The Civil Liability of Directors of a Corporation*

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The office of director is older than is sometimes thought. The earliest reference I am aware of is in 1632 when the directors of the Netherlands East India Company are said to have lodged a complaint about the conduct of English merchants at Amboyna in the East Indies. The London Gazette of 1697 carries notice of the appointment of twenty-four directors of the Bank of England, which had been incorporated in 1694. Certainly the term "director" was used in royal charters for more than a century before the first Companies Act of 1862. Lord Hardwicke was not dealing with a novelty when he said in 1742:[1]

> I take the employment of a director to be of a mixed nature; it partakes of the nature of a public office, as it arises from the charter of the crown. But it cannot be said to be an employment affecting the public government; and for this reason none of the directors of the great companies, the *Bank*, *South-Sea* &c., are required to qualify themselves by taking the sacrament. Therefore Committee-men are most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. . . .
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> Now where acts are executed within their authority, as repealing bye-laws and making orders, in such cases though attended with bad consequences, it will be very difficult to determine that these are breaches of trust.
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> For it is by no means just in a judge, after bad consequences have arisen from such executions of their power, to say that they foresaw at the time what must necessarily happen; and therefore were guilty of a breach of trust.

Lord Russell of Killowen's statement made exactly two centuries later that "directors of a limited company are creatures of

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[1] *The Charitable Corporation* v. *Sutton* (1742), 2 Atk. 400, at p. 405; 26 E.R. 642, at p. 644.

statute and occupy a position peculiar to themselves"[2] refers, however, only to limited companies, that is, companies incorporated under a joint stock companies act. I propose to deal only with this type of director, though in the nature of things the law on directors of limited companies must necessarily apply in large part to directors of companies incorporated otherwise.

The courts administering common law and equity received no direction from Parliament on the rules applicable to the holders of the office of director. Of course, courts may not legislate, though the temptation must be sore, when first a judge realizes that no longer must the inertia of his colleagues on the right of Mr. Speaker, and the criticism of his opponents on Mr. Speaker's left, be overcome before his views acquire the force of law. The courts had to hand, however, a vast reservoir of judicial authority to help them and they drew upon the law relating to trustees, agents, partners and solicitors.

In the beginning the view was taken that directors were trustees or agents, and the laws of trusteeship and agency were freely applied. At first directors were viewed as trustees or agents for the shareholders rather than for the company, then for a time the two expressions "trustees for the shareholders" and "trustees for the company" were used interchangeably. Four years after the first Companies Act was passed in England, after referring to a case in which a shareholder had filed a bill against the company and against the directors, Lord Cairns goes on: "treating the directors as his trustees, which in point of law they are, and seeking redress against them for a breach of trust".[3] In 1874 we find the Vice Chancellor of Ontario stating flatly that a director of a company is a trustee for the shareholders[4] and in 1890 another judge in the same province, Robertson J., said that a director could not serve two masters, "himself individually or personally, and the shareholders of the company, whose agent he was".[5] As late as 1905 a learned judge who later became Chief Justice of Canada, Duff J., is stating that directors owe "a duty to the shareholders as a whole" and to "the corporate body to which they [the directors] owe this duty".[6]

Possibly as a result of the *Salomon* case,[7] the courts came eventually to treat directors as trustees for the company instead of the

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[2] *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] 1 All E.R. 378, at p. 387.
[3] *Ferguson* v. *Wilson* (1866), 2 Ch. App. 77, at p. 90.
[4] *Greenstreet* v. *Paris* (1874), 21 Gr. Ch. 229, at p. 232.
[5] *Re Iron Clay Brick Manufacturing Co.* (1890), 19 O.R. 113, at p. 123.
[6] *Madden et al.* v. *Dimond et al.* (1905), 12 B.C.R. 80, at pp. 89, 91.
[7] [1897] A.C. 22.

shareholders, and it is now finally established that the company alone may call them to account, though in certain circumstances the company's remedy may have to be exercised by a shareholder suing on behalf of himself and other shareholders. It is the company's remedy, however, which is enforced, not the remedy of the shareholder.[8] As late as 1937 it was necessary for the Judicial Committee to lay down again

> 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.[9]

Although the courts were ready to apply to directors the laws of trust and agency, they were alive to the possibility that, if the application is too strict, it may cramp commercial activity. The courts have usually been alive to the significance of their decisions for commerce. In 1878 Jessel M.R. said:

> One must be very careful in administering the law of joint stock companies not to press so hardly on honest directors as to make them liable for these constructive defaults, the only effect of which would be to deter all men of any property, and perhaps all men who have any character to lose, from becoming directors of companies at all.[10]

And ten years later another English judge, Kay J., stated:

> it is quite obvious that to apply to directors the strict rules of the Court of Chancery with respect to ordinary trustees might fetter their action to an extent which would be exceedingly disadvantageous to the companies they represent.[11]

About the same time the House of Lords laid down in *Derry* v. *Peek*[12] that directors are not liable for a mis-statement in a prospectus where they had honestly believed the statement to be true.

Parliament appears to have disagreed with this gentle treatment, however, and the Director's Liability Act of 1890[13] was passed creating statutory liability where none existed in law. The provisions of this act have now found their way into the company law of Canada. I cannot speak for Quebec or Newfoundland, but similar provisions are in the Dominion act and in all the other provincial companies acts. Not only have these provisions been adopted, but the habit of extending the responsibility of directors has grown until there are now a dozen or more provisions in the Dominion Companies Act imposing upon directors statutory liabili-

[8] *Burland* v. *Earle*, [1902] A.C. 83.
[9] *E.B.M. Co. Ltd.* v. *Dominion Bank*, [1937] 3 All E.R. 555, at pp.564-5.
[10] *In re Forest of Dean Coal Mining Co.* (1878), 10 Ch. D. 450, at p. 451.
[11] *In re Faure Electric Accumulator Co.* (1888), 40 Ch. D. 141, at p. 151.
[12] (1889), 14 App. Cas. 337.
[13] 53 & 54 Vict., c. 64.

ty for a variety of things, ranging from false statements in a prospectus, through six months' wages of employees, to the failure of the company to file its annual return.

In a case already referred to, Lord Russell of Killowen also said that in some respects directors resemble trustees and in others they do not; in some respects agents, in others they do not; in some respects managing partners, in others they do not.[14] He might have added: in some respects solicitors, and in others they do not.

The laws of trusteeship were ready to hand and fitted the new statutory creature well enough, but obviously all the laws of trusteeship would not do, and so we find in 1878 directors excused for failing to get in a debt, a failure for which a trustee would have had to answer. The ground given was that directors are like managing partners of a trading partnership and therefore have a discretion whether they should sue their customers. A director was excused, too, for not disclosing to his principal, the company, knowledge of a fraud upon the company, because that knowledge had been acquired before his appointment.[15] A few years later Lord Justice Bowen remarked that:

> when persons who are directors of a company are from time to time spoken of by Judges as agents, trustees, or managing partners of the company, it is essential to recollect that such expressions are used not as exhaustive of the powers or responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered. . . .[16]

About the same time another learned judge said:

> To my mind the distinction between a director and a trustee is an essential distinction founded on the very nature of things. A trustee is a man who is the owner of the property and deals with it as principal, as owner, and as master, subject only to an equitable obligation to account to some persons to whom he stands in the relation of trustee, and who are his *cestuis que trust*. . . . The office of director is that of a paid servant of the company. . . . He cannot sue on such contracts nor be sued on them unless he exceeds his authority.[17]

The distinction between agency and directorship was made clear in 1906 when Lord Justice Cozens-Hardy said:

> I do not think it true to say that the directors are agents. I think it is more nearly true to say that they are in the position of managing partners

[14] *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] 1 All E.R. 378, at p. 387.
[15] *In re Forest of Dean Coal Company* (1878), 10 Ch. D. 450, at p. 451.
[16] *Imperial Hydrophathic Hotel Company, Blackpool* v. *Hampson* (1882), 23 Ch. D. 1, at p. 12.
[17] *Smith* v. *Anderson* (1880), 15 Ch. D. 247, at p. 275.

appointed to fill that post by a mutual arrangement between all the shareholders.[18]

That a director's position is more favourable than a solicitor's has been suggested in a number of decisions, though none may be directly on the point. For instance, it has been held that a director of a company may against the will of his company be a director in a rival and competing company, though of course he may not use for the benefit of one company confidential information acquired by him as a director of the other.[19] A solicitor may not against the will of his client act in two capacities between which there is a conflict of interest. Again, a director's position alters completely when he resigns; a solicitor, however, does not escape responsibility in a later transaction with his former client by the mere fact that he has ceased to act for the client and another solicitor has been retained in his place.[20]

The position of a director has been summed up under five heads:

(1) he must act honestly;

(2) he must exercise the reasonable care of an ordinary man acting on his own behalf;

(3) he must exhibit that degree of skill reasonably to be expected from a man of his knowledge and experience, though he is not liable for mere errors of judgment;

(4) he must give attention to the affairs of the company at board and committee meetings he attends and he should attend meetings when reasonably able to; and

(5) he may rely upon the officers and employees of the company and assume that they are performing their duties honestly so long as he has no grounds for suspecting otherwise.[21]

In determining what is the law in a common law jurisdiction of Canada, one must remember what Viscount Dunedin said in *Robins* v. *National Trust*:[22]

> when an appellate Court in a colony which is regulated by English law differs from an appellate Court in England, it is not right to assume that the Colonial Court is wrong. It is otherwise if the authority in England is that of the House of Lords. That is the supreme tribunal to settle English law, and that being settled, the Colonial Court, which is bound by English law, is bound to follow it. Equally, of course, the point of

[18] *Automatic Self-Cleansing Filter Syndicate Company, Ltd.* v. *Cuninghame*, [1906] 2 Ch. 34, at p. 45.

[19] *London and Mashonaland Exploration Company Limited* v. *New Mashonaland Exploration Company Limited*, [1891] W.N. 165.

[20] *Gibbs* v. *Daniel* (1862), 4 Giff. 1; 66 E.R. 595.

[21] *In re City Equitable Fire Insurance Company Limited*, [1925] 1 Ch. D. 407.

[22] [1927] A.C. 515, at p. 519.

> difference may be settled so far as the Colonial Court is concerned by a judgment of this Board.

A judgment of the Court of Appeal in England, though binding upon a Canadian judge at nisi prius, need not be followed by a provincial appellate court. A judgment of the House of Lords or the Privy Council, however, is binding upon a provincial appellate court and presumably, too, upon the Supreme Court of Canada. Where the Privy Council and the House of Lords differ, as they did on the question of the negligence of a bank's customer in making out his cheques, and the House of Lords[23] says the Privy Council[24] is wrong, the judgment of the Privy Council should not be followed.[25] The House of Lords was in 1931 the only body that could declare the Privy Council wrong, but since the Supreme Court of Canada has become a court of last resort, presumably it now has that prerogative as well. What happens when the House of Lords hands down a judgment contrary to one given by the Supreme Court of Canada will undoubtedly lead to much argument, but, since the question is what the English law on the point involved is, one would expect the decision of the House of Lords to prevail.

As examples of what a director may or may not do, and when he will and will not be liable, and to what extent, the following may be stated.

1. He may not accept bribes in respect of or commissions on the company's business. Where a director takes a bribe from a third party in respect of goods supplied to his company, the bribe can be recovered by the company from the director and the company may also sue the supplier for the amount of the bribe, thus in effect securing the reduction of the purchase price by that amount, or the company may rescind the contract.[26] The same thing is true where commissions are taken by a director on company business.[27] These are specific applications of the principle that a director must act honestly.

2. He must not misapply or use improperly the company's funds or property. Where the directors had paid a brokerage or commission to a stockbroker for placing the company's shares, they were held liable to repay the amount of the brokerage to the liquidator, with interest at 4%, on the ground that the payment

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[23] *London Joint Stock Bank* v. *MacMillan and Arthur*, [1918] A.C. 777.

[24] *Colonial Bank of Australasia* v. *Marshall*, [1906] A.C. 559.

[25] This was the view expressed by Ford J. in *Will* v. *Bank of Montreal*, [1931] 2 W.W.R. 364; 3 D.L.R. 526.

[26] *Salford* v. *Lever*, [1891] 1 Q. B. 168; *Grant* v. *Gold Exploration & Development Syndicate, Ltd.*, [1900] 1 Q.B. 233.

[27] *Boston Deep Sea Fishing and Ice Co.* v. *Ansell* (1888), 39 Ch. D. 339.

was ultra vires.[28] Where they made a payment to the promoter of a company and got some of it back themselves, they had to repay the liquidator what they had received, and they were not allowed set-off.[29] They have been held liable for dividends paid on the strength of the false profit shown in the balance sheet, made possible by treating bad debts as assets.[30]

3. He must not be negligent in dealing with the company's property, though he may err in judgment. "Negligence" is a negative, not a positive word.[31] To determine what constitutes negligence in a particular case, the extent of the duty said to have been neglected must be determined. The terms "negligence" and "gross negligence" have been applied, but, as was said more than a century ago, "gross negligence" is merely "negligence" with a vituperative epithet;[32] more recently, the distinction is said to be only between the duty that is owed in one case and the duty that is owed in another.[33] The way the work of the company is distributed between the board of directors and the staff is a purely business matter which has to be taken as a fact, as is also the nature of the company's business.[34] So long as the director in the light of his experience exercises honestly and with diligence the skill and intelligence with which he is endowed, he will not be held negligent. Where he fails to do so, liability follows. What is or is not negligence will have to be determined on the facts of each case. Even failure to attend meetings may amount to negligence.[35] If he signs cheques in blank and leaves them with another to be used, he must take the responsibility when they are improperly used.[36] If he is a party to the payment of dividends out of capital, or an unauthorized commission on the sale of the company's shares, he must make good.[37]

4. He must not use to his own advantage the property of the company. This is merely an extension of the principles that he must not use improperly the company's property or deal with it

[28] *In re Faure Electric Accumulator Company* (1888), 40 Ch. D. 141.

[29] *In re Anglo-French Co-operative Society; Ex Parte Pelly* (1882), 21 Ch. D. 492.

[30] *Flitcroft's case: In re Exchange Banking Co.* (1882), 21 Ch. D. 519.

[31] *Grill* v. *General Iron Screw Collier Company (Limited)* (1866), L.R. 1 C. P. 600, at p. 612.

[32] *Wilson* v. *Brett* (1843), 11 M. & W. 113, at p. 116; 152 E.R. 737, at p. 739.

[33] *In re City Equitable Fire Insurance Company Limited*, [1925] 1 Ch. 407, at pp. 427-428.

[34] *Ibid.*, at p. 429.

[35] *The Charitable Corporation* v. *Sutton* (1742), 2 Atk. 400, at p. 405; 26 E. R. 642, at p. 644.

[36] *Northern Trust Co.* v. *Butchart et al.*, [1917] 2 W.W.R. 405, at p. 421; 35 D.L.R. 169, at p. 186.

[37] *Ibid.*

negligently. In a recent case in Ontario a director was made to account for corporate property he had used in trading on the market, his liability being to repay the value of the property together with either interest or the profit he had made in the trading, but not both.[38] The application of this principle is obvious where the property belongs to the company in law. Once it is established that the property is the company's, liability naturally follows. Difficulties and confusion arise, however, where the property belongs in law to the director but in equity to the company. The problem is to establish the equitable ownership of the company.

Where directors took in their own names contracts which they ought, in the normal course, to have entered into in the name of their company, the property in the contracts was held to lie in the company and the directors were made to account to the company.[39] This, of course, is not a case of negligence but of misfeasance. When a director acquired the property independently before becoming a director, no question of equitable ownership by the company arises.[40] A sale to the company after he becomes a director may be set aside for non-disclosure; or, if rescission is impossible or the company elects not to rescind, he may be liable not for his profit, that is, the difference between the price he paid and the price he got, but for the excess of the price he got over the fair market value of the property at the time of the sale.[41] Where, however, his purchase of the property and the sale to the company were really part of the one transaction, he may be liable to the extent of his profit.[42]

To establish ownership, however, is not simple where a man has acquired the property with his own funds while a director. The principle upon which property thus acquired is held to belong in equity to the company takes its root in the law of trusteeship exemplified by *Keech* v. *Sandford*.[43] If his company had told him to acquire the property for it, and instead of doing so he had acquired it for himself, the director would of course be liable to account to his company on the ordinary principles of agency.[44] Where, however, the director, having no mandate from his company, purchased the property for his own account and later sold

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[38] *Gray* v. *New Augarita Porcupine Mines Ltd.*, [1952] 3 D.L.R. 1.
[39] *Cook* v. *Deeks*, [1916] 1 A.C. 554.
[40] *In re Cape Breton Company* (1885), 29 Ch. D. 795, at pp. 809 & 812; aff. *sub nom.*, *Cavendish Bentinck* v. *Fenn* (1887), 12 App. Cas. 652.
[41] *Ibid.*, pp. 805, 809 & 812.
[42] *Gluckstein* v. *Barnes*, [1900] A.C. 240.
[43] (1726), Sel. Cas. Ch. 61; 25 E.R. 223.
[44] *Cavendish Bentinck* v. *Fenn* (1887), 12 App. Cas. 652.

it to his company, the company cannot establish equitable ownership.[45] The facts of one of the claims in *Burland* v. *Earle* were these. Burland, who was a director of the British American Bank Note Company, bought for his own account at the liquidator's public sale for some $21,000 the lithographic plant and other assets of a company that was being wound up. Shortly afterwards he sold the property to his own company for $60,000, disclosing his ownership but not the price he had paid. Earle, who had been a director and was a shareholder, together with other shareholders, brought action against Burland, claiming *inter alia* an accounting of the profit he had made, and in the court below Burland was ordered to pay the company some $38,000, the difference between the price he had paid and the price he got from the company. This judgment was affirmed by the Court of Appeal of Ontario, but reversed on appeal to the Privy Council on the ground that there was no evidence whatever of any commission or mandate to Burland to purchase on behalf of the company. The fact that he intended to resell to the company when he originally made the purchase made no difference, and he was therefore entitled to keep the profit he had made.

A director who acquires property while in office will, however, be liable to account for his profit upon resale if two elements are present. He must have acquired the property *only* by reason of the fact that he was a director and *in the course of the exercise* of the office of director.[46] If either of these elements is missing, the company will be unable to establish its equitable ownership. It is another way of saying the same thing, that he was only able to acquire the property by the use of some confidential information he acquired in the course of the exercise of his office as a director of the company.[47] "Confidential" in this connection, I apprehend, refers to information of his company, not information of the vendor. An owner, for instance, may let it be known that he desires to sell the business of his private company. Though he may be unwilling to make public its balance sheet, he may give out the balance sheet to prospective purchasers to enable them to consider the purchase. If this information be available to anyone who chooses to show an interest in the purchase, the fact that it came to the knowledge of the director of a company when there was no reason why he should not have acquired it, had he not been a director, would not seem to fill the condition mentioned.

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[45] *Jacobus Marler Estates* v. *Marler* (1913), 85 L.J.P.C. 167n; *Burland* v. *Earle*, [1902] A.C. 83.

[46] *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] A.C. 161, at p. 194.

[47] *Bell* v. *Lever Brothers, Limited*, [1932] A.C. 161, at p. 194.

The *Gulliver* case is not in conflict with *Burland* v. *Earle* because neither of the elements mentioned were present in *Burland's* case. In the *Gulliver* case the facts were these. The directors of Regal, wishing to sell the company's assets as a going concern, arranged a lease of two more cinemas to a new wholly-owned subsidiary company, which had an authorized capital of five thousand £1 shares. The lessor required that the whole of the capital stock of the subsidiary be fully paid up. Regal was in a position to pay up only £2,000 and the deal, therefore, would have fallen through. In these circumstances Regal's five directors and its solicitor, at a meeting of Regal's directors, subscribed £500 apiece, thus making up the remaining £3,000. Later, a sale of all the shares of Regal and all the shares of the subsidiary was completed, the profit on the shares of the subsidiary being nearly £3 a share. The directors and the solicitor claimed the right to retain as their own property this profit on the shares for which they had subscribed. The House of Lords, however, held otherwise, requiring those directors who had made a profit to pay it over to Regal. One director escaped because the beneficial ownership of his shares was in third parties who were not directors. The solicitor escaped because he was not a director and had only subscribed to the shares at the request and with the consent of the board of directors of the plaintiff. The judgment is based squarely upon the presence of the two elements mentioned previously, Lord Russell of Killowen saying:

> and having obtained these shares by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office are accountable for the profits they have made out of it.[48]

Lord Porter put it this way:

> The legal proposition may, I think, be broadly stated by saying that one occupying a position of trust must not make a profit which he can acquire only by use of his fiduciary position, or, if he does, he must account for the profit so made.[49]

In *Bell* v. *Lever*, Bell and Snelling, under an agreement with Lever Brothers, became directors of another company called Niger, in which Levers owned a 99% interest. The purpose of the arrangement was to secure management for Niger, and this Bell and his associate supplied with outstanding success. Subsequently, in the course of a merger with other companies, Bell and his co-director were necessarily relieved of their offices as directors and were paid considerable sums in compensation. Subsequently Levers discovered that while in office both these men had dealt in cocoa for

[48] *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] 1 All E.R. 378, at p. 389.
[49] *Ibid.*, p. 395.

their own accounts and, cocoa being one of the products in which the Niger company dealt, Levers became incensed and sued for the return of the sums paid to them for loss of office. It was a jury trial and the jury held that Levers would have been entitled under their contract to terminate the services of Bell and Snelling for their private dealings in cocoa. Bell and Snelling took the position that they were entitled to deal in cocoa if they liked, but it was brought to their attention that a pooling agreement made Niger responsible for such contracts made by its directors, and they promptly paid over the profit they had made in their private dealings. For this they were commended by the House, but the judgment makes it clear that, had it not been for the agreement, they would have been entitled to retain their profit. Levers were held to have no cause of complaint because the directors were in no fiduciary relationship to them by reason of being directors of Niger, but were only under such obligations to Levers as were to be found in their contract of employment. Lord Atkin said expressly:

> It will be noticed that Bell was not a director of Levers, and, with respect, I cannot accept the view of Greer L.J. that if he was in fiduciary relationship to the Niger Company he was in a similar fiduciary relationship to the shareholders, or to the particular shareholders [Levers] who held 99 per cent of the shares.[50]

5. The sale of the director's property to his company, or the making of contracts with it, has to be interpreted in the light of any regulations that may be found in the by-laws or articles of the company itself. In the absence of protecting regulations, contracts of this kind may be rescinded by the company for non-disclosure, but the company may not confirm the contract and claim the director's profit because that would be to make a new bargain between the parties.[51]

6. The position of a director may be further complicated by his relationship to the shareholders of the company or some of them. For instance, where the director of a wholly-owned subsidiary takes and holds his office under an agreement with the parent corporation, of which he is not a director, his duties to the subsidiary will be those of a director of a corporation, and his duties to the parent will be those which flow from his contract. He does not by reason of his directorship of the subsidiary owe any duty whatever to the parent. As the Judicial Committee once said:

[50] [1932] A.C. 161, at p. 228.
[51] *In re Cape Breton Company* (1885), 29 Ch. D. 795, at p. 805; aff. 12 App. Cas. 652.

> the directors of the association whom he is suing were the agents of the association and not of the shareholders, and there was no privity between the shareholders as such and the directors. The fiduciary relation of the directors was to the association.[52]

Lord Atkin later in the House of Lords refused to accept the view that a director of a subsidiary, who was not a director of the parent, was in the same fiduciary relationship to the shareholders of the subsidiary or a particular shareholder who held practically all the shares.[53]

A recent case in British Columbia[54] has been criticized by Mr. J. B. Ballem in the Canadian Bar Review for February of this year.[55] In that case Raley was the president and director of the plaintiff company but was not a director of and held no office with the parent company, Safeway Stores Incorporated, a Maryland corporation. There were two other directors of the plaintiff, a solicitor and an employee. In 1936 Raley investigated the Empress Manufacturing Company Limited of Vancouver. In that same year, 1936, the defendants purchased one-half of the shares of Empress, and Raley and another purchased most of the remaining shares. The company was operated for three years under the management of one of the defendants, but in 1939, after negotiations with other parties had fallen through, all the shares were transferred to the plaintiff following a purchase negotiated by Warren.

Subsequently it came to the knowledge of the Maryland corporation that Raley had owned some of the Empress shares. A settlement was made with Raley and this action commenced against the defendants. The action succeeded on the ground that Raley had a mandate to acquire Empress and owed the duty of a trustee. The source of the mandate is expressed in these terms:

> It was one of Raley's duties to expand and build up the plaintiff's business and, in the course of so doing, to investigate thoroughly the wisdom of buying out existing businesses and to submit the results of his investigations to the head office of the plaintiff's shareholders with whose directors lay the decision to buy or not to buy.[56]

This implies that the mandate came not from the plaintiff but from the Maryland corporation. The purchase in 1939 was negotiated by Warren, who held no office with the plaintiff but was the president and a director of the Maryland corporation.

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[52] *Clarkson* v. *Davies*, [1923] A.C. 100, at p. 111.
[53] *Bell* v. *Lever Brothers, Ltd.*, [1932] A.C. 161, at p. 228.
[54] *Canada Safeway Ltd.* v. *Thompson et al.*, [1951] 3 D.L.R. 295.
[55] Comment: Company Law—Duty of Director to Account for "Secret Profits"—Outsiders Associated with Directors Affixed with Constructive Trust (1952), 30 Can. Bar. Rev. 179.
[56] *Canada Safeway Ltd.* v. *Thompson et al.*, [1951] 3 D.L.R. 295, at p. 298.

It was held that Raley should have made full disclosure to "his principal", apparently by this term meaning the Maryland corporation, because the judgment reads:

> Approval by Raley's fellow directors of the plaintiff would not suffice. Nothing less than the approval of the plaintiff's shareholders after full disclosure would have sufficed.[57]

And again:

> Raley could not buy into Empress without full disclosure to his company and to all its shareholders. In my view nothing less than a unanimous resolution of its shareholders consenting to the buy after such full disclosure would enable Raley to buy Empress shares without rendering himself liable to account for all profits made on their sale:[58]

The authorities given for this statement are the *Regal* case, *De Bussche* v. *Alt*,[59] and the Court of Appeal decision in the *Burland* case.[60]

Raley's duties to the Maryland corporation must have arisen out of contract, since he was not a director, and if the mandate came from that company the remedy of the plaintiff, were it in fact the principal in the purchase, must have been rescission or damages. Rescission, however, would have involved giving back the Empress shares, which neither the plaintiff nor the Maryland corporation elected to do. Damages could only have been given upon proof that the value of the shares at the time of purchase was less than the price paid.[61]

7. Section 95 of the Dominion Companies Act concerns the subject of contracts with a company in which a director is interested. It provides that he must declare his interest at a meeting of directors and refrain from voting on the contract. Subsection (5) goes on to provide that if he does these two things he is not accountable for any profit realized under the contract either to the company or any of its shareholders or creditors by reason only of his holding that office or of the fiduciary relationship thus established. The converse of this provision, of course, is that he is accountable for the profit if he does not do both these things, that is, declare his interest and refrain from voting.

Why the second condition was added is a little difficult to understand, since subsection (4) not only provides that the interested director is not to vote but continues that, if he does, his

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[57] *Ibid.*, p. 317.
[58] *Ibid.*, p. 321.
[59] (1878), 8 Ch. D. 286.
[60] (1900), 27 O.A.R. 540, at p. 561.
[61] *Burland* v. *Earle*, [1902] A.C. 99; *In re Cape Breton Co.* (1885), 29 Ch. D. 812.

vote will not be counted. The mere fact of his voting, therefore, could not legally make matters any worse for the company, and one would have thought that it would have been sufficient to require him to declare his interest. Whatever the reason, the two conditions are imposed.

The reasons for judgment of the Supreme Court of Canada will make interesting reading when it comes to deal with a case where a company seeks to recover the profits of its director from a contract on the ground that, though he had duly declared his interest in the approved manner, he had for some reason (perhaps because he learned that the government wanted his property for some public building) voted *contra* on the motion.

The problem of what amounts to declaring his interest does not appear to have been the subject of judicial decision under section 95. We are left, therefore, to apply decisions on similar provisions, the earliest of which appears to be one of the House of Lords in 1873.[62] There the provision in question was contained in an article of association, which provided that the office of a director should be vacated:

> If he contracts with the company, or is concerned in, or participates in, the profits of any contract with the company, or participates in the profits of any work done for the company, without declaring his interest at the meeting of the directors at which such contract is determined on or work ordered. . . .[63]

The defendant in that case was a member of a stockbroking partnership which had entered into an arrangement with a railway company to place the railway company's debentures in return for a commission of 5%. Subsequently the firm suggested to the plaintiff company, of which the defendant was a director, that it should undertake to place a quantity of these debentures, but the commission offered the company was only 1½%. When the proposal came before the board of directors, the defendant, who was present at the meeting, told the board that he, with his partner Knight, was interested in the proposal then being brought before the board, and of course all the directors knew that the business of the defendant's firm was stockbroking. Nothing more was disclosed to the board and, particularly, no disclosure was made of the difference between the rate of commission the partnership would receive and what was offered to the company. Lord Chelmsford, after stating that the whole question depended upon the

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[62] *Liquidators of the Imperial Merchantile Credit Association* v. *Coleman* (1873), 6 E. & I. App. 189.

[63] *Ibid.*, p. 192.

meaning to be given to the words of the article "declaring his interest", went on to say:

> But it must be observed that the words of the article are not 'to declare that he has an interest' but to 'declare *his* interest', which seems to involve not merely the declaration of the existence of an interest but the nature of that interest. For surely when the directors are to determine whether they will enter into any contract, or order any work to be done for the company in which a brother director is interested, it may be a most important element in their consideration what the nature of the interest is which is required to be declared.... If the directors had been fully informed of the real state of things, would they have accepted the proposal, and ought they to have done so as trustees for the shareholders?[64]

He then went on to deal with the various defences raised and to hold finally that the defendant was liable to refund the profit he must be considered to have received in trust for the association, the whole of the profit, even though his partner shared it. Lord Cairns deals with the matter in this way:

> Now has the Respondent done so [*i.e.*, complied with the provisions of the clause]? Did he declare or as that word implies, show clearly his interest? His interest might be anything, from the absolute ownership of the property sold, down to a right of a nominal charge on or payment out of it. Did he, then, 'declare' what his intention was? Certainly he did not. A man declares his opinion or his intentions when he states what his opinion is, or what his intentions are, not that he has an opinion or that he has intentions; and so, in my opinion, a man declares his interest, not when he states that he has an interest, but when he states what his interest is.[65]

With this judgment Lord Colonsay concurred, and the defendant was held liable to account to the association for commission at the rate of 3½% on all the debentures placed by the association, together with interest at 4%.

The House of Lords again dealt with non-disclosure in *Gluckstein* v. *Barnes*,[66] where it held directors liable for failure to disclose their entire interest. What happened was that a syndicate had been formed that acquired the Olympia in London. On the face of the contract the price paid was £140,000, but there were a number of encumbrances against the property, some of which this same syndicate had managed to acquire at a heavy discount. They then formed a company to take over the property, which they agreed to transfer to the company for £180,000, declaring in the prospectus that they had paid £140,000 for it. On the face of things, the profit they made was only £40,000, but when the en-

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64 *Ibid.*, p. 200.
65 *Ibid.*, p. 205.
66 [1900] A.C. 240.

cumbrances were paid out of the purchase price, the syndicate realized an additional profit of something over £20,000. The company later went into liquidation and upon a summons under the Winding-up Act the Court of Appeal ordered Gluckstein to pay the Official Receiver around £6,000 with interest. It was argued for Gluckstein that the mortgage securities had been purchased before there was any company and, the purchase being a separate and collateral transaction, the syndicate was not bound to disclose it, and if they were bound to disclose it they had discharged their duty. The judgment of Lord Macnaghten, a famous one, is worth quoting:

> These gentlemen set about forming a company to pay them a handsome sum for taking off their hands a property which they had contracted to buy with that end in view. They bring the company into existence by means of the usual machinery. They appoint themselves sole guardians and protectors of this creature of theirs, half-fledged and just struggling into life, bound hand and foot while yet unborn by contracts tending to their private advantage, and so fashioned by its makers that it could only act by their hands and only see through their eyes. They issue a prospectus representing that they had agreed to purchase the property for a sum largely in excess of the amount which they had, in fact, to pay. On the faith of this prospectus they collect subscriptions from a confiding and credulous public. And then comes the last act. Secretly, and therefore dishonestly, they put into their own pockets the difference between the real and pretended price. After a brief career the company is ordered to be would up. In the course of the liquidation the trick is discovered.[67]
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> But he [Gluckstein] complains that he may have a difficulty in recovering from his co-directors their share of the spoil, and he asks that the official liquidator may proceed against his associates before calling upon him to make good the whole amount with which he has been charged. My Lords, there may be occasions in which that would be a proper course to take. But I cannot think that this is a case in which any indulgence ought to be shown to Mr. Gluckstein. He may or may not be able to recover a contribution from those who joined with him in defrauding the company. He can bring an action at law if he likes. If he hesitates to take that course or takes it and fails, then his only remedy lies in an appeal to that sense of honour which is popularly supposed to exist among robbers of a humbler type.[68]

8. A director may be liable for the acts or omissions of his co-directors as well as for what he himself has done or not done. This liability was first suggested as long ago as 1742, when Lord Hardwicke said in the *Sutton* case:

> if some persons are guilty of gross non-attendance, and leave the management entirely to others, they may be guilty by this means of the breaches of trust that are committed by others.[69]

[67] *Ibid.*, p. 248. [68] *Ibid.*, p. 255.

[69] *The Charitable Corporation* v. *Sutton* (1742), 2 Atk. 400, at p. 405; 26 E. R. 642, at p. 644.

In the *Gluckstein* case their Lordships expressed surprise that Gluckstein had only been proceeded against for the £6,000 odd, indicating that they would willingly have held him liable for the full amount, for what his co-directors had received as well as himself. In the *Faure*[70] case the liability of the directors was declared to be joint and several.

Under the Companies Act provision is made under which in some instances a director may escape his liability by disclaiming the action taken by his co-directors. In order to avail himself of the defence, however, he must prove strict compliance with the terms of the statute.[71] He is also entitled to contribution from his co-directors where they are equally to blame, but of course not where he has derived the whole benefit.

Section 207 of the Dominion act, the counterpart of which is found, I think, in all the provincial companies acts, takes its source in a similar provision of the English act. This section empowers the court before which proceedings against a director are being taken to relieve him of liability, either wholly or partly, if he has acted honestly and reasonably, and ought fairly to be excused. The relief has been refused in Canada because the trustee had not acted as an ordinarily prudent man of business would have done.[72]

9. The liability resting on a director by virtue of his office is not to be confused with the liability he may find himself under by reason of his dealings with the shareholders as such. In *Allan* v. *Hyatt*[73] the directors took up a number of shares in the company. They later sold their own and these shares at a price greater than the option price, and the shareholders were able to recover from them the profits they had made on the resale of their shares. The shareholders were able to do this, not because the directors owed them any duty as such, but because they had acquired the options by representing that they were necessary to completion of the transaction and that the shares were worth only the option.

The same principle underlies the decision in *Loch* v. *Blackwood*,[74] though the relief sought there was merely a winding-up order because the minority shareholder had not succumbed to the representations of the director who sought to acquire her shares. The attempt to acquire the minority shares at an under-valuation was held to be sufficient to destroy confidence in the management and to make it just and equitable that the company be wound up.

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[70] *In re Faure Electric Accumulator Co.* (1888), 40 Ch. D. 141, at p. 151.
[71] *E.g.*, ss. 77,78.
[72] *Maritime Trust* v. *Eastern Trust*, [1949] 2 D.L.R. 497, at p. 506.
[73] (1914), 30 T.L.R. 444 (P.C.); 17 D.L.R. 7.
[74] [1924] A.C. 783.

10. Although not strictly relevant on the question of liability, it is appropriate to note that a solicitor-director may not sue his company for his fees.[75] In this he is less fortunate than a banker-director, who may recover his interest charges,[76] though if they are usurious they will be disallowed and reduced to what would be normal.[77] The distinction between solicitor and banker is not based, I am glad to say, on the relative morality of the two professions, but on the theory that borrowing money is not part of the enterprise of the company. The privilege of the banker does not extend to the director, who is a private money lender, at least when he takes security.[78]

The business man who reads these decisions may well adapt the remark of W. S. Gilbert's policeman: "A director's lot is not a happy one".

Law Reform

Finally there are what can be compendiously described as legal authors. To-day I believe that they are capable of exercising a major role in the matter of law reform. Half a century ago it was thought to be the duty of the legal writer to state the law as it is, and any criticism of that law was regarded as in the nature of an impertinence. To-day there is hardly a text-book, however elementary, which does not contain the suggestion that its author could improve the law if he were given the chance. Perhaps some of this change in attitude can be attributed to the influence of Sir Frederick Pollock, but it would not be fair to under-estimate the major effect of the University law schools. Criticism of the law has developed naturally with the growth of these law schools, because it has never been the function of a teacher merely to repeat knowledge. If he is to be of any value he must explain not only that a particular rule exists, but he must also consider *why* the rule exists. This will lead inevitably to a consideration whether a rule whose original cause has disappeared can still be justified. The growth of comparative law has also been of importance here because it has enabled people to realize that some of the defects in the law are not inevitable. The fact that other legal systems have been able to avoid defects which are found in our own system must influence the reconsideration of the existing rules. (From the presidential address of Professor A. L. Goodhart at the annual dinner of the Holdsworth Club of the Faculty of Law in the University of Birmingham, May 7th, 1952)

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[75] *North Eastern Railway* v. *Jackson* (1870), 19 W.R. 198; *Cape Breton Cold Storage, Limited* v. *Rowlings*, [1929] S.C.R. 505; 3 D.L.R. 577.

[76] *Sheffield* v. *Woodcock* (1841), 7 M. & W. 572; 151 E.R. 894.

[77] *Re Cardiff Preserved Coal & Coke Co. Ltd., Ex p. Hill* (1863), 32 L.T. 659.

[78] *Greenstreet* v. *Paris* (1874), 21 Gr. Ch. 229.