note, accompanying an interlocutor of 11th November 1901, was—“It is further maintained by the defenders that the agreement was of an immoral character. The defenders conceded that they were themselves parties to this immorality, but they shelter themselves under the brocard *melior est conditio possidentis*. But the defenders are doing themselves an injustice. It is not stated in the record wherein the immorality consisted, and I have not been able to discover it. An attempt was made to bring the case within the scope of the decisions in the *Edinburgh Tramway Company* against *Beattie & Mann*, 18 R. 1140, and that class of cases, in which it was held that the fiduciary relations in which the parties stood to a company prohibited them from getting any advantage from agreements entered into by them in regard to the affairs of the company, and that they were bound to account to the company for all moneys received by them under such agreement. These agreements were held to be illegal, but not in any sense immoral. But the present case is essentially different from any of those referred to. The company here is not objecting to the agreement between the parties to this action, nor is it seeking to obtain any benefit therefrom. The company has absolutely nothing whatever to do with the question between the parties. By an extraordinary resolution of the shareholders of the company it was resolved to pay £700 of bonus or commission to the defenders for certain services rendered by them. This agreement was made by the defenders directly with the company and individual shareholders—all of whom were bound by it. When the money was paid it became the exclusive property of the defenders, and they were entitled to do with it what they pleased. The company had no interest in it or any right to interfere in any way with its disposal. The fiduciary relationship to the company terminated with the liquidation and could not in any way affect the disposal of the residue after payment of all legal claims. Besides, it can only be pleaded by the company—and no third person has any right or title to do so.

“The question is one entirely between the parties to the memorandum, and in which no other person has any interest. By the memorandum the defenders undertook, on getting £700 of commission, to pay the pursuer £200, and I see no reason why I should not give effect to it. The commission was their own, and there was nothing to prevent them disposing of it as they pleased. Sharing a commission is a common, and so far as I can see, a perfectly legitimate transaction. A party may have legitimately aided another in getting a commission, or doing the work on which a commission is being paid. What objection can there be to that party being paid for his services? But it is not for the Court to inquire or determine whether the consideration given for a share of commission is adequate or otherwise. The defenders are business men who are presumably well able

to conduct their business. They agreed to share their commission to a limited extent with the pursuer, and it must be presumed that they did so for adequate and sufficient reasons. Having done this they cannot be allowed to repudiate their obligation on any such grounds as are pleaded by the defenders in this action."

On appeal the Sheriff (GUTHRIE) adhered, and in his note said—"With regard to the alleged invalidity of the agreement between pursuers and defenders on the ground that the director of a company cannot benefit by a secret profit or commission made in a transaction between the company and a third party, there is no doubt that such a profit or commission may be retained by the company, and that by the Companies Act 1862 his office of director is vacated by such conduct. No authority however has been adduced for the proposition that a contract with a person who receives a bonus from the company to get a part of that bonus is *ipso facto* void, or that its illegality can be pleaded for his own interest by the party receiving the bonus, the company having knowledge of the arrangement, or refusing, as it has done here, to make him account for the profit he has made. If the company did not know of the pursuer's bargain with the defenders, the conduct of both parties was no doubt objectionable, even illegal; but it does not appear that any but the company can call the pursuer to account. This the company has explicitly refused to do."

The defenders appealed and argued—The alleged contract here was for a corrupt consideration. It could therefore not be enforced—Bell's Prin., sec. 35; *Harrington v. Victoria Graving Dock Company*, 1878, 3 Q.B. Div. 549; *Shipway v. Broadwood* [1899], 1 Q.B. 369; *Englefield Colliery Company*, 1877, 8 Ch. Div. 388. The defenders were therefore entitled to absolver, but if there was any doubt as to the actual meaning of the contract, or the actings of the different parties, they were entitled to a proof.

Argued for the respondent—The contract here was not corrupt. The company had already accepted the view that the managers should have a gratuity, and a much larger sum had been mentioned. There was therefore no bribe in the agreement, for there was no *quid pro quo*; it was merely an arrangement for sharing the commission, and there could have been no question had it been disclosed to the shareholders at the time—Lindley on Companies, 6th ed., vol. i. 513; *Southall v. British Mutual Life Assurance Society*, 1871, L.R., 6 Ch. App. 614. But the agreement had been disclosed a month later, and apparently accepted. That closed the matter, but even if wrong in this view, still the contract was not one which was void but only one in which any benefit derived must be contributed to the company. The company, however, did not want it—*Costa Rica Railway Company v. Forwood* [1901], 1 Ch. 746.

LORD ADAM—[After giving a summary of the statements in condescendence]—Mr Horne maintained that the minute of meet-

ing dated 3rd April 1902 amounted to a ratification of the transaction contained in the agreement of 11th March. But I do not think it is anything of the sort. The matter was brought before the shareholders, and all they said was "We shall let things stand as they are; we will allow that arrangement by which we have decided that the defenders were to get £700 for their labours to stand, and you and the pursuer must settle between you as you like." They do not ratify anything. All they say is, we will not interfere. I do not consider that is a ratification of the agreement come to between the pursuer and the defenders as to the division of this surplus on the 11th of March. Well, then, if it is not a ratification of that agreement what are we to do? The pursuer says this in article 10 of his condescendence, and I do not think it is ambiguous at all—"If the whole balance of £1200 had been distributed among the shareholders (and the pursuer could have insisted on that being done) the share falling to the pursuer in proportion to his holding in the company would have been £120 or thereby, and but for the arrangement narrated in article 7th he would have insisted on the distribution of the entire balance among the shareholders." That is what is said. It means this—that here is a director of the company, in that capacity, agreeing with the managers that they shall agree together to get from the company a certain sum of money, £700, and that he, the director, and the managers shall divide that between them in a certain proportion. The pursuer tells us himself that if that agreement was not carried out—if he was not to get his share of this £700—he would have done what it was his duty to do, namely, to have this sum divided among the shareholders. In other words, he said—"I insist for my own interest, for the purpose of getting £200, that you shall get this whole sum, which otherwise I would have insisted should go to the shareholders."

That is the case, and that brings us back to this. Was this a corrupt agreement by a director with the managers? I do not think it is anything else but a corrupt agreement. It is a combination between the managers and the director of this company to get into their possession a sum belonging to the shareholders. That is the nature of the transaction, and if that is the nature of the transaction the question is, can such a corrupt agreement be sued upon? If it cannot be sued upon it is no answer to say, Oh, the company is now extinct and they cannot recover the money. That is not the question we have to deal with at all. It is whether one of two parties who entered into such an agreement can sue the other upon it. That is the question, and my humble opinion is that a corrupt agreement such as this is cannot be sued upon. Just put it the other way. If the pursuer had got the money into his hand, then I do not think the defenders, if they had sued him for it, could have recovered from him any more than he can recover from them. I am therefore of opinion that the

appeal should be sustained and the action should be dismissed, on the ground that the condescence discloses a corrupt agreement which cannot be sued upon.

LORD M'LAREN—If we looked in this case only at the agreement I should have had some difficulty in coming to the conclusion that it was corrupt, because it merely purports to be a payment of a certain sum on a contingency. But then it is explained in cond. 10 that while the pursuer does not admit all that is said by the defenders as to the means of inducing this agreement he does admit, and indeed asserts, that his inducement, or his mode of obtaining the agreement, was that if Millar & Laughland had not agreed to pay him £200 he would have used his influence as a director of the company against the vote of this sum and in favour of the division of the whole £1200 among the shareholders. Now, if Mr David Laughland had of his own accord, and without making a bargain with anyone, gone to a meeting of the company and supported the proposal for dividing the £1200 amongst the shareholders he would have been perfectly within his rights, because there was no legal obligation to pay Millar & Laughland, the managers, anything more than their stipulated salary and commission. But just because he would be within his rights in making such a proposal, I think it is plain that the bargain he made was illegal, because he says, "I am prepared to use my undoubted legal rights to promote my interest and that of the shareholders, but if you will allow me, as you invite me, to sacrifice the interests of the company and to vote you £700 to which you have no right, you in return are to pay me £200." That is the substance of the agreement in the light of the facts stated in cond. 10, and although the condescence certainly does not admit the corrupt bargain, yet we are entitled to read it along with the agreement, and the effect of the two things—the averment and the agreement taken together—is to satisfy me, just as clearly as if we had a parole proof, that this was a corrupt agreement by a director not to press the interests of the shareholders as against the interests of Millar & Laughland in consideration of his receiving £200. Now, what might be the rights of the company we are not concerned with, because the company, on the facts being brought to their notice, decided that they would take no action in the matter. If they had chosen I cannot doubt that they might have set aside the agreement altogether and reconsidered the question of remunerating their managers. It may be that the shareholders considered that, while disapproving of this bargain, yet if they had to consider Millar & Laughland's claim on its merits they would give the £700, or it may be that, as the company was being wound up, they did not want to embark on litigation; but I agree with Lord Adam that we are in no way concerned in this case with the action or inaction of the company. The question is, these par-

ties having made a corrupt bargain for profiting at the expense of the company, whether one of these parties to the bargain can sue the other for its fulfilment. I am very clearly of opinion that the right of action in such a case does not exist. It is quite unnecessary to review the authorities, because there is no point in the law of contract which is more firmly established than that when a contract is open to the objection that it is either against public policy or is a dishonest attempt to defraud a third person, then the one party cannot sue the other, but the property or fund in question must remain in its existing position. It follows therefore, in my opinion, that this action should be dismissed. I rather infer that when the case came before the late Sheriff Berry he would have taken the same view if he had been obliged to decide the merits of the case; but as he had allowed amendments he apparently thought it proper to remit the case to the Sheriff-Substitute for further consideration.

LORD KINNEAR—I quite agree with your Lordships. I think that the pursuer's condescence discloses a contract for a corrupt consideration, and that such a contract is not enforceable in law. I think the nature of the agreement is quite clearly apparent upon the face of the memorandum itself, although I of course agree with what Lord M'Laren said, that if we had nothing before us but the memorandum we should not be able to construe it and determine whether it disclosed a corrupt motive or not, or what it disclosed, because its main terms are expressed merely in figures and in initials, and it is necessary that we should know the facts in order to construe it. But then the facts that enable us to construe it are set out quite clearly and candidly in the 7th article of the condescence, which is the article that sets out the memorandum itself for the purpose of supporting the pursuer's claim, because in that article, after having previously explained that there had been an agreement for the purchase and sale of the Sunnyside Rivet Company's business, and that as the result of that agreement it had been found that there would be a balance of the price available for division among the shareholders after paying debts and expenses, he goes on to say that in that condition of matters he on the 11th of March 1901 had a meeting with the defender Edward Millar, when the matter of the destination of the price was discussed, and the respective claims of the pursuer and defenders were debated. Now, the matter of the destination of the balance of the price was a matter for the shareholders, because it was their money, and I do not see that the defenders and the pursuer had any right or duty to enter into a contract about it at all. The pursuer's business was to advise the shareholders. [*His Lordship then narrated the statement in the condescence as to the terms of the agreement, and the money being voted by the shareholders.*] Now, if that statement had stood alone, I think, for my part, I should have

very little difficulty in inferring that there was a bargain between these two parties for an illegal commission to the pursuer, but then he goes on and makes the matter perfectly clear by what he says in the 10th article of the condescence—[*His Lordship quoted the 10th article*]. Now, I agree with the observations of Lord Adam that this is not an ambiguous statement. It makes it perfectly clear, in the first place, that according to the pursuer's averments the defenders had no right at all to any part of this £1200, but that all of it was the money of the shareholders, and divisible among them without a farthing of it going to the defenders. But then it is equally clear that that being, according to his statement, the position of their rights, he goes on to say—"I would have insisted upon this way of dealing with the money and given the shareholders their own property had not I made an arrangement by which I was to get £200 out, and I preferred that arrangement to the effect of the natural and legal division which would have been made, because in the latter case I should only have got £120 and now I have £200 in addition to whatever share I may have in proportion to my holding;" and he goes on to say, "I would have insisted upon a proper division if I had not made this agreement." Now, I think that is about as clear a statement as can be of an illegal contract—a contract that is not enforceable. I observe upon it further that according to the pursuer's own statement it was his plain and obvious duty, in bringing the matter before the shareholders, to tell them that if they paid £700 to the defenders there was an agreement between them and him that he was to get £200, and I think he is chargeable with a grave breach of duty when he says that he got that for himself and did not disclose it to the shareholders; and the conclusion that that was a grave breach of duty on his part appears to me to be illustrated very clearly by the statement in the last minute to which the pursuer refers, that one of the shareholders, Mr Scobbie, wrote to the liquidator, and said—"Until after the liquidation of the company was closed I was not aware that Mr David Laughland had stipulated for any part of the bonus of £700 voted to Messrs Millar, Laughland, & Company. Had I known I certainly would have objected, and I now object to him obtaining any part of it, my consent being given on the distinct understanding that the bonus was for them only." I do not desire to found upon that as evidence because we have no evidence before us, and we dispose of the case upon the pursuer's statement only, but the pursuer makes it part of his own statement, and it is a very clear illustration of what I think the prejudice done to the shareholders by conduct of this kind upon the part of a director really is; for what Mr Scobbie says he would have done is exactly what the law assumes that any shareholder would have been entitled to do and probably would have done in his own interest if the matter had been brought before him. But I do not found upon that to the effect of disabling the pursuer from

enforcing the contract, because that is a breach of duty to the shareholders after the agreement was made, and does not enter into the motive of the agreement itself. But then, on the other hand, it was the pursuer's conduct in order to carry out, and according to his own statement for the purpose of carrying out the agreement he had made with the defenders, and so it throws light again upon the true meaning and illegal character of that agreement. I quite agree also with what has been said by both your Lordships, that there is no question here of any ratification by the shareholders of what was done after the facts were brought to their knowledge, because the minute founded upon as the ratification amounts to nothing more than this, that in the circumstances before them the shareholders did not require the liquidator to take action in the matter. That is the whole result of the minute, and that may be accounted for by reasons that have no connection at all with the notion of the shareholders being willing and ready to ratify what had been done if it required their ratification. It comes to nothing more than this, that in the circumstances in which the company is they do not direct the liquidator to raise an action. The legal result, I agree with your Lordships, is perfectly clear, that a contract of this kind according to our law is ineffectual. It cannot be enforced, and the law to that effect is stated perfectly clearly, not only by Mr Bell in his Principles, to which Mr M'Clure referred, but by Stair and Erskine, and by all the institutional writers. These writers no doubt give a number of illustrations of what they understand by a contract *contra bonos mores*, and I do not think there is to be found among them the case of a director of a joint-stock company taking a commission to the prejudice of his shareholders, but that is only because cases of that kind had not arisen when either Stair or Erskine or Bell wrote so frequently as they have unhappily arisen now. The principle laid down by all these writers is as applicable to the case of a director of a joint-stock company as is the decision of the Queen's Bench in the case of *Harrington*, 1878, 3 Q.B.D. 549. The question as to what may ultimately become of the money in the hands of the defenders is a question with which we have no concern. I do not consider whether the company, if it had still existed, or members of the company which has now ceased to exist, will have any claim or right of action against the defenders. We have nothing to do with that, but I think it clear that the pursuer has alleged a contract which he has no right in law to enforce against anybody.

The LORD PRESIDENT was absent.

The Court sustained the appeal and assolizied the defenders.

Counsel for the Appellants—H. Johnston, K.C.—M'Clure. Agents—Constable & Syme, W.S.

Counsel for the Respondents—Cullen—R. S. Horne. Agents—Auld & Macdonald, W.S.