

*Judgment of the Lords of the Judicial Committee of the Privy Council on the Consolidated Appeal and Cross-Appeal of Burland and Others v. Earle and Others, and Earle and Others v. Burland and Others, from the Court of Appeal for Ontario; delivered the 9th November 1901.*

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Present:

LORD HOBHOUSE.

LORD DAVEY.

LORD ROBERTSON.

SIR RICHARD COUCH.

[*Delivered by Lord Davey.*]

The Appellants and Respondents in these two Appeals which have been consolidated are alike shareholders in a joint stock company called the British American Bank Note Company. In this judgment the term "Appellants" will mean the Appellants in the first and principal Appeal who are Defendants in the action and "Respondents" will mean the Respondents in the same Appeal and Plaintiffs in the action.

The Company was incorporated by Letters Patent dated the 16th June 1866 under the provisions of an Act (27 & 28 Vict. c. 23) of the old Province of Canada. The objects for which the Company was formed were "to engrave and " print bank notes debentures bonds postage and " bill stamps and bills of exchange and to carry " on all other branches incidental thereto." The capital of the Company was originally \$100,000

divided into shares of \$100 each but was subsequently increased to \$200,000 of which \$170,000 only has been issued.

By Section 1 of the Act referred to provision is made for the incorporation by Letters Patent of joint stock companies for the purpose (*inter alia*) of carrying on any kind of manufacturing business, and by Section 5 it was declared that every company incorporated under the authority of the Act should be subject to the general provisions set out in Sub-sections 1 to 34 thereof. Sub-section 7 to far as material is as follows:—

“7. The Directors of the Company shall have full power  
 “ in all things to administer the affairs of the Company, and  
 “ may make or cause to be made for the Company any description of contract which the Company may by law enter  
 “ into; and may from time to time make by-laws not contrary  
 “ to law, to regulate (*inter alia*) the declaration and payment  
 “ of dividends, the number of Directors, their term of service,  
 “ the amount of their stock qualification, the appointment,  
 “ functions, duties and removal of all agents, officers, and  
 “ servants of the Company, the security to be given by them  
 “ to the Company, their remuneration and that (if any) of  
 “ the Directors, the time at which, and the place or places  
 “ where the Annual Meetings of the Company shall be held  
 “ and where the business of the Company shall be conducted.”

The Act contains no express provisions as to the formation of a reserve fund or as to the investment or application of the undivided profits of the Company.

Shortly after the formation of the Company the shareholders made a number of by-laws of which the following are material for the purpose of this litigation:—

“9. The shareholders of the Company may, at any general  
 “ meeting of the Company, vote and award to the Directors of  
 “ the Company, such compensation as they may think proper.

“10. At all meetings of the Company, every shareholder  
 “ shall be entitled to as many votes as he may own shares in  
 “ the Company, and may vote by proxy; but no shareholder  
 “ shall be entitled to vote unless he has paid all calls in respect  
 “ of his shares.

“11. The Directors shall have the management of the  
 “ affairs of the Company, the appointment, control and removal  
 “ of all the officers and employees of the Company, and

“ shall, from time to time, regulate their several duties and  
 “ remuneration.

“ 12. At every Annual General Meeting, the Directors shall  
 “ present a report and abstract of the accounts of the Company,  
 “ a concise statement of their affairs, and a true and succinct  
 “ statement of their assets and liabilities; and if they deem fit,  
 “ shall recommend the declaration of a dividend of so much  
 “ per cent. on the stock out of the earned profits of the Com-  
 “ pany; and in the interval between the Annual General  
 “ Meetings of the Company, the Directors may, at any regular  
 “ meeting, declare a dividend, whenever an actual cash balance  
 “ in the hands of the Secretary-Treasurer from the earned  
 “ profits of the Company shall, in their judgment, warrant the  
 “ payment of such dividend.

“ 13. The Directors may set apart any portion of the profits  
 “ for a reserve fund, subject to the approval of a General  
 “ Meeting, or to the appropriation of such sum by such meeting  
 “ to any other purpose.

“ 14. The number of Directors shall never be less than  
 “ three, nor more than six. Every new Board of Directors, as  
 “ soon as elected, shall elect a President and a Vice-President;  
 “ they shall also elect the President or Vice-President, or any  
 “ Director, to be at the same time manager, and if any of the  
 “ places of these officers become vacant, they may be filled by  
 “ the Board electing others in their place.

“ 16. At every Board meeting three Directors shall constitute  
 “ a quorum. The President shall preside, in his absence  
 “ the Vice-President, and failing both, any Director. The  
 “ President or Chairman, as a Director, shall have one vote.”

The Company was formed by the union of two groups one represented by the Appellant George B. Burland (who is hereafter referred to as Burland), and the other by a Mr. Smillie and the Respondent Earle. Mr. Smillie was the first president and Burland and the Respondent Earle were first directors. Mr. Smillie retired from the Company in 1881 and sold his shares. Burland from time to time increased his holding and at the date of the commencement of the action he held 1,077 shares. He was also the president and manager of the Company.

The Plaintiffs and Respondents hold between them 433 shares. The Respondent Earle continued on the Board of Directors (with two short intervals) until the year 1890 when he resigned. The Respondent Mrs. Cunningham sues as the

administratrix of James Cunningham deceased who was at one time the auditor and from 1887 until his death in 1892 was a director of the Company. The Respondent Thomas J. Gillelan was from the year 1892 and at the commencement of the action a director of the Company.

The Company's business has been extraordinarily successful. In some years it has paid to its shareholders a dividend exceeding 100 per cent. and the average of the dividends paid during the thirty years of its existence prior to the commencement of the action is said to exceed 40 per cent. per annum. In addition to the dividends so paid the Company has accumulated undivided profits to the amount (at the commencement of the action) of \$264,167. This sum was not formally carried to the credit of a rest or reserve fund but stood to the credit of the profit and loss account of the Company. Shortly before the commencement of the action the Company lost a valuable contract with the Dominion Government. The result was a serious diminution of the profits of its business.

The action was commenced by the Respondents on the 7th December 1897. By their amended Statement of Claim they prayed for a declaration that the accumulation by the Defendants of a surplus or reserve fund was *ultra vires* and for an immediate division and distribution amongst the shareholders of all sums of money accumulated and retained as a reserve fund over and above the authorised capital stock of the Company and various other items of relief. Their Lordships will confine their attention to the points which have been discussed on these appeals. These are (1) the formation of the rest or reserve fund (2) the investment of it (3) a claim by the Respondents to treat Burland as a trustee of the plant and material of a certain insolvent company called the Burland Lithographic Company which

he purchased at a sale by auction and re-sold at an enhanced price to this Company and to make him account to the Company accordingly for the profit made by the re-sale (4) a question as to certain sums drawn as salaries by Burland and the Appellant J. H. Burland.

It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so. Again it is clear law that in order to redress a wrong done to the Company or to recover moneys or damages alleged to be due to the Company the action should *primâ facie* be brought by the Company itself. These cardinal principles are laid down in the well-known cases of *Foss v. Harbottle* 2 Ha. 461 and *Mozley v. Alston* 1 Ph. 790 and in numerous later cases which it is unnecessary to cite. But an exception is made to the second rule where the persons against whom the relief is sought themselves hold and control the majority of the shares in the Company and will not permit an action to be brought in the name of the Company. In that case the Courts allow the shareholders complaining to bring an action in their own names. This however is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress and it is obvious that in such an action the Plaintiffs cannot have a larger right to relief than the Company itself would have if it were Plaintiff and cannot complain of acts which are valid if done with the approval of the majority of the shareholders or are capable of being confirmed by the majority. The cases in which the minority can maintain such an action are therefore confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the Company.

A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money property or advantages which belong to the Company or in which the other shareholders are entitled to participate as was alleged in the case of *Menier v. Hooper's Telegraph Works* (L.R. 9 Ch. 350). It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue if the act when done regularly would be within the powers of the Company and the intention of the majority of the shareholders is clear. This may be illustrated by the judgment of Lord Justice Mellish in *Macdougall v. Gardiner* (1 Ch. D. 13 at p. 25).

There is yet a third principle which is important for the decision of this case. Unless otherwise provided by the regulations of the Company a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject matter of the vote. This is shown by the case before this Board of the *North-West Transportation Company Limited v. Beatty* (12 A. C. 589). In that case the resolution of a general meeting to purchase a vessel at the vendor's price was held to be valid notwithstanding that the vendor himself held the majority of the shares in the Company and the resolution was carried by his votes against the minority who complained.

If these elementary considerations are borne in mind the solution of the principal questions arising in these appeals will not present any real difficulty. It was originally maintained by the Plaintiffs that Art. 13 of the by-laws was beyond the powers of the Company or (in other words) that a company formed by Letters Patent under the Act 27 & 28 Vict. c. 23 was bound to divide all its profits on each occasion

and could not by law reserve any portion thereof either to meet contingencies or for future division or for any other purpose of a reserve fund. The Chief Justice who tried the action held that the Company had no implied power to create a reserve fund or "least of all" to invest a reserve fund upon securities but he thought the question immaterial as the Company had not in his opinion set apart or appropriated a reserve fund and he held that the whole of the sum to the credit of profit and loss ought to be distributed amongst the shareholders. But in his formal judgment or decree he allowed the Company to deduct and retain "a reasonable sum for contingencies the amount in case the parties differed to be settled by the Chief Justice." In the Court of Appeal it was held that it was within the powers of the Company to set apart "a fair and reasonable sum" out of the profits as a reserve fund and it was the duty of the directors to invest it in a proper manner. But the learned Judges seem to have thought that the Company had not exercised the power except as to a sum of \$44,022 and they held that the balance in question after deducting that amount was distributable amongst the shareholders. In their formal judgment the Court inserted a saving for the right of the directors and shareholders to appropriate out of future profits "such further reserve fund as the needs of the Company may properly require."

Their Lordships are not aware of any principle which compels a joint stock company while a going concern to divide the whole of its profits amongst its shareholders. Whether the whole or any part should be divided or what portion should be divided and what portion retained are entirely questions of internal management which the shareholders must decide for themselves and the Court has no jurisdiction to control or review

their decision or to say what is a "fair" or "reasonable" sum to retain undivided or what reserve fund may be "properly" required. And it makes no difference whether the undivided balance is retained to the credit of profit and loss account or carried to the credit of a rest or reserve fund or appropriated to any other use of the Company. These are questions for the shareholders to decide subject to any restrictions or directions contained in the Articles of Association or by-laws of the Company.

If the Company may form a reserve fund or retain a balance of undivided profits it must (it would seem) have power to invest the moneys so retained. The junior Counsel for the Respondents contended that the Company in the absence of express power to invest could employ the money only in its own business. This contention has no support either in principle or in authority and if it were sound the objects for which a reserve fund is needed would in many cases be defeated. The business of this Company affords a cogent instance. In order to obtain a Government contract it may be called upon to make a large deposit or purchase new and expensive plant. It has no power to borrow and if it had no rest or reserve fund it would have no funds out of which to make the necessary expenditure. Upon what securities then may the Company invest its undivided profits or reserve fund? It is conceded at the Bar that the Company is not confined to such investments as trustees are authorised to make. The answer therefore can only be that the reserve fund may lawfully be invested on such securities as the directors may select subject to the control of a general meeting.

The annual accounts of the Company from the year 1873 onwards are in evidence. They consist of a profit and loss account and a balance sheet. These accounts were regularly placed



before the general meeting. The balance sheets show under a separate heading the investments from time to time held by the Company consisting for the most part of bank shares and mortgages. It is not for their Lordships to judge of the propriety or sufficiency of these investments. It may have been expedient for business reasons for the Company to hold an interest in the various Canadian banks. The investments when made reappear in subsequent balance sheets and seem to have been of a permanent character. There is therefore no ground for the suggestion of the directors using the reserve fund for the purpose of trafficking or speculation in stocks and shares.

The investments were wholly or for the most part made in the name of Burland alone. This was for obvious reasons unwise and imprudent but it must have been within the knowledge of the Respondent Earle the late Mr. Cunningham and the Respondent Gillelan and no complaint or remonstrance seems to have been made until the institution of the present suit. Burland is of course bound to account for all the moneys of the Company come to his hands. Very full accounts are directed by the Judgment of the Court of Appeal including special directions as to a loan made to one Bennett with respect to which Burland is charged with foisting upon the Company a bad debt of his own. There is no appeal from this portion of the judgment and the accounts and enquiries will be prosecuted accordingly. Mr. Haldane asked for some injunction with respect to these matters but did not make clear to their Lordships the form or extent of the injunction to which he considered his clients were entitled. The Court of Appeal granted an injunction to restrain the Appellants and the Company from

employing the net profits and earnings of the Company already or which may hereafter be earned in the purchase of shares of the capital stocks of banks or other companies and from using any portion of the net earnings and profits for the purpose of making loans to persons or corporations and also an injunction to restrain the Appellant Burland from investing in his own name or "personally controlling" any portion of the earnings or moneys of the Company or from dealing with the same otherwise than in accordance with the judgment. For the reasons which have already been given it is clear that so sweeping an injunction against the directors and the Company cannot be maintained. And it is equally clear that the injunction against Burland cannot be maintained. It is not *ultra vires* for the Company if it thinks fit to do so to invest in the name of a sole trustee however imprudent and undesirable such a course may be. Nor can Burland as shareholder manager and president of the Company be restrained from exercising any personal control over any portion of the Company's earnings in which indeed he has the largest interest.

If it appeared that under the guise of investing undivided profits or the reserve fund the directors were in fact embarking the moneys of the Company in speculative transactions or otherwise abusing the powers vested in them for the management of the Company's business different considerations would of course arise. But it does not appear to their Lordships that the investment of the surplus profits in bank shares or bonds of trading companies really bears that character or was intended to be or was otherwise than a *bona fide* exercise of the powers of the Company and the directors. The temporary investment of \$50,000 in the Lachine Rapids Hydraulic and Land

Company was more open to criticism but on objection being made Burland took this investment to his own account and it is a little remarkable that his having done so is now made a topic of complaint against him.

The next matter to which the Appeal relates is the sale to the Company by Burland of the lithographic plant &c. of the Burland Lithographic Company. It appears that that Company had been carrying on business in Montreal and having become insolvent was wound up under the provisions of the Winding-up Act. Burland was interested in the Company as a stock-holder and a creditor. At the public sale by the Liquidator on the 10th May 1892 Burland bid for and purchased all the assets of the Company in four lots. The price paid by him for Lot 1 was \$21,564 and he shortly afterwards sold the property comprised in that lot to the Appellant Company for \$60,000. The property together with some other plant purchased from another company was subsequently sold to a company formed for the purpose at an enhanced price payable in shares which were distributed as a bonus amongst the shareholders of the Company.

In these circumstances Burland has been ordered to pay to the Company the sum of \$38,436 being the amount of the profit realised by him on the resale. Both Courts have held that the resale was by Burland's advice and influence, and was made without disclosing to the Company the price at which he had purchased. It was also held in the Court of Appeal that Burland had bought the property with the intention and for the purpose of reselling it to the Company. It appears from the evidence of the Respondent Earle who was then the next largest shareholder to Burland and a director that he was present at the sale and knew all about the transaction and from the

evidence of Gillelan that he knew what Burland had paid "very shortly after." There was evidence of two witnesses Reinhold and Monk that the price to the Company was not unfair. But their Lordships do not think it necessary to pursue these topics because they are of opinion that the relief prayed by the amended Statement of Claim and granted in the Courts below is altogether misconceived. There is no evidence whatever of any commission or mandate to Burland to purchase on behalf of the Company or that he was in any sense a trustee for the Company of the purchased property. It may be that he had an intention in his own mind to resell it to the Company but it was an intention which he was at liberty to carry out or abandon at his own will. It may be also that a person of a more refined self-respect and a more generous regard for the Company of which he was president would have been disposed to give the Company the benefit of his purchase. But their Lordships have not to decide questions of that character. The sole question is whether he was under any legal obligation to do so. Let it be assumed that the Company or the dissentient shareholders might by appropriate proceedings have at one time obtained a decree for rescission of the contract. But that is not the relief which they ask or could in the circumstances obtain in this suit. The case seems to their Lordships to be exactly that put by Lord Cairns in *Erlanger v. New Sombrero Phosphate Company* (3 A.C., 1218). In that case the bill prayed for rescission or alternatively for the profit made by Erlanger and his syndicate on the re-sale to the Company. Lord Cairns said at p. 1235: "It may well be that the prevailing idea in their mind was not to retain or work the island but to sell it again at an increase of price and very possibly to promote or get up a Company

“ to purchase the island from them ; but they  
 “ were as it seems to me after their purchase  
 “ was made perfectly free to do with the island  
 “ whatever they liked to use it as they liked  
 “ and to sell it how and to whom and for what  
 “ price they liked. The part of the case of the  
 “ Respondents which as an alternative sought  
 “ to make the Appellants account for the profit  
 “ which they made on the re-sale of the property  
 “ to the Respondents on an allegation that the  
 “ Appellants acted in a fiduciary position at the  
 “ time they made the contract of the 30th  
 “ August 1871 is not as I think capable of being  
 “ supported and this as I understand was the  
 “ view of all the Judges in the Courts below.”

Reference may also be made to the judgments of Mr. Justice Pearson and Lords Justices Cotton and Fry in *In re Cape Breton Company* (26 Ch. D. 221 and 29 Ch. D. 795). To rescind the sale is one thing but to force on the vendor a contract to sell at another price is a totally different thing.

The question of salaries stands in this wise. Burland's salary as manager was fixed in the year 1879 at \$5,000 per annum. This was increased from time to time to \$12,000. It was not disputed that he is entitled to draw a salary of that amount and both Courts have so held. But in addition to this fixed salary he has since 1888 drawn a further sum of large amount to which he claims to be entitled under the terms of a resolution of the Board of Directors of the 24th April 1888. The Chief Justice held that the title to this increment as well as to the fixed salary was a question of internal management and dismissed this part of the Respondents' claim. The Court of Appeal thought that the question turned on the true construction of the resolution referred to and holding that Burland was not

entitled to the increment under the terms of the resolution ordered him to repay the amount thereof drawn by him since the date of the resolution. The amount which he is directed to repay on this account is \$53,000 or thereabouts. Their Lordships agree with the Court of Appeal that Burland's right to retain this sum depends on the construction of the resolution and it was so put by his Counsel Mr. Blake. The resolution is in the following terms:

“The Manager read letters from Mr. Goodeve and Mr. Ross with reference to their salaries and removal to Ottawa and having made explanations of the difficulties arising out of necessity for removal to Ottawa it was

“Resolved that the Manager be requested to make the best arrangement he can with reference to the assistance given the employees and that an increase of salary be given the staff equal to five per cent. on the capital stock held by each of them to meet all difficulties incurred owing to such removal.”

The first observation which arises on this resolution is that *prima facie* the amount of stock held by the members of the “staff” bears no relation to the value of their services. But it was not contended that the resolution was *ultra vires* and Mr. Blake was perhaps right in saying that it must be looked at in the concrete and that the directors who passed it probably knew the holdings of the members of the “staff” and how it would work. But what is the effect and construction of the resolution? Who are the “employees”? Who are the “staff”? Are they the same or a different set of people? And is the manager a member of the “staff” within the meaning of the resolution? This question is one of considerable difficulty. Some but having regard to Burland's position in the Company not

much weight is to be given to the Company having acted on his construction for ten years or more. On the whole their Lordships are not prepared to differ from the Court of Appeal on this point. In the circumstances they think that Burland cannot have been intended to be included in the "staff." At best the resolution is ambiguous and considering Burland's position it is not unfair to invoke against him the rule of construction *contra proferentem*. He was the leading man in these transactions and it rested on him to make it clear that a resolution under which he claims a much larger benefit than anybody else should carry that meaning on the face of it.

The same question arises with regard to the Appellant J. H. Burland though in his case the sum in question is not so large. The last named Appellant was at the date of the resolution secretary of the Company and there does not seem to be any valid reason why he should not be included in the "staff." There is however a further point with regard to J. H. Burland. It appears that he ceased to hold the office of secretary in 1895 when he was appointed vice-president but in the resolution appointing him to the latter office there is no mention of salary. Therefore, say the Respondents, he is not entitled as Vice-President to any salary or to the increment under the resolution of the 24th April 1888. There is evidence that there was a change in the distribution of offices in 1895 and that J. H. Burland continued to do the same class of work as he had done as secretary that office having been united with that of treasurer. He was allowed by the directors to continue to draw his former salary without any observation until the commencement of the present action and their Lordships think that the inference may fairly be drawn from all the circumstances of the case that he was

intended to retain his salary although there was a shifting of the offices.

The Order of the Court of Appeal which is under review is dated the 13th November 1900. The declarations and directions contained in it are conveniently divided into numbered paragraphs. The result of their Lordships' judgment on the first and principal Appeal may be stated thus: Paragraphs (1), (2), (4), (8), (10), (11), (12) and (13) should be discharged. Paragraph (9) should be varied by substituting "Defendant" for "Defendants" in the third line and omitting the words "and Jeffrey H. Burland" in the fourth line. There should be an Order that the action be dismissed with costs in both Courts so far as relates to (1) the questions of undrawn profits and the investment of the reserve fund (2) the claim to the profits made by the Appellant George B. Burland from the sale to the Company of the plant machinery and materials of the Burland Lithographic Company (3) the claim against the Appellant Jeffrey H. Burland in respect of the sums drawn by him as salary since the 28th May 1895 and (4) so far as any injunction was prayed against the Defendants in the action or any of them.

The disposal of the costs of the action involves some complication and difficulty of adjustment. By the decree of the Chief Justice the Defendants were ordered to pay to the Plaintiffs their costs of the action. This decree however was superseded by the Order of the Court of Appeal. By that Order (paragraph 12) Burland and J. H. Burland were ordered to pay the costs occasioned by the Plaintiffs' Appeal to the Court of Appeal in respect of the salaries withdrawn by them and by (13) so much of the costs of the Plaintiffs up to and including the trial as were attributable to the question of the rights of the parties in respect of the accumulated fund and the costs



of the Appeal to the Court of Appeal for Ontario (meaning apparently the whole costs of both parties of the Appeal of the Defendants) were ordered to be paid out of the said fund. There is no mention in the Order of the Court of Appeal of the costs of the action up to trial so far as relates to the question of salaries the question as to the re-sale of the lithographic plant and the account directed by paragraphs (3) (5) and (6). There is therefore no subsisting Order as to the costs of those portions of the action.

The Defendants have now succeeded on all questions relating to the accumulated fund and as to the sale of the lithographic plant. On the other hand they have failed as to Burland's salary and succeeded as to J. H. Burland's salary. It would be almost impossible to do justice by a strict apportionment of the costs of the action up to trial and to endeavour to do so would lead to certain inconvenience and consequent expense in taxation. On the consideration of all the circumstances their Lordships think that justice will be met by (1) discharging all orders as to costs made in the Courts below (2) directing the Plaintiffs to pay to the Defendants two-thirds of their costs of the action up to and including the trial (3) directing the Defendants to pay to the Plaintiffs two-thirds of the costs of the Plaintiffs' Appeal to the Court of Appeal which rightly succeeded as to Burland but ought to have failed as to J. H. Burland and the Plaintiffs to pay to the Defendants two-thirds of the costs of the Defendants' Appeal to the Court of Appeal which ought to have succeeded except as to the directions for Burland accounting. Paragraph (14) of the Order of the Court of Appeal as to subsequent costs will stand.

Their Lordships will humbly advise His Majesty that the Order of the Court of Appeal

be varied in the manner above stated as to substance and costs.

The Respondents in the principal Appeal will pay to the Appellants two-thirds of their costs of that Appeal and the Appellants will pay to the Respondents one-third of their costs of the same Appeal. The costs of the Cross-Appeal will be paid by the Appellants therein.

In the Court below the greater part of the Plaintiffs' costs up to trial and the costs of the Defendants' Appeal were ordered to be paid out of the accumulated fund. If the parties agree their Lordships think it would be a proper case in which to make that Order as to all the costs in the Courts below and of the principal Appeal to this Board.

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