1968 *Feb. 12, 13 14, 15 Oct. 1

ANNIE BLANCHE BURROWS *et al.* (*Plaintiffs*) .... APPELLANTS;

AND

OTTO WILHELM BECKER *et al.* (*Defendants*) .... RESPONDENTS;

AND

OCEAN TOWERS LTD. .... (*Defendant*).

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Corporations—Representative action brought by minority shareholders—Internal affairs of company complained of—Issues between company and promoters—Cause of action, if any, properly belonging to company and not to shareholders.

Appeal—Appellant complying with part of judgment under which benefits accrued to him—Whether precluded from appealing other part.

The plaintiffs were minority tenant-shareholders in a company which owned and operated a large "self-owned apartment block". Before possession of the building was transferred to the company, the building was managed by the company's promoters and during this period the loss arising from the parking spaces was charged against the company. Similarly, the rent of the suite allotted to the caretaker was also charged against the company.

In a dispute which arose between the plaintiffs and the promoters and the directors, the substantial issues related to (i) the portion of the mortgage which was to be paid off by revenue from the garage and (ii) the caretaker's suite. Having first expressed their dissatisfaction at an annual meeting, the plaintiffs brought a representative action and were afforded substantial relief at trial. An appeal was allowed by the Court of Appeal and the action was dismissed on the ground that the action was precluded by the rule in *Foss v. Harbottle* (1843), 2 Hare 461, 67 E.R. 189. The plaintiffs then appealed to this Court.

Held: The appeal should be dismissed.

The issues relating to the caretaker's suite and to the portion of the mortgage attributable to the garage were the only issues involving money between the company and the promoters. They were questions of accounting which depended on the company's recognition of its obligations, if any, with respect to these matters. Such a cause of action properly belonged to the company and not to the shareholders. The question of the application of the funds of the company was within the powers of the company. A group of shareholders could not complain of acts which were valid if done by the majority of the shareholders or were capable of being confirmed by the majority.

It was necessary, therefore, that the company be the plaintiff in any action to redress this wrong, if it existed, and the Court had no jurisdiction

*PRESENT: Abbott, Judson, Ritchie, Hall and Spence JJ.

to interfere with the internal management when the company was acting within its powers. If a majority of the shares were controlled by those against whom relief was sought, the complaining shareholders might sue in their own names but in that case they had to show that the acts complained of were either fraudulent or *ultra vires*. The Court below had made a clear finding that it had not been shown in this case that the majority of the shares were controlled by the promoters.

In dismissing the preliminary objection whereby the plaintiffs argued that the defendants having complied with the trial judgment as to the issue to them of a new allotment of shares in place of an issue held to be illegal and void, they had taken and enjoyed the benefits to them under this portion of the judgment and were, therefore, precluded from appealing, the Court agreed with the Court below that: (*a*) the actions of the defendant promoters did not bring them within the principles of estoppel enunciated in *Lissenden v. C.A.V. Bosch Ltd.*, [1940] A.C. 412, and (b) the defendant promoters had done no more than comply with the judgment which they were bound to do.

On a further subsidiary issue, the Court also agreed with the Court below that in the particular circumstances no unauthorized reduction in capital or trafficking in shares was involved in a proposal that the company should purchase the caretaker's suite. The shares appurtenant to that suite had already been beneficially owned and held for the company but by an irregular allotment, and the intention was merely to extinguish them.

APPEAL and CROSS-APPEAL from a judgment of the Court of Appeal for British Columbia[1], allowing an appeal from a judgment of Munroe J. Appeal and cross-appeal dismissed.

C. C. I. Merritt, Q.C. for the plaintiffs, appellants.

John L. Farris, Q.C. and *Ronald C. Bray,* for the defendants, respondents.

The judgment of the Court was delivered by:

JUDSON J.:—In 1956 a group of real estate promoters formed three private holding companies, namely, B & W Apartments Ltd., owned by the defendants Becker and Walsh, W & E Apartments Ltd., owned by the defendants Walsh and Enders, and F & N Apartments Ltd., owned originally by Forst and Nemetz but subsequently acquired by the defendants F. A. Lockwood and W. W. Lockwood (hereafter called the "Vendor Companies") for the purpose of financing and building a large "self-owned apartment block".

[1] (1967), 63 D.L.R. (2d) 100.

The promoters entered into a construction contract with Becker Construction Co. Ltd., a company wholly owned by the defendant Becker, and on November 25, 1957, incorporated Ocean Towers Ltd., as a private company authorized to issue 2,020 shares without nominal or par value. Ocean Towers was to be the owner of the apartment building. Its articles of association provided that no corporation except a trust company could be a shareholder and that all shares should be allotted, and could only be transferred, in units of 26 and 32 shares respectively and in one unit of 50 shares. Each unit represented an apartment suite and each purchaser was to get a 50-year renewable lease. On the same day the vendor companies made an agreement to sell the apartment building to Ocean Towers. The building was to have 18 floors with a total of 69 suites, including a penthouse, and 108 covered automobile parking spaces.

The construction contract provided for a price to include the cost of construction plus a fee of $100,000. A mortgage for $900,000 was arranged with an insurance company. The promoters intended that the mortgage, both as to principal and interest, was to be paid off in this way:

(a) As to $738,000 by monies provided from the sale of blocks of shares representing suites;

(b) As to $162,000 by the revenue from the parking spaces.

Agreements were made to sell some suites at a price based upon the estimated cost of the building. As the building progressed, it became apparent that the estimated cost would be exceeded. Those who had agreed to buy suites based upon the original estimated cost were given the option to cancel their purchases. Only one person took advantage of this offer. The prices of the suites were increased to take care of the increased costs. Nothing turns on this rearrangement and the rearrangement itself requires statement only in outline. The number of shares was increased to 2,421. The 26-share suites became 31-share suites; the 32 became 38; the penthouse suite rose from 50 to 75. The price of each share remained at $1,000. The mortgage arrangements remained the same. An amending agreement was made between the three vendor companies and Ocean Towers to give effect to these changes and the memorandum and articles of association of Ocean Towers were also amended. Some adjustments were made for the small number of tenant-shareholders who had agreed to purchase their suites under the old agreement. However, most of the tenant-shareholders, including the plaintiffs, purchased their suites under the new agreement. It is clear that nearly all, if not all, the tenant-shareholders signed an acknowledgment that they had received, read and approved the amended "particulars of the transaction" as well as the revised memorandum and articles of association.

In the absence of what is now known as *condominium* legislation, these financial arrangements exposed the purchasers of suites to real hazards. Their security of tenure depended upon everything going according to plan. If suites were unsold, someone had to assume responsibility for the payments attributable to these suites. In this case the vendor companies assumed the responsibility. When the amending agreement was made in January 1957, they took up 776 shares. These shares were issued to Canada Trust Company in trust for the vendor companies who now held a total of 828 shares. These shares were paid for by a cash payment of $278,400, which was credited to the purchase price of the building, and promissory notes totalling $417,600 dated to coincide with the commencement of mortgage payments on April 1, 1960. These shareholdings were reduced from time to time by the sale of suites and at the time when this action was commenced in November 1964, the vendor companies still held 543 shares.

It had been expected that the building would be completed and possession and management transferred to Ocean Towers by November 1, 1959. This transfer was not made until January 1, 1964, and until this date the promoters managed the building. Until the first annual meetting of the company on January 31, 1961, the board of directors were appointees of the promoters but on this date the board was increased from three to seven and a new board was elected consisting of two promoters and five tenant-shareholders. The trial judge found that this was an independent board and it is apparent from the evidence that it was an able and conscientious board.

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The three plaintiffs, who are the appellants in this Court, are shareholders in Ocean Towers. They own 62 shares. They claim to have the support of 22 tenant-shareholders who own 759 shares. Their combined holdings are, therefore, 821 shares out of a total of 2,421.

The action is brought against two main groups of defendants. The first group were those who were promoters and the three companies that they formed for this purpose. At the date of the writ, the promoters had a total of 688 shares. There were four individual defendants who were not promoters. They held a total of 181 shares. No appeal has been taken against the judgment of the Court of Appeal dismissing the claim against these defendants. The two other directors who were sued were W. W. Lockwood and John Leslie Bartram. Lockwood was a promoter and Bartram represents the estate of Frank Wallace Walsh, who was a promoter. Again, the Court of Appeal dismissed the action against these two and no appeal has been taken from this dismissal.

The judgment at trial afforded substantial relief to the plaintiffs. The Court of Appeal allowed the appeal and dismissed the action on the ground that the action was precluded by the rule in *Foss v. Harbottle*[2]. I think it better to begin with to state what the substantial issues were. The first of these was the liability of Ocean Towers to take care of that part of the mortgage which was attributable to the parking spaces. This amounted to $162,000. The expectation was that revenues from the parking spaces would be sufficient to repay this sum over a certain period. This expectation was not realized because for a time there were many empty suites. Subsequently, after possession of the building was turned over to Ocean Towers on January 1, 1964, there were rearrangements made in the parking spaces and two increases made in the rentals. These increases and rearrangements were sufficient from then on to take care of this portion of the mortgage.

But, in the meantime, while the promoters were managing the apartment until January 1, 1964, the loss arising from the garage was charged to operating expenses and against Ocean Towers. When the property was turned over

[2] (1843), 2 Hare 461, 67 E.R. 189.

on January 1, 1964, it was apparent from the statement of adjustments, and the directors had known this for at least three years, that the retirement of the $162,000 portion of the mortgage was being looked after in this way. They also knew that there was a deficit and that the deficit had been charged as operating expenses. There can, in my opinion, be no doubt about this and the directors do not suggest otherwise. The statement of adjustments had been prepared by an independent firm of auditors who had been appointed to examine the accounts of the promoters. This was not the firm of auditors that had represented previously both the company and the promoters. The accounts were prepared and submitted on the basis that the $162,000 portion of the mortgage was the responsibility of the company and that this had been so from the beginning. These accounts were accepted by the directors. They had been aware from the time of their election that this was the way the garage was being financed and there was no question in their minds of the propriety of this. The suggestion of impropriety seems to have arisen for discussion at the annual meeting of shareholders held on March 19, 1964, and adjourned to April 2, 1964. At this time the dissident group raised the question.

To summarize, the judgment of the learned trial judge found that the promoters were liable for the $162,000 portion of the mortgage attributable to the garage. He reopened the accounts which had been finally approved by the directors on February 13, 1964, for the purpose of reversing the charges already made up to the date of the take-over of the building and for the subsequent period from January 1, 1964, up to the date of judgment, May 1, 1966. He awarded the sum of $23,231.68 by way of indemnity. In other words, under this judgment the promoters and not the company are responsible for the payment of this portion of the mortgage.

On this issue the trial judge found that there had been a breach of fiduciary duty on the part of the promoters in that they had failed to disclose to the applicants for shares in Ocean Towers that the responsibility for the payment of the $162,000 portion of the mortgage would be on Ocean Towers out of garage revenues and that any deficiency would have to be made good by the company.

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The Court of Appeal did not make any finding on this branch of the case as it was not necessary for their decision because they founded their judgment on the application of the rule in *Foss v. Harbottle* and their conclusion that the plaintiffs had not brought this within the exceptions to that rule enunciated in *Burland v. Earle*[3]. Mr. Justice Norris indicated that in his view there had been breaches of fiduciary duty. Mr. Justice Bull indicated that he would not have found any breach of fiduciary duty. Mr. Justice Tysoe declined to express an opinion on this issue on the ground that it might be an embarrassment if there were future litigation in a properly constituted action. However, his analysis for the financial set-up is the same as my own, and to me, it is clear that this $162,000 that I have been dealing with was not the obligation of the promoters and if it were necessary for me to express an opinion, I would not agree with the trial judge. The documentary evidence makes it plain that free parking was not to be provided and was not included in the price of the suites. The course of dealing is strong affirmation of the impossibility of any misunderstanding on this point. An independent and experienced board of directors never had any doubt.

In my opinion, the financial set-up was accurately stated in the particulars which were given to each shareholder. Briefly, the price of the building was the amount received from the sale of the treasury shares plus the sum of $162,000 "representing the cost of the covered parking spaces". The particulars also went on to say that "the covered parking spaces have been valued at $162,000 and as no provision has been made for the allocation of stock with respect to same, the purchase price of said parking spaces shall be paid from the proceeds of the mortgage aforesaid. The company will on request allot parking spaces to shareholders at a monthly rental to be determined." In other words, Ocean Towers was mortgaged for $900,000, and $162,000 from this mortgage was used to pay the sum of $162,000, which was part of the purchase price in addition to the amount received from the sale of treasury shares.

3 [1902] A.C. 83.

I have examined the record for the purpose of discovering what tenant-shareholders signed certificates which stated that they had read certain documents which really composed the "prospectus" of the company. Munroe J. had this to say on the matter:

> A reading of the memorandum and articles of association of Ocean and of the forms of lease, when read in conjunction with the said agreement, together with a statement of "particulars" prepared by the solicitor of Ocean—all of which documents each applicant for shares certified that he (or she) had read—and which certificate is, I hold, binding upon them...

Tysoe J.A. agreed:

> In view of the above changes, a new form of memorandum for use in the sale of suites was prepared consisting of "particulars" of the transaction accompanied by copies of the memorandum and articles of association (as amended) of the company, a conformed copy of the executed new agreement, ex. 12, and a copy of the draft 50-year lease to be signed by a tenant-shareholder. These were delivered to prospective purchasers of suites and most, if not all, applicants were required to and did sign thereon an acknowledgment that same had been received, read, and approved. The learned trial judge found, correctly in my opinion, that those who signed such acknowledgments were bound thereby, notwithstanding evidence given by some that they did not receive and/or read the documents.

Taking as a starting point the list of shareholders dated December 31, 1963, there is evidence that all the original shareholders except three signed certificates stating that they had read the documents. There is no evidence that R. G. Buchanan or Tucker signed a certificate. Neither was called to give evidence. Mrs. Burrows bought by way of sublease and assignment from Becker and she gave evidence that she never saw any documents until March 1964.

There are cases where an original tenant-shareholder assigned his lease and shares to a third party. There is no evidence that any of the assignees signed a certificate. Mrs. Burrows appears to be in this position.

The other ground of complaint on the part of the plaintiff-shareholders related to the caretaking services. There could be no doubt on the material before the Court and before all the shareholders that maintenance costs were for the company and its shareholders and not for the promoters. The form of lease provided for a monthly payment for these costs of $69 for inside suites and $86 for outside suites. What has been referred to as a prospectus stated

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that there would be a 24-hour caretaking service. The original intention was to employ three shifts of caretakers. This was found to be more expensive than having a man and his wife live on the premises in one of the suites. This arrangement began in May of 1960 and suite 202 was allotted to the caretaker and his wife. It was shown by the evidence that this arrangement was cheaper than the 24-hour service originally contemplated. The shares representing suite 202 were in the hands of the promoters along with the other shares that they had taken up to keep the building going.

The learned trial judge found misrepresentation on the part of the promoters with reference to this suite and he reopened the accounts for the purpose of reversing the charges made for it to operating expenses. In my opinion, in so doing he was plainly in error. There was nothing in the material before the shareholders and before the Court to justify any conclusion that the promoters were to provide a caretaker's suite in perpetuity at their own expense. Once the board of directors had decided to do the caretaking in this way instead of by non-residential employees, the rent of the caretaker's suite was a proper charge to operating expenses.

The learned trial judge concluded that equity required of the promoters frank disclosure to each applicant for shares that Ocean would have to purchase from the promoters the suite now occupied by the caretaker if it desired to have him continue in residence. He further found that a failure to make such disclosure amounted to a misrepresentation of a material fact if, as the promoters said, it was not within their contemplation that suite #202 should be made available without cost to Ocean as a place of residence for the caretaker. He did not refer to the uncontradicted evidence that the cost of providing the suite, together with the caretaker's remuneration, was less than the $600 per month originally estimated to be included in the maintenance to cover the cost of a 24-hour caretaker service. He also held that the proposal that Ocean should purchase this suite would be *ultra vires,* it being contrary to the principle of *Trevor v. Whitworth*[4].

[4] (1887), 12 App. Cas. 409.

On this point the Court of Appeal held that in the particular circumstances no unauthorized reduction in capital or trafficking in shares was involved in the proposal that Ocean Towers should purchase the caretaker's suite.

The issues relating to the $162,000 portion of the mortgage and the caretaker's suite are the only issues involving money between the company and the promoters. All others were of a subsidiary nature. I have dealt with the two money issues in detail because the Court of Appeal founded its judgment on the rule in *Foss v. Harbottle* and not on the merits of the case, but the facts of this case show that the rule is a salutary rule and not one of mere technicality. Here was a group of shareholders which wanted the company to litigate these two issues. Their dissatisfaction was first expressed at the annual meeting held on March 19, 1964, and adjourned to April 2, 1964. They made their own nominations for the board of directors but failed to secure their election. Instead, the meeting elected five tenant-shareholders and two representatives of the promoter group. There were three resignations of directors on April 28, 1964. Replacements were made, one of whom was a member of the plaintiff's group. At no time was there any requisition for a special general meeting to instruct the directors to bring this action. It is, I think, clear from the evidence that the directors had little confidence in the outcome of a company action. They were taking legal advice when the writ of summons was issued on November 30, 1964.

It is true that the plaintiffs as shareholders and tenants along with all the others were interested in these two issues. But they were not seeking to assert personal claims as shareholders against the promoters such as damages for fraud or rescission of their contracts to purchase shares. They were insisting that the company, as plaintiff, should litigate these issues and that if the company failed to do so, they had the right to bring the action. These money issues were between the company and the promoters. They were questions of accounting which depended upon the company's recognition of its obligations, if any, with respect to the $162,000 portion of the mortgage and the caretaker's suite. Such a cause of action properly belongs to the company and not to the shareholders. The question of the

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application of the funds of the company was within the powers of the company. A group of shareholders cannot complain of acts which are valid if done by the majority of the shareholders or are capable of being confirmed by the majority.

The company, therefore, must be the plaintiff in any action to redress this wrong, if it exists, and the Court has no jurisdiction to interfere with the internal management when the company is acting within its powers. If a majority of the shares are controlled by those against whom relief is sought, the complaining shareholders may sue in their own names but in that case they must show that the acts complained of are either fraudulent or *ultra vires*. The Court of Appeal in the reasons of Tysoe J.A. made a clear finding that it had not been shown in this case that the majority of the shares were controlled by the promoters. The independence of the board of directors after January 31, 1961, is beyond question.

Tysoe J.A. summarized the facts relating to control in the following passage:

> When all is said and done I remain faced with the following stark facts. At the relevant time the promoters did not possess a majority of the shares of the company and even if their shares are added to those of the directors and four former directors the total does not represent a majority. There were an unidentified number of shareholders who had not declared themselves—an uncommitted group holding over 20 per cent of the issued share capital of the company. No one of this group was a witness at the trial. The Court was not directed to any evidence indicating how any of the members of this floating group of uncommitted shareholders would or might have voted on the crucial question of whether the company should bring action against the promoters, with or without sufficient information to enable them to form an intelligent judgment. Nor is there evidence from which the Court might infer, rather than speculate, that some members of the floating group would have given proxies to others to vote their shares either for or against the bringing of an action against the promoters. In this situation it is much easier to hazard a guess than to speak with any certainty.

I agree with his conclusions and they fully support his judgment in declining to interfere with the internal affairs of this company and his finding that the "plaintiffs have not shown that any attempt to have the company bring this action in its own name would have been futile". I accept his analysis of the facts of this case and their relevancy in connection with the rule in *Foss v. Harbottle.*

They are set out in his reasons for judgment contained in (1967), 63 D.L.R. (2d) 100, and I refrain from repeating them. This is sufficient to dispose of the appeal on these two points.

The next issue in this appeal relates to a block of 543 shares which at the time of the institution of the action were in the hands of the promoters. I have mentioned these shares earlier in the reasons. They were the rest of the block of 776 shares issued pursuant to a resolution of January 29, 1959, to Canada Trust Company in trust for the three vendor companies. These shares were issued in breach of arts. 3 and 4 of the articles of association and the issue was, therefore, illegal and void. The trial judge rectified this illegality by directing the cancellation of these 543 shares and the issue of the same number in units of 31 and 38 shares to the defendant promoters personally and the delivery of their joint and several promissory notes to secure the unpaid balance of the purchase price. The reason for this was that the promoters, if they bought shares pending their further sale to tenant-shareholders, were to adhere to the form of agreement which the tenant-shareholders who did not pay for their shares in full were to sign.

I do not think that this issue requires further discussion. Tysoe J.A. said:

> The effect of this judgment is simply to correct the irregularities resulting from the breaches of arts. 3 and 4 of the articles of association of the company and to produce such a result that "the original resolution of January 29, 1959 will be adhered to as nearly as possible". With respect, it appears to me that this was a sensible way of dealing with this matter and I am unable to see any error in what was done. In my opinion this claim must fail.

According to Tysoe J.A., the defendants were bound to comply with the provisions of this part of the judgment and they did so. In the Court of Appeal the plaintiffs argued that by complying with the judgment, the defendants had taken and enjoyed the benefits accruing to them under this portion of the judgment and were, therefore, precluded from appealing. The same point was argued in this Court by way of preliminary objection and I would dismiss this preliminary objection for the same reasons that were given in the majority judgment in the Court of Appeal.

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Mr. Justice Tysoe and Mr. Justice Bull dismissed the motion on two grounds:

(a) that the actions of the defendant promoters did not bring them within the principles of estoppel enunciated in *Lissenden v. C.A.V. Bosch Ltd.*[5];

(b) that the defendant promoters had done no more than comply with the judgment which they were bound to do.

Mr. Justice Norris dismissed the motion on the first ground. Again, I have nothing to add to the reasons for judgment of Tysoe J.A. on this point.

On the question of the *ultra vires* issue of these shares, I do, however, wish to state that in my opinion this was an action that any shareholder could bring and that the rule in *Foss v. Harbottle* has no application.

There is one further subsidiary issue to be dealt with, namely, the 31 shares appurtenant to suite 202, the caretaker's suite. When Ocean Towers was converted into a public company, 455 shares were allotted to Canada Trust Company in trust for Ocean Towers. All of these shares except the 31 shares appurtenant to suite 202 were sold to tenant-shareholders but the 31 shares were still outstanding in the name of Canada Trust Company in trust for Ocean Towers when the action was instituted. The trial judge ordered the cancellation of these shares on the ground that they had been illegally issued. The Court of Appeal stated that the cancellation raised no problems and that it was not attacked and must therefore stand.

There was, however, an agreement made on December 31, 1963, between the vendor companies and Ocean Towers under which Ocean Towers was to keep possession of suite 202 subject to payment of a purchase price of $28,000. The agreement was conditional upon its approval by a resolution of shareholders and this has never been done. The agreement was declared to be illegal and void by the trial judge. The declaration of illegality was set aside by the Court of Appeal and, in my opinion, correctly.

The Court of Appeal pointed out that the agreement was not a purchase of these 31 shares from the vendor

[5] [1940] A.C. 412.

companies. The vendor companies had never taken them nor showed them in their accounts as being owned. The shares had always been beneficially owned by and held for the company but by an irregular allotment. They had never been issued. The gist of the judgment of the Court of Appeal on this point is contained in the following passage:

> In effect, the agreement constituted a purchase of a leasehold interest, or leasehold entitlement, vested in the Vendor Companies by their obligation under ex. 12 to take over all unsold suites in part payment on the purchase price of the building. The $28,000 took the place of and recompensed the Vendor Companies for the loss of the purchase price of the suite and the shares appurtenant to it which would have been added to the purchase price of the building had the suite with its shares been taken over by the Vendor Companies. Neither the form nor the intention thereof was to purchase shares. Only the company had any interest in the shares, and the intention was merely to extinguish them. In my view, under the peculiar circumstances of this matter, no unauthorized reduction in capital or trafficking in shares was involved, and the learned trial Judge's finding that ex. 37 was *ultra vires,* illegal and void, and that it be cancelled, cannot stand.

Again, I agree in full.

There was a cross-appeal by the promoters in which it was argued that the rule in *Foss v. Harbottle* applied to every cause of action asserted in this litigation and that the Court of Appeal should have simply ordered a dismissal of the action. The attack was directed against the order of the trial judge, affirmed by the Court of Appeal, relating to the 543 shares. I have already stated my opinion that the rule in *Foss v. Harbottle* has nothing to do with this cause of action. The cross-appeal fails and must be dismissed.

I would dismiss the appeal and the cross-appeal both with costs.

Appeal and cross-appeal dismissed with costs.

Solicitors for the plaintiffs, appellants: Bull, Housser & Tupper, Vancouver.

Solicitors for the defendants, respondents: Clark, Wilson, White, Clark & Maguire, Vancouver.