

Privy Council Appeal No. 116 of 1931.

The Australian Investment Trust, Limited - - - - *Appellants*

v.

The Strand and Pitt Street Properties, Limited - - - - *Respondents*

FROM

THE SUPREME COURT OF NEW SOUTH WALES.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE
PRIVY COUNCIL, DELIVERED THE 7TH JULY, 1932.

Present at the Hearing:

LORD TOMLIN.
LORD THANKERTON.
LORD MACMILLAN.
LORD WRIGHT.
SIR JOHN WALLIS.

[*Delivered by* LORD TOMLIN.]

This is an appeal brought pursuant to leave granted by the Supreme Court of New South Wales from an order dated the 9th April, 1931, of that Court in its equitable jurisdiction (Long Innes, J.), allowing the respondents' demurrer to the appellants' statement of claim in the action.

In the action the appellants are seeking to have the share register of the respondents rectified by the deletion therefrom of the name of the appellants as the holders of 16,308 shares of £1 in the capital of the respondents.

The question at issue is whether an underwriting agreement made on the 15th April, 1929, and subsequently adopted by the respondents pursuant to which the shares in question were allotted to the appellants is, as the appellants allege, *ultra vires* the respondents.

Both parties to the appeal are companies limited by shares incorporated in New South Wales under the provisions of the New South Wales Companies Acts, 1899 to 1918.

The New South Wales Companies Acts, 1899 to 1918, contain no provision expressly authorising the payment of underwriting commissions such as that first introduced in England by section 8 of the Companies Act, 1900, and now embodied in section 43 of the Companies Act, 1929, and both sides agree that the law applicable in New South Wales to the question involved in this appeal can be treated as identical with that which prevailed in England before section 8 of the Companies Act, 1900, came into operation.

It is upon a consideration of the English law as it stood before section 8 of the Companies Act, 1900, came into operation, that the learned judge in the Court below reached his conclusion, and that their Lordships have now to determine the appeal.

The facts as appearing in the statement of claim demurred to are in effect as hereinafter stated.

On the 15th April, 1929, by means of two letters the first from the appellants to one Keith Williams as trustee for a company then about to be formed and registered and the other from Keith Williams to the appellants an agreement for the underwriting by the appellants of a proposed issue of capital of the proposed company was entered into.

The first of such letters was as follows :—

“ STRAND & PITT STREET PROPERTIES LIMITED.

(A Company about to be formed and registered under the provisions of the New South Wales Companies Acts 1899—1918 and herein referred to as ‘ the Company.’)

CAPITAL : £250,000 in 250,000 Shares of £1 each.

To KEITH WILLIAMS, Esquire,
17, O’Connell Street,
Sydney, N.S.W.
(as Trustee for the Company).

Sir,

1. With reference to the proposal to offer one hundred and seventy-five thousand ordinary shares in the Company to the public for subscription at One pound per share and for the considerations hereinafter mentioned THE AUSTRALIAN INVESTMENT TRUST LIMITED a Company formed and incorporated under the New South Wales Companies Acts and carrying on business at Sydney aforesaid (hereinafter referred to as ‘ the Trust ’) hereby underwrites the whole of the said One hundred and seventy-five thousand shares so to be offered with a right to make a firm and irrevocable application for sixty thousand of such shares.

2. The Trust’s application and subscription are to be on the terms of the Company’s prospectus to be finally settled and issued PROVIDED ALWAYS that it shall be issued within sixty days from the date hereof and that such Prospectus as finally settled and issued does not differ in any material particular from the draft prospectus as now published a copy of which is annexed hereto and signed by Frederick John Leslie Dunlop on behalf of the Trust.

3. The Trust’s firm application for sixty thousand shares or any part thereof if and when made is to be viewed as marked in relief of its underwriting and in respect to such underwriting the Trust or its nominee is not to be allotted any greater number of shares than the number which it has underwritten.

4. All applications which may be initialled by or for the Trust and (subject to that which is hereinafter mentioned) approved by you and sent in by the Trust to you or to the Company prior to the time fixed by the prospectus for closing the list of subscribers are to be applied primarily in relief of the Trust's underwriting and shall not be reckoned as subscriptions by the public ALWAYS PROVIDED that prior to such closing due notice is given to you by the Trust that it requires such initialled applications to be so applied as in relief of its own application.

5. All such applications as are mentioned in the last preceding paragraph shall be approved and accepted by the Company provided that they are presented on a form of application approved by the Company that the applicants are responsible persons and that the applications are accompanied by application moneys according to the terms of the Prospectus. In the event of any dispute arising as to whether any applicant is a responsible person every applicant shall be deemed to be a responsible person if any Bank be of opinion that such applicant is a responsible person or company to take up the number of shares applied for.

6. The Trust hereby irrevocably authorises you or the company by any one of its officers in the name or on behalf of the Trust to sign and put in an application in the form referred to in the Prospectus as published for the number of shares underwritten by the Trust and to take an allotment in its name in respect thereof and the Trust hereby agrees to pay to the Company the application and allotment moneys immediately after receiving notice of allotment.

7. Subject as hereinafter mentioned the Company shall within fourteen days after it shall have become entitled to commence business pay to the Trust a commission in cash of one shilling per share on the shares hereby underwritten including those firmly applied for by it but no commission is payable until the application moneys payable on the shares have been paid to the company and notice of allotment given to the applicant.

8. No allotment to the Trust is to be made before the expiration of seven days after the first issue of the prospectus.

9. The obligations of the Trust hereunder are to hold good notwithstanding any variation between the draft prospectus annexed hereto and the prospectus as finally settled and published provided that the amount of the capital of the Company namely two hundred and fifty thousand pounds divided into two hundred and fifty thousand shares of one pound each is not altered and that the terms of subscription namely five shillings per share on application five shillings per share on allotment and the balance in calls of not more than five shillings per share at intervals of not less than three months are not altered and provided further that such prospectus as finally settled and published does not differ in any material particular from the draft prospectus attached hereto.

10. You are to be at liberty on behalf of the Trust to concur with the Company in making a contract under which the Company is to take your place for the purposes hereof and thereupon you will be released from any liability hereunder.

11. Any notice to the Trust may be served by sending the same by post addressed to the Trust at the address under stated and shall be deemed to be served on the day following that on which it is posted.

Be so good as to notify the Trust of your Acceptance of this proposal.

Dated this Fifteenth day of April, 1929.

THE AUSTRALIAN INVESTMENT TRUST, LIMITED.

Signature : F. J. L. DUNLOP, Managing Director.

Address : Brook House, 17, O'Connell St., Sydney."

The second letter was as follows :—

“ ACCEPTANCE OF UNDERWRITING PROPOSAL.

STRAND AND PITT STREET PROPERTIES LIMITED.

(A Company about to be formed and registered under the provisions of the New South Wales Companies Acts 1889-1918.)

CAPITAL: £250,000 in 250,000 Shares of £1 each.

THE AUSTRALIAN INVESTMENT TRUST, LIMITED,
17, O'Connell Street,
Sydney.

Dear Sirs,

Referring to your letter to me of the Fifteenth day of April 1929 proposing to underwrite One hundred and seventy-five thousand ordinary shares of One pound each in the above named company I HEREBY as Trustee for the Company Strand and Pitt Street Properties Limited AGREE to accept same upon the footing and subject to the conditions referred to in your said letter.

Dated the Fifteenth day of April, 1929.

KEITH WILLIAMS,

Trustee for the proposed Company.”

The respondents (the Company contemplated by the letters of the 15th April, 1929) were duly incorporated on the 23rd April, 1929, with a capital of £250,000 divided into 250,000 shares of £1 each.

A prospectus was issued offering 175,000 shares for public subscription. This prospectus which presumably was substantially identical with the draft prospectus copy of which was annexed to the first letter of the 15th April, 1929, contained (*inter alia*) the following passages :—

“ UNDERWRITING AGREEMENTS.

A copy of the underwriting agreement dated Fifteenth of April 1929 between Keith Williams as trustee for Strand and Pitt Street Properties Limited of the one part and The Australian Investment Trust Limited of the other part may be inspected at the offices of Messrs. Alfred Rofe & Sons, Solicitors to the Company, Rofe Chambers, O'Connell Street, Sydney.

A clause in the former agreement meaning thereby the underwriting agreement provides that the underwriters shall have the right to make firm application for and be allotted 60,000 of the shares now offered for subscription.

BROKERAGE.

The underwriters will pay a brokerage of 6d. per share on allotments in respect of applications identified as coming through members of any recognised Stock Exchange. The directors reserve the right to reject any application without giving reasons therefor.”

On the 11th June, 1929, by an agreement in writing between the appellants, Keith Williams and the respondents, the agreement contained in the two letters of the 15th April, 1929, was duly adopted by the respondents and made binding on the appellants and respondents, and Keith Williams was discharged from liability thereunder.

On the 30th June, 1930, the appellants set up that the underwriting agreement was, *ultra vires*, the respondents and unenforceable.

On the 9th October, 1930 the respondents, in pursuance of the underwriting agreement, allotted to the appellants 16,308 shares of £1 each in the capital of the respondents.

On the 29th October, 1930 the appellants filed the statement of claim in the suit out of which this appeal arises, alleging that the taking up of any of the shares pursuant to the underwriting agreement involved payment by the respondents out of their share capital of commission in respect of such shares, and claiming to have the share register rectified by the deletion therefrom of the name of the appellants as the holders of any of the 16,308 shares.

The respondents demurred *ore tenus* on the 9th April, 1931. Mr. Justice Long Innes, in a valuable judgment in which the authorities are carefully reviewed, and which has been of much assistance to their Lordships, reached the conclusion that the demurrer should be allowed. At the same time, the learned Judge gave the appellants liberty to amend the statement of claim within 21 days, and ordered that in default of amendment within that time the suit should be dismissed.

Leave to appeal to His Majesty in Council was subsequently obtained from the Supreme Court of New South Wales.

The decision of the House of Lords in *Ooregum Gold Mining Co. of India v. Roper* [1892] A.C. 125 made it plain that a company limited by shares could not issue its shares as fully paid up for a money consideration less than their nominal value.

In his speech in that case Lord Watson at p. 136 after referring to the relevant sections of the Companies Act 1862 said :—

“ In my opinion these enactments read together indicate the intention of the Legislature that every member who takes shares from the company in return for cash shall either pay or become liable to contribute their full nominal value.”

and later on he said :

“ Consequently, if shares are issued against money, it appears to me that any payment to the company less than the nominal amount of the share must, by force of this statute, and notwithstanding any agreement to the contrary, be treated as a payment to account, the member remaining liable to contribute the balance when duly called for. A company is free to contract with an applicant for its shares ; and when he pays in cash the nominal amount of the shares allotted to him, the company may at once return the money in satisfaction of its legal indebtedness for goods supplied or services rendered by him. That circuitous process is not essential. It has been decided that, under the Act of 1862, shares may be lawfully issued as fully paid up, for considerations which the Company has agreed to accept as representing in money's worth the nominal value of the shares.”

The difference between subscribing for shares and placing shares had been previously well explained by Lord Justice Mellish in *Gorissen's* case 8 Ch. 507 at p. 515, where he said :

“ It appears to me that an agreement to place shares, even although the person making it binds himself that within a specified time, or within a reasonable time, he will place a certain number of shares, is a materially different thing from an agreement to take a certain number of shares.

If a person agrees to take shares then by agreeing to take shares he does at that moment become a shareholder and the company are entitled and are indeed bound at that moment to put him on the register. But if he agrees to place shares he does not agree to become a shareholder nor are the company entitled to put him on the register as a shareholder but he simply agrees that he will procure other persons to take the shares."

The principles indicated in the foregoing quotations are in no respect impinged upon by the decision that payment by a company of brokerage to brokers for placing its shares with other persons is legitimate (see *Metropolitan Coal Consumers Association v. Scrimgeour* [1895] 2 Q.B. 604).

The point as to the validity of commission paid by a company to a person for subscribing for or underwriting its share capital was however never clearly decided in England before the passing of the Companies Act 1900 unless as has been urged before their Lordships such a decision is to be found in the case of *Licensed Victuallers' Mutual Trading Association ex. p. Audain* 42, Ch.D. 1, which will be examined presently.

Upon this point of commission Lord Lindley in the Sixth Edition of his work on Companies published in 1902 at p. 43 expressed himself as follows :

" After some doubt it was decided before the Companies Act 1900 was passed that a limited company might pay a reasonable sum to brokers by way of brokerage for placing its shares but the better opinion seems to have been that such a company could not make any payment out of capital to a person for subscribing for or underwriting its shares."

When the matter was before the judge below the parties agreed that for the purpose of construing the letters of the 15th April, 1929 the word " underwrite " should be taken to mean " to agree to take up by way of subscription in a new company or new issue a certain number of shares if and so far as not applied for by the public." This is a definition which seems to express accurately the meaning of the word underwrite in the sense in which it is commonly used.

Now it is not disputed that an agreement by a company to pay a commission to a person in consideration of his subscribing *in presenti* for a definite number of shares in the company's capital would be *ultra vires* the company. It would in effect be an arrangement whereby he was allowed a rebate or discount on the amount payable by him for the shares for which he agreed to subscribe.

But it is said that the position is different where as in an underwriting agreement, on the one hand, the obligation of the subscriber is to subscribe only for such number of shares, if any, as the public may not take up, so that in the result he may not be under liability to subscribe for any share at all, while, on the other hand, the consideration for the obligation to subscribe, namely the commission, is payable in any event and is not in amount related to the number of shares, if any, which ultimately have to be taken up under the agreement.

For the purpose of determining whether such an underwriting agreement is within the powers of the company their Lordships are content to apply the test suggested by Lord Watson in the passages already quoted from his speech in *Oregon Gold Mining Co. of India v. Roper ubi supra*. What are the services rendered by the underwriter in return for the commission over and beyond his agreement to subscribe for shares? In their Lordships' opinion the answer must be that there are none.

In the case of an agreement to subscribe for a definite number of shares *in presenti* it could not be suggested that there was any consideration for the commission beyond the agreement to take shares. What further obligation is imposed on the underwriter or what further service does he undertake to render because the number of shares (if any) which he becomes bound to take up depends upon a contingency, namely, the course the public will take in regard to the issue?

The learned judge below has said:

"In substance an underwriting agreement is a contract of guarantee or indemnity whereby the underwriter in effect guarantees that the whole of the shares in question will be subscribed by undertaking that to the extent to which they are not otherwise subscribed he will apply for them himself. It is in effect equivalent to a contract of insurance and might be expressed as such."

With all respect to the learned judge their Lordships are of opinion that the ambit of the obligation of the underwriter cannot be altered or enlarged by changing the language by which the contract is described. The obligation in fact is and remains nothing more or less than an obligation to subscribe for shares in the company. It is true that it is an obligation to subscribe for shares only on the happening of a contingent event the number if any of the shares to be taken up depending upon the magnitude of the event, but this is an obligation of the same nature as an obligation to subscribe for a definite number of shares *in presenti* though of more uncertain burden until it is crystallised by the happening of the contingency.

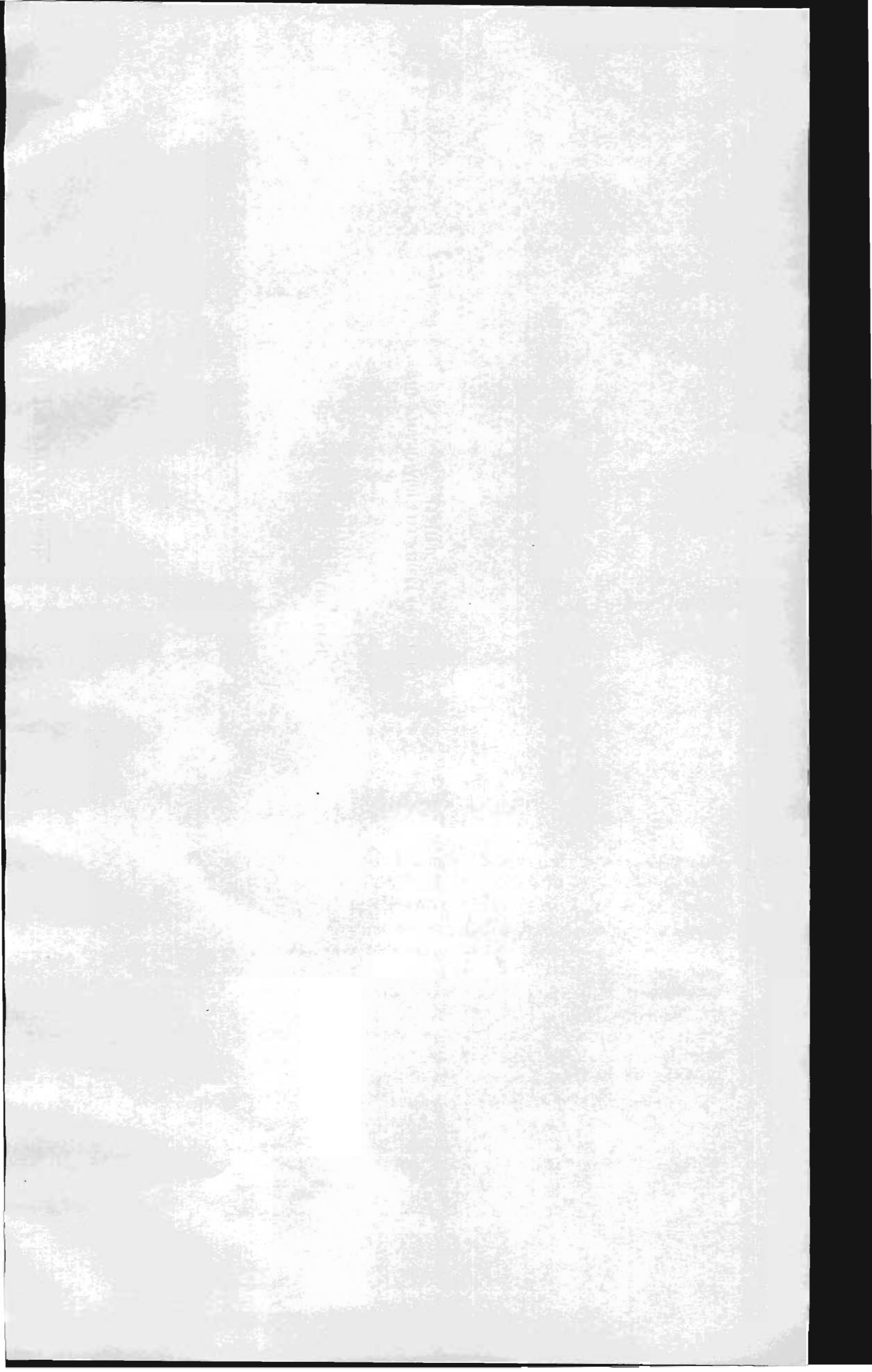
In both cases the commission is agreed to be paid to induce the same thing namely the undertaking of the obligation to subscribe. No other service than undertaking this obligation is in either case rendered by the receiver of the commission. In both cases he in effect receives from the company a discount or rebate upon the amount payable upon the shares which he has to take up. It cannot make any difference that under the underwriting agreement he may not in the event have to take up any share and may yet get his commission all the same.

It is true that the benefit to the company of an underwriting agreement may be great but to resolve the question now under consideration the benefit to the company is not a relevant matter. The solution must be found in the obligation undertaken by the underwriter.

It has however been contended before their Lordships that this view of the matter is inconsistent with the decision of the English Court of Appeal to which Lord Lindley (then Lord Justice Lindley) was a party in *Re Licensed Victuallers Mutual Trading Union ex. p. Audain* 42, Ch.D. 1. Two points only were decided in that case. *First* after hearing expert evidence the Court determined the meaning of the term "underwriting" and *secondly* the Court held that the phrase in the underwriting agreement "at 15 per cent. discount" did not mean discount but commission. The question whether an agreement to underwrite shares for a commission was *intra vires* or *ultra vires* the company does not appear to have been argued by counsel or considered by the Court. Their Lordships are therefore unable to obtain any assistance from this decision.

The reference in the prospectus in the present case to payment of brokerage by the underwriters (a matter not mentioned in the underwriting agreement) does not in their Lordships' opinion affect the matter. Applying the considerations which have been already indicated their Lordships reach the conclusion that the learned judge below was in error in allowing the demurrer and that the appeal must succeed. The order of Mr. Justice Long Innes should be discharged and in lieu thereof the demurrer of the respondents should be dismissed and their Lordships will humbly advise His Majesty accordingly.

The costs here and below will be borne by the respondents.



In the Privy Council.

THE AUSTRALIAN INVESTMENT TRUST,
LIMITED,

v.

THE STRAND AND PITT STREET PROPERTIES,
LIMITED.

DELIVERED BY LORD TOMLIN.

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