Lord Shand—I concur. We are not informed of the circumstances under which this deed was granted, but I observe that in the previous litigation in 1843 it was stated that the deed was executed by Mr Downie at the solicitation of friends, as he was apparently about to contract a second marriage. The mother of the beneficiaries had died, and unless there were some antenuptial contract in clear terms excluding a share of the goods in communion, the daughters were in a position to claim and share those goods on her predecease. Thus one sees the key to the granting of this deed as an onerous deed. This is also apparent from the declaration in the body of the deed, that these "provisions in favour of my said daughters shall be held as including all sums of money or provisions settled on them, or to which they might be entitled to succeed in virtue of the marriage articles or settlement entered into between me and my late spouse, their mother, and are to be in full of all portion-natural, legitim, or bairns' part of gear, or other right or claim to which they might be entitled *ex lege* in consequence of my death or that of my late spouse."

The deed, therefore, is not only in the form of a personal bond, but is clearly onerous, and I observe it declares itself to be irrevocable. In the next place, it contemplates that the money shall be paid away from the granter's estate; and thirdly, although the framer of the deed had before him every possible contingency, there is no clause suggesting that any part should revert. It appears to me that every presumption is in favour of the right vesting in the children or survivor, and against the view that the money should revert to the estate of the granter. Now, in this view of the presumption, I attach all importance to the words upon which Lord Deas dwelt at the outset of the deed itself. It rather appears to me that the argument of the respondent would render it necessary to strike the word "heirs" out of the deed.

My general view of the deed is that Mr Downie bound himself to pay £36,000 to his three daughters, with contingent right to his son in event of his surviving, and that the fee was given to the children subject to two matters for which Mr Downie desired to provide, viz., firstly, the event of the marriage of a daughter with issue, and secondly, the case of a daughter dying without issue survived by her brother. Now, it appears that all the restrictions are intended for one or other of these purposes and if one of these purposes is no longer to be served the right vests. That there was no purpose in the mind of the granter other than these two purposes we can find in the first clause, to which reference has been made, where again and again there is a provision limiting the right of the daughter to test, and that is invariably followed by the statement of the purpose for which this is done, viz., that the surviving son may get the benefit of the balance. If that clause stood alone there would be no difficulty in the question. The whole difficulty arises from the succeeding clause (quoted *supra*). In regard to that clause, the first observation is that it does not apply to the original shares, but is limited to the accrescing shares. Secondly, when the granter uses the words "subject to the same rules," his meaning was to protect the rights of the child, and the right of the survivor to the accresced money was to be in the same position as the right to the original shares. My opinion is that no part of this fund reverts to the granter of this deed, but that there was a right to dispose of it in the surviving daughter.

The Lords recalled the interlocutor, and ranked and preferred Miss Downie's trustees to the fund.

Counsel for Miss Downie's Trustees—Gloag—Lang. Agents—Ellis & Blyth, W.S.

Counsel for Mr Downie's Trustees—Mackay—Campbell. Agents—Maitland & Lyon, W.S.

Counsel for Miss Rose Downie's Trustees—Mansfield. Agents—Lindsay, Howe, Tytler, & Co., W.S.

Friday, March 17.

FIRST DIVISION.

[Lord M'Laren, Ordinary.

LEES *v.* TOD AND OTHERS.

Public Company—Director—Misrepresentation—Fraud—Annual Report—Auditor.

It will not establish bad faith or dishonesty in a board of directors that they relied upon their manager and auditor for the accuracy of details as to the state of investments and the extent to which shares had been paid up, published in their reports and balance-sheets, the manager and auditor being competent persons and skilled in accounting.

In order to found an action of damages against the directors of a limited liability company at the instance of a shareholder, on the ground of fraudulent misrepresentations contained in reports and balance-sheets, the pursuer must show (1) that these misrepresentations were on material points; (2) that his purchase was induced by them; and (3) that the directors acted dishonestly and in bad faith.

Where it is sought to make directors liable for false and fraudulent statements made by them to shareholders and the public, there must be evidence of *mala fides* or of such insufficient grounds for these statements as to negative the possibility of *bona fides*; mere errors of judgment or false statements made in the belief of their truth will not throw liability upon the directors.

A shareholder of a heritable security company which had gone into liquidation brought an action of damages against the directors on the ground of alleged fraudulent misstatements in the annual reports and balance-sheets of the company, on the faith of which the pursuer stated that he had purchased his shares. The alleged misrepresentation lay in (1) treating as loans by the company on heritable security sums which had either not been lent on heritable security, or of which the securities had been assigned; and (2) in treating as paid up, capital which had not been paid up. The defenders did not deny that as a matter of fact these errors had occurred in the reports and balance-sheets. It was not averred by the

pursuer, on the other hand, that the defenders were guilty of conscious misrepresentation, but it was averred that they had a general knowledge of the practice of lending on personal security; that they might easily have discovered the error by comparing the balance-sheet which it was intended to issue with the trial balance-sheet prepared by the manager and laid on the directors' table; and that part of the calls erroneously stated to be paid up were due by some of the directors. The reports and balance-sheet were prepared by the manager, and were certified by the auditor as correct. The failure of the company was not due to the mismanagement of the directors, and it did not appear that any loss had arisen from the practices in question. *Held* that the directors had acted *in bona fide*, and consequently were not liable.

The Caledonian Heritable Security Company (Limited) was incorporated in 1872 as a company limited by shares under the Companies Acts of 1862 and 1867, the amount of the capital being £200,000 divided into 40,000 shares of £5 each. The objects of the company were by the memorandum of association declared to be "to advance or lend money on security of all kinds of heritable property, or for the purpose of building, draining, enclosing, or otherwise improving the same; to make advances for the execution of works undertaken in virtue of powers conferred by any public or local Act of Parliament on the securities thereby authorised, and also on the security of annuities and on other assignable properties; and on or for the purchase of reversionary interests heritably secured; to receive money by way of loan, cash-credit, debenture, deposit, or otherwise; and the doing of all such other things as are incidental or conducive to the attainment of the above objects."

The articles of association provided that the regulations contained in the first schedule, Table A, annexed to the "Companies Act 1862" should, subject to certain specified alterations, be the regulations of the company. Table A contains the following provisions relative to accounts:—"(78) The directors shall cause true accounts to be kept—Of the stock-in-trade of the company; of the sums of money received and expended by the company, and the matter in respect of which such receipt and expenditure takes place; and of the credits and liabilities of the company. The books of account shall be kept at the registered office of the company, and, subject to any reasonable restrictions as to the time and manner of inspecting the same that may be imposed by the company in general meeting, shall be open to the inspection of the members during the hours of business. (79) Once at the least in every year the directors shall lay before the company, in general meeting, a statement of the income and expenditure for the past year, made up to a date not more than three months before such meeting. (80) The statement so made shall show, arranged under the most convenient heads, the amount of gross income, distinguishing the several sources from which it has been derived, and the amount of gross expenditure, distinguishing the expense of the establishment, salaries, and other like matters; every item of expenditure fairly chargeable against the year's income shall be brought into account, so that a just balance of profit and loss may be laid before the meeting; and in case where any item of expenditure which may in fairness be distributed over several years has been incurred in any one year, the whole amount of such item shall be stated, with the addition of the reasons why only a portion of such expenditure is charged against the income of the year. (81) A balance-sheet shall be made out in every year and laid before the company in general meeting, and such balance-sheet shall contain a summary of the property and liabilities of the company, arranged under the heads appearing in the form annexed to this table, or as near thereto as circumstances admit. (82) A printed copy of such balance-sheet shall, seven days previously to such meeting, be served on every member in the manner in which notices are hereinafter directed to be served."

With reference to the above regulation 81, article 15 of the articles of association of the company provided as follows:—"The regulation No. 81 of said table is hereby modified to the effect that the balance-sheet may be made out in such other form and heads as the directors may appoint, as better calculated for exhibiting the progress of the business and position of the company."

Table A of the Act further provides, with reference to audit, as follows:—"(83) Once at the least in every year the accounts of the company shall be examined, and the correctness of the balance-sheet ascertained by one or more auditor or auditors. (92) Every auditor shall be supplied with a copy of the balance-sheet, and it shall be his duty to examine the same, with the accounts and vouchers relating thereto. (93) Every auditor shall have a list delivered to him of all books kept by the company, and shall at all reasonable times have access to the books and accounts of the company. He may, at the expense of the company, employ accountants or other persons to assist him in investigating such accounts, and he may in relation to such accounts examine the directors or any other officer of the company. (94) The auditors shall make a report to the members upon the balance-sheets and accounts, and in every such report they shall state whether, in their opinion, the balance-sheet is a full and fair balance-sheet, containing the particulars required by these regulations, and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs; and in case they have called for explanations or information from the directors, whether such explanations or information have been given by the directors, and whether they have been satisfactory; and such report shall be read, together with the report of the directors, at the ordinary meeting."

The company carried on business from the date of its formation in 1872 until July 1880, when it stopped payment; it was then resolved that it should be voluntarily wound up, Mr Peter Couper, chartered accountant, Edinburgh, being appointed liquidator. The voluntary liquidation was thereafter ordered to be continued, subject to the supervision of the Court, by interlocutor of the First Division of the Court of Session dated 11th December 1880. Prior to November 1879 only £1 per share had been called up; but at that time the directors made a call of £1 per share,

and after the company went into liquidation the liquidator made a call of the remaining £3 per share.

This was an action of damages by a shareholder against the directors, manager, and auditor, on the ground that he had been induced to purchase his shares on the faith of the reports of the company's affairs issued from 1874 onwards, which he alleged were false and fraudulent.

The following were the material averments of the pursuer:—"The defenders prepared a report of the company's operations during the year ending 31st December 1874, which was submitted to a general meeting of shareholders on the 24th of March 1875. The report, which is referred to, was based upon a balance-sheet adjusted along with the said report at a meeting of directors on 10th March 1875, at which all the defenders with the exception of the said Alexander T. Niven (the auditor) were present. The said balance-sheet was issued along with the report, bearing a docquet in the following terms, signed by the said Alexander T. Niven as auditor of the company:—'*Edinburgh, 11th March* 1875.—Having examined the accounts of the Caledonian Heritable Security Company (Limited) for the year ending 31st December 1874, I have found the same to be correctly stated and sufficiently vouched and instructed; and certify that the foregoing abstract exhibits a true state of the company's affairs as taken from the books.—ALEX. T. NIVEN, C.A., *Auditor*.' The said report and balance-sheet did not exhibit a true account of the company's affairs at that date, but were false and misleading, in respect that they represented the company as being in a sound and satisfactory condition, as earning profits admitting of a good dividend being paid, and its shares as being a good and sound investment. In particular, the said report and balance-sheet were false and misleading, in respect that (1) under the heading 'Issue of Shares' the report states 'the number of shares issued is 11,410, representing a capital of £57,050, whereof £1 per share, or £11,410, has been paid up, as shown in the balance-sheet. Of these shares 3000 were issued at a premium of £1 per share, and the premium received thereon, amounting to £3000, has, in accordance with a resolution come to at an extraordinary general meeting of the company held on 23d December last, been carried to a reserve fund.' This statement was false, in respect that 700 shares at par, and 3000 at a premium of £1 per share, had been allotted to George Lamb, 45 Kingston Road, Glasgow, the valuator of the company, in trust, and that nothing had been actually paid upon the said 3700 shares. It appears, however, from the books, that the directors made a temporary loan of £6700 to the said George Lamb and a Mr James Wotherspoon, without receiving any security for the same, and that this £6700 was entered in the shareholders' ledger as balancing the sum due upon the shares. The entry is as follows:—

George Lamb, 45 Kingston Street, Glasgow.
In trust:—

1874.			1874.	
Dec. 28.	To first call of £1 per share on 3700 shares . .	£3700	Dec. 31. By cash	£6700
,,	Premium on 3000 shares at £1 per share . .	3000		
		£6700		£6700

At this date, accordingly, the shareholders' capital was overstated by £3700, and the reserve fund had no existence at all. (2) The deposits were said to amount to £87,329, 14s. 10d., showing an increase during the year 1874 of £52,467, 11s. 2d. This sum is falsely stated, in respect that it includes a loan of £12,000 borrowed from the Scottish Provident Institution upon the security of an assignation by the company, or the directors or some of them, defenders in the present action, dated 18th and recorded in the register of sasines 25th May 1874, to a heritable bond held by the company to the amount of £17,000, granted by George Lamb and others over property in Partick, Glasgow. The said sum of £12,000 is also entered in the deposit ledger of the company under the account of the Scottish Provident Institution as 'Cash on deb. No. 9,' and is treated as an ordinary deposit made by the Scottish Provident Institution. (3) The loans on heritable securities are stated to amount to £108,159, 10s. 5d., showing an increase of £61,075, 19s. 6d. during the year 1874. This statement is also false and misleading, in respect it conceals the fact that the heritable securities held as part of the security offered to the public had been specially assigned in security of the said loan of £12,000 by the Scottish Provident Institution to the extent of £17,000, and further, in respect that there was included the sum of £6700 previously mentioned, for which no heritable security had been given. The said report, balance-sheet, and docquet, on or about the said 24th March 1875, appeared in the public newspapers, and the contents thereof, with the consent and knowledge of the defenders, were thus made known to the public. Denied that any heritable security was given for the loan of £7000, as stated in the answers."

All the defenders lodged answers, but on 8th June 1881 the defences for Wilson, the manager, who had been sequestrated, were of consent allowed to be withdrawn, and subsequently, Niven, the auditor, was tacitly allowed to drop out of the case, his estates likewise having been sequestrated. The following was the material portion of the answer for the directors to the above averment:—"At a meeting of directors held on 20th January 1875 the manager stated (as the minute bears) 'with reference to the allocation of the 700 shares at par and the 3000 shares at £1 premium to Messrs James Wotherspoon, George Lamb, William L. Lamb, and Walter Bell, all of Glasgow, that he had obtained an obligation by the two first-named gentlemen, dated 30th December 1874, for the sum of £6700, which he produced to the meeting, with the certificate for the 3700 shares in favour of Mr George Lamb in trust, to be held as a further security, this sum being a temporary loan to these parties which it is arranged shall be repaid within six weeks or two months from that date. The directors approved of and confirmed this arrangement.' The said parties were then in good credit, and the directors had no reason to doubt their sufficiency for the amount. At a meeting of directors held on 3d March 1875 (being prior to the date of the report and balance-sheet objected to by the pursuer) a proposal was submitted by Mr Lamb and Mr Wotherspoon for a loan of £7000 over heritable property at Partick belonging to them, and was agreed to. This loan was duly carried through, and on 30th July 1875 the sum of £6700

was paid out of the proceeds of this loan to the directors, and the temporary advance of that amount wiped off, the balance of £300 being paid over to Messrs Lamb and Wotherspoon. (2) Admitted that the sum of £87,329, 14s. 10d. included a sum of £12,000 advanced by the Scottish Provident Institution under the following circumstances:—In February 1874 the directors had under consideration a proposal for a loan of £17,000 over property at Hillhead, Glasgow. They considered the proposal an advantageous one for the company; and as the funds in hand at the time did not admit of their granting the loan, they agreed to entertain it, 'provided the chairman, manager, and law-agents see their way to borrow £10,000 or £12,000 for five or six years, at 4½ per cent., on an assignation to the security.' The directors were advised that it was within their powers to raise money in that way if they considered it (as they in fact considered it) for the interest of the company to do so. The Scottish Provident Institution agreed to advance the £12,000 on obtaining, besides a debenture in the ordinary form, an assignation in security to the bond for £17,000; and that transaction was carried through. Explained, the mode of stating the account in no way affects the result of the balance-sheet, which truly represents the liabilities of the company. (3) Admitted that the sum of £108,159, 10s. included the above-mentioned loan of £17,000 and the £6700 lent to Lamb and Wotherspoon; and explained that it was proper and necessary to enter these sums among the assets of the company, and that the accuracy of the balance-sheet was not thereby affected.

The report and balance-sheet for the year ending 31st December 1875 were averred to be false and misleading, in respect that "(1) The paid-up share capital was said to amount to £15,000 and the reserve fund to £6600. This statement is false, in respect that £3700 of the share capital and £3000 of the reserve fund had not been paid, as mentioned in the preceding article. (2) The deposits were put down at £133,498, 2s. 11d., being an increase during the year of £46,168, 8s. 1d. This statement was false and misleading, in respect that there was included the £12,000 borrowed on special security from the Scottish Provident Institution, as mentioned in the preceding article, and a sum of £4750 which had been paid to account of a loan of £17,000 made to George Lamb, valuator of the company, and his friend Mr James Wotherspoon, but which was not so applied in the company's books, but included in the balance-sheet among deposits. (3) The loans on heritable security were put down at £154,473, 14s. 11d., being an increase of £46,314, 4s. 6d. during the year. This statement was false and misleading, in respect that, as mentioned in the preceding article, the securities had been assigned to the extent of £17,000, and further, in respect that there were included a balance due by the Caledonian Provident Investment Society of £3529, 5s. 1d., and a balance of £3739, 10s. 7d., due by the Edinburgh and Glasgow Heritable Company (Limited), for neither of which sums was there any heritable security held, they being merely balances on account-current. The defenders the said Robert Bryson and Robert Turnbull were directors of the said Caledonian Provident Investment Society, and the said Richard Wilson [the manager of the defenders' company] was the secretary. The defenders the said James Tod, John Clapperton, and Robert Turnbull were directors of the said Edinburgh and Glasgow Heritable Company (Limited), and the said Richard Wilson was the manager. The said report, balance-sheet, and docquet were issued and published by or with the knowledge and consent of the defenders, in the same manner as the report, balance-sheet, and docquet of the previous year, as aforesaid."

In answer the directors explained "that the subjects on the security of which the loan of £17,000 was granted were being sold off from time to time by the borrowers, and that the sum of £4754, and the further sums mentioned below, as being the sums obtained on such sales, were carried to an account in the borrower's name in the deposit ledger, and on 31st December 1878 were transferred to the loan ledger, and credited to the borrower's loan account" (with respect to the sum of £17,000, they referred to their previous answer, quoted *supra*). "Believed to be true that the sum of £154,473, 14s. 11d. included sums lent by way of temporary deposit to the two companies here mentioned, and explained that as the Caledonian Heritable Security Company had occasionally more money on hand than could advantageously be laid out at the time, the manager (following the usual practice of all similar companies, but without special communications with the present defenders, and without special instructions from them) occasionally made temporary deposits with other companies, for which a considerably higher rate of interest was received than bank deposit rates."

The report and balance-sheet for the year ending 30th December 1876 were alleged to be false and misleading, in respect that "(1) The shareholders' capital and the reserve fund were overstated to the extent of £3700 and £3000 as formerly. (2) The deposits were stated at £208,207, 11s., being an increase during the year of £74,709, 8s. 1d. This was false and misleading, in respect that in addition to the loan of £12,000 from the Scottish Provident Institution previously mentioned there was included a loan of £4500 borrowed from the trustees of Mrs Pitcairn on the security of an assignation by the company or the directors, or some of them, defenders in the present action, dated 10th and recorded in the register of sasines 15th May 1876, to an heritable bond by James Carrick for £7000 over subjects in Buchanan Street and Buchanan Square, Glasgow. This transaction was also entered in the books as a deposit. There was also included a sum of £9576 paid to account of the said loan of £17,000 to Lamb and Wotherspoon, which was not so applied in the company's books, but included in the balance-sheet among deposits. (3) The loans on heritable security were stated to amount to £225,476, 6s. 8d. during the year. This was also false and misleading, in respect that the securities had been assigned to the extent of £24,000, while £37,119, 19s. 3d. was not lent on heritable security at all, but consisted of balances due by the Caledonian Provident Investment Society and the Edinburgh and Glasgow Heritable Company (Limited). The said report, balance-sheet, and docquet were also published by or with the consent of the defenders as aforesaid."

In answer the directors "admitted that the sum of £208,207, 11s. included a sum of £4500 which the directors, acting as they believed for the advantage of the company, borrowed from Mrs Pitcairn's trustees, and which they treated in a similar way to the sum of £12,000 above mentioned. Admitted that the entry £225,476, 1s. 7d. included the securities which had been pledged to the Scottish Provident Institution and Mrs Pitcairn's trustees, as well as the amount of the temporary loans made as above mentioned to the Caledonian Provident Investment Society and the Edinburgh and Glasgow Heritable Company."

The report and balance-sheet for the year ending 31st December 1877 were alleged to be false and misleading, in respect that "(1) With regard to the shareholders' capital and reserve fund, certain of the 3700 shares held in trust by George Lamb had been disposed of and the money received, but the shareholders' fund still remained overstated to the extent of £2500, in respect that nothing had been received upon 2500 of the 3700 shares, and the reserve fund was overstated to the extent of £1800, in respect that nothing had been received on 1800 of the 3000 shares issued at a premium of £1 per share in 1874. The report of this year also bore, that 'in terms of a resolution agreed to at last annual general meeting, 5000 new shares were issued to the shareholders in proportion to their respective holdings, at £3 per share (being a premium of 40s. per share), the whole of which were accepted by the shareholders, with the exception of between 200 and 300 shares, which the directors arranged to take up among themselves. They are therefore in a position to report that the whole of this issue has been placed. From the premiums thereon the reserve fund has been increased from £6600 to £15,000, and a balance of £1600 has been carried to the credit of profit and loss account, all as shown in the balance-sheet. The number of shares now issued is therefore 20,000, representing a subscribed capital of £200,000, whereof £1 per share, or £20,000 has been paid up.' The balance-sheet also represented that the whole sums due on these 5000 shares had been paid, whereas at the end of 1877 no less than £9706, 14s. 6d. was unpaid. The shareholders' capital and the reserve fund were in this way overstated to the extent of £9706, 14s. 6d. (2) The deposits were stated to amount to £225,833, 14s. 9d., as against £208,207, 10s. in the previous year, but of this £16,500 was, as previously explained, borrowed upon special assignations, of which the report and balance-sheet take no notice. Further, the directors had borrowed £1000 from the *curator bonis* of Dr John Wilkinson, in security of which they had assigned a security by the Ivanhoe Building Association over subjects in West Crosscauseway to the extent of £1000. There was also included the sum of £12,345, 15s. paid to account of the said loan of £17,000 which was not so applied in the company's books, but included in the balance-sheet among deposits. (3) The loans on heritable securities, &c., were entered as £257,703, 12s. 11½d. within the year. This statement was, however, false and misleading, in respect that the securities had been assigned to the extent of £24,000, while the sum of £9706, 14s. 6d., included in the said amount, consisted of balances due on the new shares mentioned above, and £10,109, 17s. 8½d. had been advanced without heritable security to the Caledonian Provident Investment Society, and £16,748, 8s. 11d. to the Edinburgh and Glasgow Heritable Company (Limited). The said report, balance-sheet, and docquet were published by or with the consent of the defenders as aforesaid. The statement in the answers that the 3700 shares referred to were not held 'in trust' after 16th February 1876 is denied, and explained that it was an agreement between the directors and the holders of the shares that they were to be held as unregistered. Explained further, that 1650 of these shares (including a proportion of the new issue of shares which were allocated to the original shares) are still held in trust, and that the holding of these shares in trust will cause an ultimate loss to the company of several thousand pounds. The said 1650 shares are presently held as follows:—Andrew Miller, who was a clerk in the office of the company, in trust, 1400; and Richard Wilson, manager of the company, in trust, 250. The directors further in the year 1877 sold 100 shares which also stood in the name of the said Andrew Miller in trust, and the proceeds thereof, amounting to £78, 15s., were carried to the credit of the reserve fund account. The directors also in the month of May 1879 sold 700 of the said 3700 shares which then stood in the name of the said James Wotherspoon, and the proceeds, amounting to £527, 7s. 6d., were also carried to the credit of the reserve fund; 1100 of the said shares also stand in the name of W. L. Lamb, which are the property of the company."

The directors "explained as regards the 3700 shares (under reference to the preceding answers) that these shares were not held in trust after 16th February 1876, on which date George Lamb transferred the whole of them to various parties, by whom the transfers were accepted in the usual way. Explained that the 250 shares referred to, standing in name of Richard Wilson in trust, have nothing to do with the 3700 shares, but were the portion of the new issue of 5000 shares allotted to James Wotherspoon, and which he declined to take up. A few other shareholders declined to take up shares allotted to them in the same way, and the whole were carried along with Mr Wotherspoon's to the account in name of Richard Wilson in trust. As regards the 5000 new shares, it is admitted that the balance-sheet contains the statement here quoted. Explained that although when the report was made up there was a balance of £9706, 14s. 6d. due in respect of the shares here referred to, this was not known to these defenders. Explained further that the shares had all been placed, and the parties debited with the amount due; and at that time they were all reputed and believed to be good for the sums owing by them. (2) Reference is made to the preceding answers. (3) Admitted that the sum of £9706, 14s. 6d. was included in the entry £257,703, 12s. 11½d., being dealt with in the same way as the sum of £12,000 before referred to. Explained that no loss will be sustained through the advance to the Caledonian Provident Investment Society. *Quoad ultra* denied, under reference to the books of the company, and under the explanation that the 100 and 700 shares here mentioned were properly dealt with, the proceeds thereof being carried to account of sums due to

the company by the holders of the shares, and that the 1100 shares were the property of the company only in so far as the holder could not transfer them until the debt due by him to the company was paid."

The reports and balance-sheets for the years 1878 and 1879 were also founded on by the pursuer, but these having been issued after he had purchased his shares, were held irrelevant.

The pursuer further averred—"(Cond. 14) The defenders, by whom the said reports were respectively made and submitted as aforesaid, meant and intended that the said reports, or at least the import or contents of the same, should become known to the public, and they knew that by the publication as aforesaid of said reports their import or contents had become known to the public, and especially to stockbrokers, law-agents, and others in the practice of dealing in the sale and purchase of shares in joint-stock companies. The defenders further knew that transactions in the sale and purchase of shares of the said company would take place on the faith of the said reports, and of their being true and accurate representations of the state of affairs and pecuniary condition of the company. By means of the said publication, and through the shareholders who attended the meetings at which the said reports were submitted as aforesaid, the representations in the said reports of and regarding the company's affairs for the various years to which the said reports related became known to the pursuer and the public generally. The pursuer had no other means of obtaining or acquiring information on the affairs of the company.

"(Cond. 15) The pursuer, on or about the 4th of January 1878, relying upon the truth and accuracy of the said reports for the years 1874, 1875, and 1876, purchased 50 shares of the capital stock of the said Caledonian Heritable Security Company (Limited), at the price of £2, 10s. per share, the total price paid by the pursuer for the said shares, including the broker's commission and stamps, being £127. The pursuer also, on or about the 16th December 1878, relying upon the truth and accuracy of the said report for the year 1877, purchased 50 additional shares of the said capital stock at the price of £1, 10s. per share, the total price, including broker's commission and stamp, being £76, 2s. 6d.; and on or about the 19th February 1879, in reliance upon the truth and accuracy of the said report for the year 1877, he made a third purchase of 100 shares at 10s. per share, the total price paid, including broker's commission and stamp, being £51, 12s. 6d. Upon the whole of the said shares so purchased by the pursuer only £1 per share had been paid up, leaving a sum of £4 per share to be called for. At the time of making the said purchases the pursuer had no means of becoming aware of, or obtaining any knowledge in regard to, the circumstances and position of the company and its affairs except through and by means of the said reports and the representations therein. If the said reports had disclosed the true state of the company's affairs, instead of misrepresenting them as they did, the pursuer would not have purchased his shares.

"(Cond. 16) The said reports, with the docquets or reports thereon by the defender Niven, as auditor foresaid, when they were made and submitted to the shareholders of the company as aforesaid, were false in the knowledge of the defenders, by whom they were respectively made and submitted as above set forth, and grossly misrepresented the position of the company. At least the said reports and docquets were made, submitted, and published as aforesaid by the defenders without their having any reasonable ground for believing that the statements therein contained were true. (Cond. 17) The defenders falsely and fraudulently made and submitted the said reports for the years 1874, 1875, 1876, 1877 [and 1878] to the shareholders of the company, all, as before stated, for the purpose of misrepresenting and concealing the true condition and actual state of the company's affairs, of creating a false impression in regard thereto, of giving to the shares of the company a fictitious value in the market, of misleading and deceiving the pursuer and the public generally, and of inducing them to believe, contrary to the truth, that the said company was in a sound financial condition, and in a satisfactory and prosperous state, that it was earning profits capable of paying a good dividend, and that the shares were a good and sound investment. In making the foresaid false and fraudulent representations in regard to the company's position and the state of its affairs, the defenders had a deep personal interest, all of them being proprietors in the concern.

"(Cond. 19) The pursuer, after the embarrassed condition of the company became known, made inquiry as to its condition, and it now appears, and he avers, that for several years prior to the company's going into liquidation it had been in a state verging upon insolvency, if not altogether insolvent. The directors had not, in terms of the said Companies Act of 1862, charged the revenue of each year with 'every item of expenditure fairly chargeable against the year's income,' but they had divided among the shareholders sums by way of dividend and bonus—sums which had never been earned, and which were to a great extent paid out of the capital stock of the company. In particular, in the above sum of £9435, 15s. 4d., which was in the balance-sheet for the year ending 31st December 1879 thrown back from the arrears account into the instalment loan account, and so was made to appear in the amount of loans on heritable securities, there was included a sum of £4038, 3s. 5d. of interest which the defenders alleged had been received from their debtors, and which had in previous years been divided among the shareholders as dividend, but no part of which had ever been received.

"(Cond. 20) Well knowing the state in which the company stood, and the manner in which the accounts had been manipulated, the defenders, down to a very recent period prior to the liquidation, continued their advertisements to the public newspapers and otherwise that the company was in a thoroughly sound and substantial position financially, that the loans were all on well selected heritable security, that they had a reserve fund of £17,000, and a large amount of uncalled capital, and soliciting loans on deposit or debenture. The pursuer avers that the affairs of the company had been extremely embarrassed and thoroughly unsound for many years prior to the liquidation, and that a large proportion of the so-called heritable securities consisted of second and third bonds over properties previously

burdened with other bonds, to the extent in some cases of £30,000, or £40,000, making it financially impossible for a second or third bondholder to negotiate for a transference, and in some of those cases where the borrower had got into arrear with payment of his interest the defenders had to pay the interest to prevent the property being sold. At the date of the liquidation there had been advanced to the said George Lamb, the valuator of the company, and his friends, nearly £100,000. There was also due at the same date by the said Edinburgh and Glasgow Heritable Company (Limited) the sum of £24,500, which was not heritably secured. The pursuer understands that under threat of judicial proceedings the directors have refunded to the liquidator part of the foresaid sum, but the balance is irrecoverable, and becomes a total loss to the company." With reference to this last averment the defenders "explained that a claim was made by the liquidator of the Caledonian Heritable Security Company against the present defenders in respect of said advances, and that the claim has been settled and discharged by the liquidator under authority of the Court."

"(Cond. 22) By reason of the false and fraudulent representations published and made known by the defenders as aforesaid, in reliance on which the pursuer was induced to purchase and retain the said shares as above stated, the pursuer has sustained loss and damage as follows:—(*First*) The sum of £147 sterling, paid for fifty shares of the capital stock of the said company at the rate of £2, 10s. per share, being the sum first concluded for; (*Second*) The sum of £76, 2s. 6d., paid for fifty shares of the said stock at the rate of £1, 10s. per share, being the sum second concluded for; (*Third*) The sum of £51, 12s. 6d., paid for one hundred shares of said stock at 10s. per share, being the sum third concluded for; (*Fourth*) The sum of £200, being a call of £1 per share upon the said two hundred shares, paid on or about the 6th February 1880, which is the sum fourth concluded for; and (*Fifth*) The sum of £600, being a call of £3 per share upon the said two hundred shares, payable upon the 6th October 1880 (paid or in the course of being paid), which is the sum fifth concluded for; the said sums amounting in all to £1054, 15s. exclusive of interest." He offered to assign the shares acquired by him on payment of these sums.

The pursuer pleaded—"The pursuer having been induced to purchase and retain the shares in question in consequence of the false and fraudulent representations of the defenders as condescended on, is entitled to decree against them (1st) for restitution and repayment of the whole sums expended by him in the purchase of said shares, and in payment of the calls made thereon as aforesaid, with interest on said sums; or otherwise (2d) for the amount of the loss and damage sustained by him as aforesaid."

The defenders (the directors) pleaded, *inter alia*—"(3) The reports of the said company being true statements of its financial condition, and having been made in *bona fide* by the directors, the defenders are entitled to absolvitor. (4) The pursuer having suffered no loss for which the defenders or any of them are responsible, they should be assoilzied. (5) The pursuer's averments, so far as material, being unfounded in fact, the defenders should be assoilzied with expenses."

The Lord Ordinary (M'Laren), after a proof, the import of which sufficiently appears from his Lordship's opinion and the opinions of the Court *infra*, pronounced this interlocutor—"Finds it not proved that the defenders, directors of the Caledonian Heritable Security Company, or any of them, have made fraudulent representations in the reports and balance-sheets libelled: Therefore assoilzies the said defenders James Tod, &c., from the conclusions of the action."

The following was the opinion of the Lord Ordinary:—"In this action the pursuer seeks to recover from the defenders, directors of the Caledonian Heritable Security Company, the amount of the instalments and calls paid by him on his shares in that company, which is now insolvent, on the ground that he was induced to purchase the shares by the fraud of the defenders. He alleges that the annual reports and balance-sheets issued by the defenders for the years 1874, 1875, 1876, and 1877 do not correctly represent the transactions of the company; that these documents were falsified for the purpose of deceiving the public with reference to the credit and stability of the company; and that his losses as a shareholder are the consequence of the deceit practised upon him as one of the public to whom the reports and balance-sheets were addressed.

"It was proved to my satisfaction that printed copies of the annual reports and balance-sheets were circulated by the defenders amongst members of the legal profession, and therefore, although these documents are in form addressed to shareholders, I think they must be deemed to be also addressed to the public. They were circulated, no doubt, for the purpose of attracting business to the company, and not with an immediate view to influencing the price of the shares. I think, however, that an intending purchaser of shares was entitled to regard the reports and balance-sheets as documents addressed to the public, and, subject to the limitations which I shall afterwards state, I think he was entitled to rely on the representations in fact contained in these documents with reference to the nature and extent of the company's business, and its results to the shareholders.

"It may conduce to clearness if I state in the outset that although the condescendence contains general charges of false and fraudulent representation by statements in the reports and balance-sheets, I do not understand that the directors' reports are founded on for any specific statements alleged to be fraudulent. The false statements are said to be contained in the balance-sheets, and the reports are said to be fraudulent because they refer to the balance-sheets as documents showing the true state of the company's affairs. The pursuer very properly has not attempted to make a separate case of the terms of commendation which the directors use when speaking of the prosperity and future prospects of the company's business. I am therefore relieved from the duty of criticising the language of the reports, and shall proceed to examine the various heads of false representation said to be contained in the balance-sheets.

"Before doing so, I must point out that such balance-sheets as were published by this company are not documents professing to give a full and complete view of the company's financial position. The articles of association of

the company (No. 81 of the statutory schedule) contemplate a balance-sheet containing 'a summary of the property and liabilities of the company arranged under the heads appearing in the form annexed to this table.' On referring to the statutory form annexed to the table of regulations I find that it is such a statement as may be comprised in a printed octavo page—giving results but not particulars. In the column applicable to liabilities I find that debts of the company are to be classified under six heads, one of them being titled—'Debts for interest on debentures or other loans.' In the column applicable to assets, debts owing to the company are classified under three heads, viz., (1) Debts considered good, for which the company hold bills or other securities; (2) debts considered good, for which the company hold no security; and (3) debts considered doubtful and bad.

"By the articles of association of the Caledonian Heritable Security Company the regulation No. 81 of the statutory table is modified to this effect, 'that the balance-sheet may be made out in such other form and heads as the directors may appoint, as better calculated for exhibiting the progress of the business and the position of the company.' I do not think that in fair construction this article alters the character of the balance-sheet or imposes on the directors the duty of giving more specific information than is contemplated under the statutory form of balance-sheet.

"It appears to me that a balance-sheet drawn up in accordance with the requirements of the articles of association is a document communicating to the shareholders the results of the directors' consideration of the financial position of the company, but that it is not a document professing to qualify the shareholders to judge for themselves as to the company's financial position. The withholding of information such as an intending shareholder would desire to be possessed of is not a breach of duty on the part of the directors, and is certainly not fraudulent. But the information which the balance-sheet professes to give must be true, according to the belief of the directors at the time.

"I come now to the particular cases of inaccuracy in the balance-sheets of the Caledonian Heritable Security Company which are charged as acts of fraudulent misrepresentation.

"(1) It is alleged that the liabilities of the company under the head of 'deposits' were overstated to the extent of £12,000 in the year 1874, £17,000 in 1875, £25,000 in 1876, and £26,000 in 1877. This result was arrived at in two ways—1st, by including under the name of 'deposits' sums received by the company for which security was given; 2dly, by including under the same head sums received by the company from their debtors, and which it is said ought to have been treated as repayment of debt. As to the first point, the facts are that the directors, being in want of funds to take up a proposal for a loan, obtained the sum required (£12,000) from the Scottish Provident Assurance Company, giving heritable security for the advance—and that in subsequent years smaller sums were obtained from other lenders on similar terms. The arrangement with the Scottish Provident Company is explained in the evidence of Mr Wilson, the manager. If the directors had borrowed money on heritable security to enable the company to fulfil its current obligations, I should have considered it a serious error to include such receipts under the head of deposits. But when it is considered that the business of the company consisted in obtaining the use of money at a lower, and the lending it out at a higher rate of interest, I am not prepared to say that money obtained for the purpose of being lent out again, or for the extension of the company's business, must necessarily be distinguished in the balance-sheet under a separate heading merely because security was given for it. Strictly speaking, it was not a deposit, because security was given, but it was part of the borrowed capital of the undertaking—borrowed with a view to be lent out at interest, and not to meet the necessities of the company. The misdescription—if it be such—or the absence of distinguishing words applicable to the transaction, was not of a character calculated to convey a false impression as to the resources of the company or the extent of its transactions. It must be observed that where diverse transactions are grouped under a few general heads, as must be the case in the published balance-sheets of joint-stock companies, the titles of the heads cannot be strictly accurate for all the entries comprised in them. It is sufficient if the titles fairly represent the general character of the transactions, which are properly brought together for the purpose of striking a balance of profit and loss.

"Next, the inclusion under the name of deposits of sums received from debtors appears to me to have been quite honest in the particular case. The debtor Lamb had borrowed two sums, £17,000 and £6000 respectively, from the company. He was under obligation to pay off the debt by fixed yearly instalments. Portions of the property were from time to time sold, and the prices were paid to the company. Out of the proceeds of sales the company paid themselves the interest and instalments for the year, and put the balances to the credit of Mr Lamb as a deposit. I see nothing wrong in this. Mr Lamb was in good credit at the time, and it was not desired to reduce the heritable debt otherwise than by the stipulated instalments. Moreover, it was for the benefit of the shareholders that the balance should be placed to Mr Lamb's credit on deposit, because the company made a profit by the difference of interest.

"With regard, therefore, to the alleged overstatement of the amount of deposits, I am not of opinion that there is any substantial inaccuracy, and there is assuredly nothing in the least to lead to the supposition that the directors had intentionally misstated the accounts. The statement objected to does not affect the balance—does not suggest an apparent gain, or conceal a losing or hazardous transaction—and it is difficult to see how it could affect the value of the shares to a purchaser.

"(2) The next objection is, that in all the balance-sheets the sum credited to the shareholders as 'interest' includes interest due but not paid. It appears that during the four years in question there was always a certain amount of interest in arrear, but this interest, as well as the principal, was covered by the heritable securities held by the company, and up to the time of the pursuer's

purchase no part of it was considered bad or irrecoverable. It was therefore properly stated as an asset of the company entering into the balance of profit. The directors, I may add, did not divide the whole of the apparent profit, but in each year carried a considerable sum to the credit of a reserve fund, so that the objection resolves itself into this—that the balance-sheet does not separate the interest into two heads—Paid and Unpaid. The statutory form of balance-sheet which the company adopted as its model does not make such a division. It appears from the evidence of accountants (Mr Molleson) that it is the practice of companies to take credit for interest accrued but not paid, where such interest is considered good. I cannot say, therefore, that the omission to distinguish arrears of interest from interest actually paid constitutes a fraudulent misrepresentation, though I think it is to be regretted that the shareholders were not informed of the existence of arrears of interest either in the report or in a note to the balance-sheet. It was, indeed, contended on the part of the pursuer that the directors were not entitled to declare a dividend out of income not actually received, and that such a declaration of dividend is itself a fraud. I cannot subscribe to this doctrine. Dividends are payable out of the profit arising on the transactions of the year, and profit includes income accrued although not paid. In many mercantile undertakings the income of the year is never received within the year, but it is represented by bills, which do not become payable until the expiry of the customary period of credit.

"(3) It is further objected that the balance-sheets for the four years in question are false in so far as they treat as a paid-up instalment the sum of £6700 due by Mr George Lamb on his shares in the company. It is averred on record that Lamb held this stock in trust for the company, but the supposition is not borne out by the evidence. It appears that by arrangement with the company Lamb borrowed on a postponed heritable bond the sum necessary to pay the instalments due on his shares. The bond was for £7000; he received £300 from the company in cash, and the difference (£6700) was put to his credit in the books of the company in payment of his instalments. If the security had been first-class it would have been a legitimate transaction, but I cannot approve of the action of the directors in taking a postponed bond in security of a loan representing so large a portion of the company's capital. The action, however, does not raise any question of wrongful or negligent administration. But in an action of damages in respect of false representations, I cannot say that the inclusion of Mr Lamb's stock in the aggregate of paid-up instalments was a false and fraudulent representation. The entry was correct in form, according to the bargain between Mr Lamb and the company. Whether it was a correct entry in substance depends on the further question whether Lamb's bond was a good security. It has not been proved to me that at the time the bond was taken, and according to the value of property then current in Glasgow, the security would be considered bad, and unless I am to hold that the security was valueless, and the transaction a fraud, I cannot sustain this ground of action.

"(4) There remains for consideration a misrepresentation of a very serious character, which occurs, I think, in all the balance-sheets issued prior to the pursuer's purchases of shares. In the column of assets the balance-sheets profess to set forth the amount of the company's invested funds, that is, the paid-up capital and the money received from depositors and re-invested. In each of the balance-sheets referred to these investments are described as 'loans on heritable security.' It appears that during the whole of this period sums varying from £6000 in 1874 to £52,000 in 1877 were advanced on current accounts to other companies, and chiefly to two, the Caledonian Provident, and the Edinburgh and Glasgow Heritable Company. These advances are included in the entry of sums said to be lent on heritable security, and the true character of the transaction is not disclosed in the reports and balance-sheets. It was explained in the course of the evidence that the Caledonian Company had been induced to accommodate the other companies in this way by the necessity of finding an immediate outlet for its uninvested funds, on which the directors were paying interest at deposit rates. It appears, also, from a statement prepared by Mr Molleson, that the balances due by the two companies fluctuated very much in each year, so that an annual balance-sheet would not sufficiently exhibit the state of the accounts between the companies. There can be no doubt, in my apprehension, that the shareholders and the public ought to have been informed that the entry titled 'loans on heritable security' included loans to companies—temporary or otherwise, as the case might be—for which no security was held; and I think that the suppression of this fact, from whatever cause, amounts to a misrepresentation in a matter of fact which might have a material influence on the mind of an intending purchaser of the company's stock.

"I have felt considerable difficulty in forming an opinion as to whether the directors are to be held responsible for this misrepresentation or *suppressio veri*, having regard to the direction of Lord President Colonsay in *Addie's* case (sustained on appeal) with reference to the extent to which directors are entitled to rely on information furnished to them by officers of their company.

"I am satisfied on the evidence that the directors were cognisant of the course of dealing under which their uninvested funds were lent to the two companies on accounts-current. But I do not think the directors were aware of the extent to which this system of accommodation had been carried. Mr Tod, the chairman, who seems to have known more of this matter than the other directors, says that the directors believed these were 'short loans, and for comparatively small sums.' As a director of the Edinburgh and Glasgow Company, Mr Tod learned in the autumn of 1876 that the advances to that company had by this time amounted to the large sum of £22,000. The matter must also have been brought under the consideration of the defenders, because Mr Tod adds—'I should wish to explain that the manager of the Caledonian Company had no instructions from the directors to lend that money to the Edinburgh and Glasgow Heritable Company, and it was a surprise to the directors of both companies when they found that so much money had been transferred without their knowledge or consent.' He afterwards states that the

directors of the Caledonian Company were much annoyed at so much money having been put in the power of another company, and that they were led to expect that the over-draft of the Edinburgh and Glasgow Company would be reduced.

"Such being the state of the directors' knowledge on the subject of the unsecured advances, I have to consider how the balance-sheet of the Caledonian Company came to be framed without any reference to these advances. I see no reason to doubt that the books of the Caledonian Company were properly kept. None of the professional witnesses have taken exception to the statement of the company's accounts in its books in any particular. On this point I refer to the evidence of Mr Turnbull, C.A., a witness for the pursuer. I should not, however, expect as a matter of course that the company's ledger, or the cash-book from which the ledger was posted, would show whether a particular loan was or was not heritably secured. The ledger contains an account of the cash transactions of the company with each of its debtors and creditors. But supposing the directors to have, in breach of their duty, lent money to an individual borrower, either on insufficient security or without security, the ledger would not necessarily disclose this fact, It would only show the particulars of the relation of debtor and creditor which subsisted between the borrower and the company in consequence of the cash transactions between them. Thus it happened that the trial balance-sheet for 1876, which is simply a transcript of the balance entries in all the separate accounts in the ledger for the year, contains no words which would attract attention to the peculiarity of the accounts of the Edinburgh and Glasgow and Provident Companies as being accounts for unsecured loans. The printed balance-sheet for this, as for previous years, was made up under the direction of the manager, and in it the whole of the funds of the company which were lent out at interest are summed up in one entry under the head of 'Loans on heritable security, £225,476.' The books of the company were audited by Mr A. T. Niven, the auditor appointed by the shareholders, and the trial balance-sheets, as well as the printed abstracts, were passed by him before being submitted to the directors. How it could have escaped the attention of the auditor that the entry of 'Loans on heritable security' included advances to companies on their simple obligation it is difficult to understand. It would appear from his own statement that he accepted the manager's certificate of the indebtedness of the Provident and Edinburgh and Glasgow Heritable Companies as equivalent to a certificate that heritable security had been given.

"The printed balance-sheets so prepared were circulated in proof among the directors, and were considered at board meetings at which the trial balance-sheet applicable to the year was laid on the table. It does not appear that the trial balance-sheets, or the books of the company from which they were made out, were ever referred to by the directors at any of the meetings which were held for the purpose of considering the balance-sheets and apportioning profits. Still the directors had a certain degree of knowledge of these transactions. If at any of the meetings it had presented itself to the mind of a director that the entry 'to loans on heritable security' included unsecured advances, and he had brought the subject before the other directors, and the board had passed the entry without alteration, this would, in my judgment, amount to a fraud on the shareholders and the public. If the error had suggested itself to any one director, and he had suppressed it, this again would have been his individual fraud, for which, in such an action as the present, I should be prepared to hold him responsible. But there is no evidence, and indeed no suspicion, of conscious and deliberate suppression of the truth by any of the directors in regard to this matter. I am satisfied, from the direct testimony of the manager and directors, and from the circumstantial evidence in the case, that the omission to distinguish unsecured from secured loans was never referred to at the meetings held for the purpose of revising the reports and balance-sheets. See on this subject the evidence of Mr Wilson. I see no reason to believe that if a doubt had occurred to any of the directors he would have refrained from mentioning it and taking the opinion of the board upon it. I did not understand the pursuer's counsel to make a case against the directors of deliberate fraud, and on that aspect of the case I am prepared, on the whole evidence, to find for the defenders.

"But it is maintained against the defenders that they must be held responsible under this action as for a fraud if they have issued balance-sheets containing statements which (in the words of the direction in *Addie's* case) they had not reasonable grounds for believing to be true, or (in the language of Lord Cairns in another case, L. R., 4 H. of L. 79) in ignorance whether they were true or untrue. For the directors it is pleaded that in publishing the balance-sheets they did not put forward those abstracts as statements the correctness of which they vouched from personal knowledge and personal revision, but rather as documents prepared by the officers of the company in whom they, the directors, had confidence, and revised by the auditor. The report for the year 1876, the last of the series in question, contains this paragraph :—'Annexed the directors beg to submit the balance-sheet and relative profit and loss account, duly docqueted by the auditor of the company.' The balance-sheet is certified as follows :—'*Edinburgh, 20th February* 1877.—Having examined the accounts of the Caledonian Heritable Security Company, Limited, for the year ending 30th December 1876, I have found the same to be correctly stated, and sufficiently vouched and instructed, and I certify that the foregoing abstracts exhibit a true state of the company's affairs as taken from the books. (Signed) ALEX. T. NIVEN, C.A., *auditor*.' The balance-sheet does not bear to be subscribed by the manager or directors, or to be adopted by them otherwise than in terms of the paragraph quoted. The balance-sheets for previous years are similarly authenticated. The chief difficulty of the case is in determining whether there was a duty incumbent on the directors to satisfy themselves personally as to the correctness of the balances submitted to the shareholders, so that the annual financial statements should be held to be for all purposes personal representations of the directors; or whether the directors were acting within the scope of their duty in presenting to the shareholders the balance brought out by their confidential officers, and approved by the auditor, without

subjecting these to the test of personal examination? In considering this question there is room for a distinction. It is possible that in a question with a shareholder alleging negligent administration of the company's affairs the certificate of the auditor might not relieve the directors from responsibility, especially if the facts certified were such as were, or ought to be, within the cognizance of the directors in the exercise of their duty of superintendence of the company's affairs. But in an action founded on alleged fraudulent misrepresentation it is a material consideration that the document containing the false statement is submitted by the directors in terms which disclose the grounds of their belief in its accuracy, and with a tacit reference to the certificate of the auditors as their authority for making the statement. On this subject the direction of Lord President Colonsay in *Addie's* case (3 Macph. 901) is significant. Speaking of the directors' report in that case his Lordship observed—'There is implied in their report a representation to the effect that they have reasonable ground to believe in the truth of what they assert, and those to whom it is addressed or circulated are entitled so to understand it. This does not mean that it is incumbent on the directors personally to go through the books and test the accuracy of them, or of the results brought out in them. It is not to be expected or supposed that the directors have done so. They are entitled to rely on the information furnished to them by the officials to whom the details of the business are committed, and in whom confidence is placed. That affords reasonable grounds for the directors believing in the truth of the results so brought out, and of the inferences reasonably deducible from them. And if it should unfortunately turn out that the information so furnished to the directors was false, by reason of the negligence or fault of those whose duty it was to furnish correct information, the directors who honestly believed it, and were themselves deceived by it, cannot be held to have practised any fraud on the shareholders or the public.'

"On the best consideration which I have been able to give to this case I am of opinion that, in the discharge of their duty to the shareholders the directors were entitled to rely on the accuracy of the balance-sheets prepared by their manager and certified by the auditor of the company. Consistently with this opinion, I hold that it was the duty of the directors to examine the balance-sheets and to use their general knowledge of the company's affairs to assist them in the revision of these documents before submitting them to the shareholders. But in a question with a member of the public who refers to the balance-sheets for information to guide him in relation to a purchase of shares, I am not prepared to say that the directors can be made responsible for undesigned omissions. Mere negligence must not be confounded with fraud.

"In issuing these balance-sheets to the public the directors gave them for what they purported to be—abstracts of the balances of the company's transactions certified by the auditor. In a question with a member of the public—and assuming, as I do, that the directors were not aware of the inaccuracy of the entries objected to—I do not consider that the defenders are to be taken as vouching anything more than this, that the particular balance-sheet is entitled to all the credit due to a document compiled by trustworthy officers from the books of the company, and certified by the auditor of the company as correct. In the view I have taken it is unnecessary to consider the question of damage, but as the subject was touched on in the argument, it may be proper that I should indicate my opinion, which is, that the transactions which the directors are charged with fraudulently misrepresenting or concealing did not very materially contribute to the state of insolvency which has unfortunately overtaken this company. It appears, indeed, that the assets of the Edinburgh and Glasgow Company were insufficient to make good the whole of the sum lent to that company, and a claim was made on the defenders (the directors of the Caledonian Company) to indemnify the shareholders against the anticipated loss, which claim they have satisfied by a payment of £12,000, as stated by Mr Couper, the liquidator of the company. But the greater part of the losses sustained by the Caledonian Company has arisen in connection with loans on heritable security, which proved insufficient in consequence of error in judgment on the part of the directors, or in consequence of a fall in the value of heritable property in Glasgow exceeding the limit of possible depreciation on which a prudent investor would calculate. According to the evidence of the pursuer, this was a risk which he understood and meant to take when he purchased his shares. If the whole funds of the company had been invested on heritable security, he would, in the character of purchaser, have had nothing to complain of, because the funds of the company would, in the case supposed, be invested in terms of the articles of association, and the balance-sheets would (as regards these investments) be strictly accurate. But if the securities taken had been similar in character to those which resulted in the ruinous loss which has been spoken to by the company's officials, the result to the shareholders would not have been materially different. Can it then be said that the pursuer has suffered in consequence of trusting to the representations of the defenders? He may say, no doubt, I am content to submit to the loss resulting from the risks which I undertook, but I am not bound to submit to losses resulting from a different kind of risk. On the other hand, it is not made out to my satisfaction that loss has in fact resulted upon the accounts in which advances were made without heritable security. It is not necessary that I should offer an opinion on this branch of the case, and I only suggest it as a subject of consideration in case of a different view being taken by a higher Court on the question of fraud. My opinion is that the defenders are entitled to be absolved from the conclusions of the action."

The pursuer reclaimed, and after explaining in detail the nature of the various acts of alleged fraudulent misrepresentation, argued—It was not contended that the directors had been guilty of fraud in a moral or criminal sense, merely that they were civilly liable. It was not said that they were guilty of conscious misrepresentation. What was said was that they were under a duty to satisfy themselves of the general accuracy of the reports and balance-sheets, and that they had not done so. Their belief may have been honest in one sense, but being arrived at on most unsatisfactory grounds, which the slightest trouble and

inquiry would have displaced, it was not for the present purposes *bona fide* belief. That was particularly the case with reference to the error of describing as "loans on heritable security" what had been advanced on current account to other companies. It was the fair result of the evidence, and the Lord Ordinary was satisfied that the directors were cognisant of this general course of dealing, and although it was not said that this practice was actually present to their minds when they issued the reports, still their general knowledge of it imposed a greater duty of checking the reports and balance-sheet with the trial balance-sheet than was implied, as the pursuer contended, in the ordinary duty of their office. And a similar observation applied to those directors whose calls were in arrear—surely they must have known, though they might not have actually recollected, that fact?

Argued for the defenders—The defenders were not liable. Having, as they had, the guarantee of the manager and the docquet of the auditor, they were not bound to inquire into the accuracy of what it was the duty of these officials to prepare and to certify. They were liable only for what they knew *de facto*, and it was conceded that they did not *de facto* know of the errors founded on. The utmost that could be said was that the defenders, or some of them, had been aware of facts which, had they recollected them, might have enabled them to discover the errors; but that was not enough. They had no duty to inquire. But were the errors material? They resolved themselves into an advance without security to the Edinburgh and Glasgow Company of £16,000, (for the advance to the Caledonian Security Company was in a manner, though not in strict law, heritably secured), and of £9000 unpaid calls. Neither amount was large looking to the company's total dealings, and it was plain, looking to the circumstances of the pursuer's purchase of the shares, that had he known either error he would have bought all the same. Lastly, the errors had caused no loss to the company, which had failed from circumstances entirely beyond the control of the directors.

Authorities—*Western Bank* v. *Addie*, June 9, 1865, 3 Macph. 899—May 20, 1867, 5 Macph. (H. of L.) 80; *Burnes* v. *Pennell*, February 5, 1848, 10 D. 689—June 16, 1849, 2 Clerk and Fin. 497; *Brownlie* v. *Millar*, July 16, 1878, 5 R. 1076—June 10, 1880, 7 R. (H. of L.) 66; *Inglis* v. *Douglas*, February 16, 1861, 23 D. 561; *Gordon* v. *Davidson*, February 26, 1864, 2 Macph. 758; *Trial of the City of Glasgow Bank Directors*, Couper's Separate Report, Lord Justice-Clerk Moncreiff. p. 436; *Reese River Mining Company* v. *Smith*, March 18, 1869, L.R. 4 (H. of L.) Eng. and Ir. Ap. 64, Lord Cairns, p. 79; *Reek* v. *Gurney*, Nov. 6, 1871, L.R. 13 Eq. 79—July 31, 1873, L.R. 6 (H. of L.) 377—Lord Romilly, M.R. pp. 110 and 113, *cf.* 13 Eq.; *Scott* v. *Dickson*, 1859, 29 L.J. Exch. 62. *note*; *Hallmark's* case, May 29, 1879, L.R. 9 Chan. Div. 329; *Weir* v. *Bell*, May 18, 1878, L.R. 3 Exch. Div. 238; *Wilde* v. *Gibson*, June 6, 1848, 1 Clerk and Fin. 1848; *Ormrod* v. *Huth*, June 19, 1845, 14 Mees. and Welsby, 651; *Collins* v. *Evans*, February 1, 1844, 13 L.J. Q.B. 180.

The Lords made avizandum.

At advising—

Lord Deas—The Caledonian Heritable Security Company (Limited) was formed and incorporated in 1872 under the Acts 1862 and 1867 for the purpose of lending money on the security of heritable property, or for various other purposes enumerated. On the other hand, they were authorised to receive money on loan, cash-credit, debenture, deposit, or otherwise. Their business, in short, although it is not expressly so said, was to borrow money at the lowest rates at which they could get it, and lend at the highest. The capital of the company was declared to be £200,000, divided into 40,000 shares of £5 each. To qualify a shareholder to be a director it was necessary that he should hold 100 shares. Of the five defenders who are sued simply as directors, four held office from the first. Three of these qualified themselves by subscribing for five times the number of shares necessary—namely, 500 shares each in place of 100—and the other two by subscribing for 250 shares each. Mr Nelson was not one of the directors originally, but became one shortly after the company was constituted, and had on that occasion 200 shares allotted to him.

It is to be noted in the outset that the company was a highly successful company till the failure of the City of Glasgow Bank in October 1878, which we all know proved ruinous to a great majority of the shareholders of that bank, gave a general shock to credit, and naturally made the creditors of such a company as that now in question—debenture-holders, depositors, and others—desirous in all haste to get up their money. The ultimate consequence of this was that the company stopped payment on 13th July 1880, and is now in voluntary liquidation.

The pursuer first became a shareholder of the company on 4th July 1878, when he purchased 50 of the nominally £5 shares at £2, 10s. per share. This, it will be observed, is the only purchase made by him before the failure of the City of Glasgow Bank. It is not disputed that considerably prior to the pursuer's first purchase £1 per share had been paid up. That first purchase, he says, he made on the faith of the reports and balance-sheets of 1874–75–76. The pursuer's second purchase was 50 shares on 16th December 1878 at £1, 10s. per share. This purchase, he says, was on the faith of the report and balance-sheet of 1877. His third and last purchase was 100 shares on 19th February 1879 at 10s. per share. This purchase was admittedly made before the report of 1878 was issued, and consequently on the faith of the report of 1877.

In the present action the pursuer seeks to recover from the directors of the company the prices he thus paid for his shares, together with the amount of the two calls since made thereon—the one of £1 per share and the other of £3 per share, all as specified in his condescendence. I shall immediately notice the grounds on which his action is rested. In the meantime I may observe that it is rather remarkable that the pursuer should have purchased in what was so decidedly a falling market. He says—"I thought there was just a mere panic in the market. I did not purchase the shares as a speculation. (Q) Had you any doubt that something had happened to depreciate the value of the company's property?—(A) That was stated as a probable result. Question repeated—(A) Yes.

That a number of directors and shareholders were selling their shares, and that the market had been flooded with shares. I understood that was the cause of the company's property being depreciated." From the pursuer's account of these two purchases I should say that they were not merely a speculation, but a speculation of a very unusual kind. In substance, what he says is that he purchased into the concern on learning that a number of the directors were in the act of escaping out of it! Knowledge of that fact—if it had been a fact—would not, I think, have attracted many other purchasers. It was not a fact, however, and he evidently had no authority for suggesting it, for being asked "Who told you that sales of shares were made by the directors?" he answers, "I do not know whether they were directors' shares or not." And the question being repeated, he says, "I cannot tell."

The reports and balance-sheets are addressed only to the shareholders, but I agree with the Lord Ordinary that they must be considered to be put into the hands of the public as well as into the hands of the shareholders, and that the pursuer is consequently quite entitled to say that he purchased on the faith of them.

It is to be observed that there is no attempt in the pursuer's condescendence to state a case of negligence or neglect of duty of any description. It is therefore unnecessary to consider whether a gross case of that kind might or might not have been so stated as to be relevant to infer pecuniary conclusions such as are here insisted on.

The ground of action on which the pursuer relies is thus stated in article 17 of his condescendence. Article 17 is in these terms:—"The defenders falsely and fraudulently made and submitted the said reports for the years 1874, 1875, 1876, 1877, and 1878 to the shareholders of the company, all as before stated, for the purpose of misrepresenting and concealing the true condition and actual state of the company's affairs, of creating a false impression in regard thereto and giving to the shares of the company a fictitious value in the market, of misleading and deceiving the pursuer and the public generally, and of inducing them to believe, contrary to the truth, that the said company was in a sound financial condition, and was earning profits capable of paying a good dividend, and that the shares were a good and sound investment."

There can be no doubt of the relevancy of the averments in this article, subject to the correction which falls to be made for the sake of accuracy, although it may be otherwise of no moment, that the pursuer includes in it by mistake the report of 1878 as one of the reports on the faith of which he purchased, whereas in the same condescendence he states that his third and last purchase of 19th February 1879 had been made on the faith of the report for 1877. Accordingly in his evidence he says—"The report for the year ending 31st December 1878, which was submitted to a meeting of the shareholders on 28th March 1879, was not issued before I made my last purchase. In making that purchase the last report I had seen was the one issued on 6th March 1878—that is, the report for 1877. I must have bought the shares on 19th February 1879 on the faith of the report for the year 1877. I also bought my shares on the 16th December 1878 on the faith of the same report."

The allegations in article 17, I have said, are perfectly relevant, but I cannot discover where the proof of them is to be found. The only documents authoritatively issued to the shareholders, and thereby to the public, and which we find were habitually prepared and issued in that form, accordingly were the reports and balance-sheets already mentioned. The pursuer does not allege that there was anything either irregular or defective in the form of these documents, and coupling No. 81 of the statutory table with No. 15 of the articles of association, it seems plain that the reports and balance-sheets are not open to any such objection. Accordingly Mr Molleson, whose extensive experience in such matters is well known, says—"I think these balance-sheets are made out in the usual way." And again—"I think the form adopted by this company was the usual form adopted by companies of this class for compliance with the Companies Act of 1862."

All these reports and balance-sheets were prepared and certified as correct by the manager and auditor respectively. Both of these officials were duly qualified professional men, members of the body of Chartered Accountants in this city. They were annually elected by the shareholders to their respective offices from the date of the company's incorporation in March 1872 downwards. These officers describe in their evidence the manner in which the reports and balance-sheets were made up. There was first prepared by the bookkeeper a trial balance-sheet, which was a very voluminous document. A draft of the balance-sheet itself, which was a mere abstract of the trial balance-sheet, and required to be nothing more, was also prepared by the bookkeeper under the inspection and revision of Mr Wilson, the manager, and then the report and balance-sheet itself for the year, also prepared by Mr Wilson, together with the books of the company and vouchers (as I understand his not very clear evidence as to the order of these proceedings), were sent to the auditor, who returned them with a docquet bearing, in the same terms with that first in date which is in the prints before us, that having examined them, "I have found the same to be correctly stated, and sufficiently vouched and instructed, and I certify that the foregoing abstract exhibits a true state of the company's affairs as taken from the books." The trial balance-sheets themselves could not be published, for the reasons indicated by Mr Molleson, that this would have exposed the names and affairs of the customers.

But the pursuer, after averring in article 16 of his condescendence, as he had done in his other averments above quoted, that the foregoing reports were false in the knowledge of the defenders, has made what is obviously intended for an alternative averment in the following words:—"At least the said reports were made, submitted, and published as aforesaid by the defenders without having any reasonable ground for believing that the statements therein contained were true."

The relevancy of this as a separate averment is apparently intended to be rested upon some expressions in Lord Colonsay's charge in *Addie's* case, and of which charge, taken as a whole, all the other Judges then in the First Division, as

well as myself, approved by disallowing the exceptions to that charge. Since then one noble Lord in the Court of Last Resort has expressed his approval of the words used in the charge as to requiring reasonable grounds of belief, while another noble Lord has expressed himself adverse to the use of these words, thereby, I should say, neutralising each other's observations, and leaving the authority of this Court sanctioning the whole charge, including these words, to stand as it did. The question, however, did not arise in *Addie's* case what would be effect of belief which had no reasonable ground to rest upon. From the observations I made in that case it is obvious that I recognised the doctrine in the charge that reasonable grounds of belief are necessary. It is plain enough, however, that Lord Colonsay was of opinion—and I must hold myself to have agreed with him—that reports prepared by the proper officers of the company on the state of its affairs may of themselves afford reasonable grounds of belief on which the directors are entitled to rely, although these reports may contain only results without particulars.

In his charge to the jury in *Addie's* case Lord Colonsay observed—"That in submitting to the shareholders a report on the affairs of the bank and the results of its business for the past year, the directors have a duty to perform, and it is part of their duty not to put forth any statements as to the affairs or the prosperity of the bank which they have not reasonable grounds to believe to be true. There is implied in their report a representation to the effect that they have reasonable ground to believe in the truth of what they assert, and those to whom it is addressed and circulated are entitled so to understand it. This does not mean that it is incumbent on the directors personally to go through the books and test the accuracy of them, or the results brought out in them, and their report is not to be taken as importing or implying that they have done so. They are entitled to rely on the information furnished to them by the officials to whom the details of the business are committed, and in whom confidence is placed. This affords reasonable grounds for the directors believing in the truth of the results brought out, and of the inferences reasonably deducible from them. And if it should unfortunately turn out that the information so furnished to the directors was false by reason of the negligence or fault of those whose duty it was to furnish correct information, the directors, who honestly believed it, and were themselves deceived by it, cannot be held to have practised any fraud on the shareholders or the public."

This law, which I concurred with Lord Colonsay in laying down in 1865, I adhere to now in 1882. It appears to me to be conclusive in the present case, to this effect at all events, that the directors must be held to have been in good faith in relying on the reports and balance-sheets till the contrary is proved. The pursuer must prove clearly and unequivocally that they did not believe them to be true. Of that I can find no proof whatever.

All the defenders, who are called simply as directors, presented themselves for examination and cross-examination, and have been fully examined accordingly. It may be right to glance at what they say they understood to be the position they occupied, and as to what they say they believed.

The first in order is Mr Clapperton. He says—"At the commencement of the company I was requested to become a director, which I did, and held office throughout. Mr Richard Wilson was appointed manager of the company at the commencement, and continued throughout." He then names the auditor and the valuators in Glasgow and Edinburgh, and he says—"I had perfect confidence in the integrity and ability of all these parties." And again—"I took nothing to do with the keeping of the books of the company. I did not consider it any part of my duty to overhaul the books." He further says—"I as director took no part whatever in the preparation of the annual report and balance-sheet." And further—"I gave no directions whatever with regard to the heads in the books under which any of the transactions of the company were to be entered, or as to what heads should be put into the balance-sheet, and what should be put under the different heads. I did not think that was within my department. I relied on the manager and the auditor to make the balance-sheet right with regard to that matter. When the balance-sheet was put before me, certified by the auditor, I assumed it to be correct. I never saw any trial balance-sheet. I left that to the auditor."

The other defenders who are called as having been directors give a similar account of their position, and of the good faith with which they relied on the reports and balance-sheets. Thus Mr Bryson says—"I believed the statements made to us by the manager and auditor. We had perfect confidence in all our officials."

Mr Turnbull says—"I had perfect confidence in the officials of the company. I did not interfere in any way in regard to the bookkeeping, nor in regard to the heads under which the business of the company should be grouped in the annual balance-sheets. I left that to the manager and to the auditor who had been appointed by the shareholders."

Mr Nelson says—"I took no part whatever in adjusting the balance-sheets. I relied on the manager for that, and I thought he would be kept right by the auditor."

Mr Tod says—"Throughout we had perfect confidence in our manager, and also in the auditor." And he adds—"I never gave any instructions as to how transactions were to be entered in the books or grouped in the balance-sheet. I left that to the manager and the examination of the auditor."

To the same effect Mr Nelson says—"I gave no directions, and did not interfere in any way, with reference to the mode in which the transactions complained of in the record were entered in the books or balance-sheets. I trusted that to the manager, supervised by the auditor."

The manager expressly confirms the above evidence of the directors. He says—"The directors never gave any instructions as to the headings under which the different items were to be put in the balance-sheet."

It has been noticed that in the report for 1877 the capital is stated on the footing that the new shares issued in that year had been fully paid up. Now, this undoubtedly, as at the date when that report was issued, could not be said to have been an accurate statement. But it is quite satisfactorily proved that as all the subscribers were quite able and ready to pay when required, it

was rather at the request than otherwise of the office-bearers of the company that payment was for a short time postponed, which enabled the company to draw five per cent. interest for the money in place of depositing it in bank at one per cent. interest. All the outstanding arrears which had been thus allowed to lie over were accordingly found recoverable without difficulty, and were paid with five per cent. interest. There was assuredly nothing fraudulent in this arrangement.

The only other transaction affecting the capital of the company which the pursuer alleged to be false and fictitious on the face of the reports was that, much commented on at the bar, which took place between the company and George Lamb, their Glasgow valuator. That transaction took place in March 1875, when the acquisition of shares in the then flourishing company was deemed a most desirable object to be secured. The company agreed to allocate 3700 shares to Lamb, and gave him a temporary loan of £6700 to enable him to pay the price, which, including the first call and premium, was precisely equal to the amount of the loan. These sums were represented as mere cross entries, but it appears from the evidence of Mr Molleson, who examined the books and relative papers, that heritable security was given for the loan by Lamb (I quote Mr Molleson's words) and his partner Wotherspoon, and that "by the application of the proceeds of the sale of portions of the property that had been carried to the deposit-account the whole debt was thus wiped off, and the company did not lose anything by it."

To come to take now a more general view of the case, two facts appear to me to be established which would interpose a serious stumbling-block in the way of the pursuer's success in this action even if all the other anwsers to it could be obviated. These are—first, that the prosperity of the company, which at one period was undoubted, was terminated only and obviously by causes over which the directors had no control, and for which they were not responsible; second, that the stoppage of the company and the necessity for liquidation arose in like manner from causes over which the directors had no control, and for which they were under no responsibility whatever.

These two facts may be fairly enough deduced from the pursuer's own evidence. As to the prosperity of the company, he notices that in the report for 1876 the dividend announced to be paid was ten per cent. on the subscribed capital and ten per cent. bonus, and that in the report for 1877 a dividend was announced of ten per cent. on the subscribed capital and five per cent. bonus. He does not suggest any doubt that these dividends were duly earned, nor do any of the accountants do so who have examined the books, which he himself must also have had an opportunity of seeing since he became a director of the company in March 1880.

Then, as to the causes which terminated this prosperity, the pursuer himself says in his evidence—"In the end of 1878 and beginning of 1879 circumstances occurred in the financial world to make the shares fluctuate a good deal." In reference to the low price of 10s., at which rate he purchased his two last lots of shares, he says the depreciation was attributed to the failure of the City of Glasgow Bank—"I do not know how it did so, but these things affected the market." As to the company itself, of which he had thus become a shareholder, he says—"There was no public rumour affecting their credit." Being asked—"Did you find in your practice that what had been considered a safe margin prior to 1878 became dangerously narrow after that?" He answers—"Yes, that was a general feature of the heritable security market after 1878." It is a fair inference from these and other passages in the pursuer's evidence that he was pretty well aware that general causes quite sufficient to account for the depreciation of his shares and the loss entailed by them had come into operation after he purchased them, over which causes the directors could have had no control, and for which they were in no way responsible.

This, however, is made perfectly clear by the evidence of Mr Molleson, who explains that he has had full access to the books and papers of the company, and he says—"From an examination of the books and papers prior to the end of 1877 the company appears to have been in a sound and prosperous condition. I have examined to see whether a number of the directors and shareholders of the company were shareholders of the City of Glasgow Bank, and I have made a list of such as were, with the number of shares of this company held by each. The particulars are as follows:—Robert Craig, 533 shares; Adam Curror, 880; Kenneth Mathieson, 500." These three your Lordships know were directors. He then names a number of individuals other than directors who held among them, I think, 1272 shares, and he continues—"In consequence of the failure of these people their shares were forced upon the market." The effect was that the price fell from £2, 10s. in September 1878 to 9s. 6d. in December 1879. He adds—"I find that the loss of the credit of the company affected their deposits, and these immediately began to be withdrawn. In October 1878 there was withdrawn £14,494; November, £13,531; December, £9037—in all, £37,062." He then mentions the amount of deposits received during the same three months, amounting in all to £8685, leaving a nett diminution in three months of £28,277. He adds—"Contemporaneously with this there was a great depreciation in the property market, and such properties as the company held in security were not realisable."

I have thought it only fair to the defenders to point out that in and after 1878 causes quite independent of the actings and management or mismanagement of the directors unexpectedly occurred amply sufficient to account for the shares of the company having become sources of loss in place of profit to all the shareholders, including the pursuer. This, however, is not necessary for the defence of the directors. Still less is it necessary to adduce affirmative evidence of good faith on their part if the pursuer has failed to prove bad faith; but there are various circumstances of real evidence in their favour which seem to me of themselves very difficult to resist.

The pursuer says in his condescendence—"In making the foresaid false and fraudulent representations in regard to the company's position and the state of its affairs the defenders had a

deep personal interest, all of them being proprietors in the concern."

The pursuer's theory thus seems to be that the directors' object in the alleged fraud was either their own personal profit, by adding new partners and thereby strengthening the concern, in which view they must have expected it to be prosperous, or the object was to diminish their own loss in the knowledge that the concern was rotten.

Prima facie, I should have thought that their deep interest in the concern was rather a guarantee for good faith than a motive for fraud. They were not mere adventurers who had nothing to lose, but persons of substance and of character. The pursuer says in his evidence—"I knew the directors personally, and their individual reputation was high."

There are, however, other circumstances of real evidence which seem to me to prove conclusively their good faith at the outset, and continued to the end. More particularly—(1) None of them sold any of the substantial number of shares they originally subscribed for. (2) On the contrary, all of them added largely to their original holdings by accepting new shares at a premium and paying the calls thereon. Thus, Mr Clapperton, who was an original subscriber for 350 shares, held at the stoppage 561 shares. Mr Bryson, who was an original subscriber for 500 shares, took up his full proportion of new shares at a premium, and after giving off 200 to his son, retained to the end 566 shares. Mr Tod, who had subscribed for 250 shares, accepted on allocation 167 shares at a premium of £3 a share, and retained at the end 534 shares. Mr Nelson had 200 shares allotted to him when he became a director. He took up others at a premium, and he held at the end 366 shares. Mr Turnbull was an original subscriber for 500 shares, and his holding at the end was 734 shares. (3) Another conclusive circumstance of real evidence of the good faith of the directors to the end is that even after the alarm and fall of credit spoken to by Mr Molleson, caused by so many shareholders of the company being ruined by the City of Glasgow Bank, those of the directors who had deposits with the company did not withdraw them as many of their customers did. Mr Bryson, for instance, had £500 still deposited with the company at the date of the stoppage. Mr Milne had £14,000 on deposit at that date; his sister had £1200; and his brother-in-law had £5000 also still on deposit with the company.

On the whole, I can have no doubt that the interlocutor of the Lord Ordinary falls to be adhered to, and I may add that the individual reputation of the directors stands as high in the end as the pursuer candidly admitted it did at the outset.

Lord Mure—This action has been brought by the pursuer for payment of £1054, 12s. 6d. as the amount of the sums paid by him in the purchase of shares in the Caledonian Heritable Investment Company, of which the defenders are the directors, and of the calls since paid by him upon those shares, with an alternative conclusion for the sum of £1100 as the amount of the loss and damage sustained by the pursuer through the purchase of the shares.

The general ground upon which the pursuer seeks repetition of these sums is that he was induced to purchase the shares through the false and fraudulent representations of the defenders, made in the reports and balance-sheets submitted by them to the shareholders and the public, more especially in the balance-sheets for the years 1874 to 1877 inclusive. These balance-sheets he alleges were so made and published in the knowledge of the defenders that they were false, or at least without the defenders having any reasonable ground for believing that the statements contained in them were true; and he further alleges that this was done for the purpose of misrepresenting and concealing the true condition of the company's affairs, of inducing the public to believe that the company was in a sound financial condition, and of giving the shares a fictitious value in the market.

The main grounds on which the balance-sheets for these years are challenged on the record are —1st, that the amount of the shareholders' capital and reserve fund was overstated; 2d, that the amount of the sums held in deposit was also overstated; and 3d, that of the sums stated as held in loan on heritable security a very considerable amount was not so held. In disposing of the case the Lord Ordinary has dealt with these three objections under the 1st, 3d, and 4th heads of the note to his interlocutor; and he has also dealt with another question not very specifically raised in the record, viz., the allegation that in some of the balance-sheets interest which was due but had not been paid was credited to the shareholders and carried to the profit and loss—so that the dividend was to that extent paid out of capital. This last objection was not insisted on during the discussion on the reclaiming-note; and the questions of fact therefore which your Lordships have to dispose of in considering the objections taken to the balance-sheets fall to be dealt with under the three heads to which I have already referred.

First—Taking these objections in the order adopted by the Lord Ordinary, the first point to be considered is, whether there is any ground for the allegation that the balance-sheets are overstated and false, in respect of the amount entered under the head of "deposits and debentures." This objection, as explained by the Lord Ordinary, is founded on two distinct allegations—1st, that under that head sums are included for which security had been given; and 2d, that sums were also included which consisted of partial payments to account of money borrowed from the company, and which were therefore not deposits in the proper sense of that expression.

(1) The first of these allegations relates mainly to the sum of £12,000 borrowed from the Scottish Provident Institution, and to a sum of £4500 borrowed from Pitcairn's trustees, for both of which sums security appears to have been granted. With reference to these sums, I concur with the Lord Ordinary in thinking that it is not absolutely necessary that money so borrowed for the purpose of being again lent—although it may not be a deposit in the ordinary sense of that expression—should be entered under a separate heading in the balance-sheet. These sums were undoubtedly liabilities of the company, and fell to be entered, under that general description of liabilities, on the debit side of the account. But there is another ground on which, as it appears to me, this part of the objection is obviated.

The heading on the liability side of the balance-sheet under which these loans are entered is not limited to deposits. It also includes debentures. Now, for these advances debenture bonds appear to have been granted by the company. This is explained in the evidence of Mr Molleson, and Mr Turnbull, who speaks to the debenture for the £12,000 as entered in the company's register of debentures; and to the question whether anyone looking at that register would not at once assume that the money had been lent on debenture, he answered, "Yes, if the entry in that register is correct, I think there is nothing wrong in putting it among the deposits and debentures,"—and the same observation appears to me to apply to the entry of the money due to Pitcairn's trustees, which is proved by Mr Molleson to have been entered in the debenture register. No foundation exists for this branch of the objection.

(2) With reference to the second head of this objection, viz., the entering under the head of "deposits and debentures" the sums repaid by Lamb of the money borrowed by him, I adopt the view expressed by the Lord Ordinary in his note, which appears to me to be borne out by the evidence in the case. I have not been able to come to the conclusion that there was any substantial inaccuracy in the way in which these sums are stated. This money when lent must have been money taken from the deposit side of the account, and when repaid it was not, I think, necessarily wrong to include it on the same side of the account.

Second—With reference to the alleged overstatement of shareholders' capital in the matter of the £6700 due upon Lamb's shares, I am satisfied that the explanation given of this matter in the answers made by the defenders to the condescendence is substantially correct. The explanation is this—that in the first instance a temporary loan was made to Lamb, on the joint obligation of Lamb and Wotherspoon, of £6700, being the amount of the calls due on those shares; that at a meeting held on the 3d of March 1875, prior to the date of the report and balance-sheet objected to, it was arranged that a loan should be made to those parties of £7000 on heritable security; that this transaction was duly carried through; that the temporary loan was then wiped off—£300 of the £7000 being paid to Lamb, and the balance of £6700 held as applied in payment of the shares. This is, I think, proved by the evidence of Mr Molleson, and is substantially corroborated by Mr Turnbull, who, when asked, "Do you say, with regard to these shares, that there was a misstatement of fact in respect that Lamb's £6700 had not been paid?" answered—"It was only paid in the way I have explained before; I am not prepared to say that that was wrong." I am of opinion, therefore, that the result which the Lord Ordinary has arrived at on this point is correct.

But there is another objection made under this head which does not appear to have been stated to the Lord Ordinary, to the effect that the statement in the balance-sheet of 1877-78 as to the amount of shareholders' capital was incorrect to the extent of about £9700 of calls which had not been paid up. This point is attended with some nicety. As matter of fact that sum was in arrear, and a considerable amount of it appears to have been due on shares belonging to the directors. It was, however, not paid up because of an arrangement made by these directors, not as a body but as individual shareholders, at the request of the manager, who had difficulty at the time in finding satisfactory investments for money, that they should retain the money at five per cent. interest in the meantime, and pay up the calls on demand, which they accordingly agreed to do. Now, if in these circumstances the balance-sheet had borne that the shares had been "paid up" it would be difficult to say that there had not been a misstatement to that effect. But that is not the nature of the entry in the balance-sheet. The entry is, "By shareholders' capital, in so far as called up, £20,000;" and that was a correct entry, because capital to that amount had been called up, although it had not all been paid; and if the same expression had been used in the report with which the balance-sheet was submitted to the shareholders I do not think any objection of the description now raised could have been taken to this part of the balance-sheet. This is evidently the view of Mr Turnbull, the accountant examined on the part of the pursuer, who, when questioned on this point with reference to the use of the words "paid up" in the report, says—"To have said 'called up' would have been quite right. No doubt the money was called up;" and he adds, "that the report was probably written after the auditor docqueted the account."

In these circumstances the question comes to be, whether when the balance-sheet, examined and docqueted by the auditor in terms of the statute, is correct, and contains no misrepresentation in the above respect, any shareholder or purchaser who made no inquiry as to whether it was correct at the time should be afterwards entitled to challenge the balance-sheet as false in respect of the incorrect statement contained in the report? I am disposed to think that in such a case the statement in the balance-sheet is the one by which the rights and liabilities of the parties should be ruled, and on this ground I am of opinion that it is not proved that in this respect the statement in the balance-sheet is false.

Third—But the more serious and important question remains, relative to the misrepresentations said to be contained on the credit side of the balance-sheets as to the amount of loans held on heritable security. These are entered under the one general head, "Loans on heritable security," &c., and with reference to this entry the conclusion I have come to is, that there has been misrepresentation in several respects, and more particularly as to the money advanced in loan to the Edinburgh and Glasgow Heritable Security Company, for which no security was held, and the amount of which fluctuated from time to time as explained under the fourth head of the Lord Ordinary's note. At the date of the balance-sheet of 1877, to which our attention was more specially directed, the sum so advanced to that company exceeded £16,700. This loan, which was substantially one on open account, had at one time amounted to a much larger sum, but had been reduced by a loan for £15,000 over heritable property in Glasgow under a transaction which was guaranteed by the Edinburgh and Glasgow Company.

Under this head there was also included, 1st, £9700, being a balance due on new shares which

was not in any way heritably secured, and 2d, the amount of two heritable securities which had been assigned, the one to the Scottish Provident Association, and the other to Pitcairn's trustees, in security of loans made by these parties, but from which no deductions appear to have been made in respect of the assignation of the securities.

In these three respects there was, I think, misrepresentation in matter of fact of the state of the company's affairs by including those sums in the balance-sheet under the head of "Loans on heritable securities," and this was a misrepresentation which, I agree with the Lord Ordinary in thinking, might have a material influence on a party who examined the balance-sheet with a view to the purchase of shares in the company.

A further sum of £10,000 was objected to under this head as an advance made on open account to the Caledonian Provident Investment Society. But I do not think that objection was substantiated, because for that sum a transaction of the nature of an heritable security had been entered into, as explained by Mr Molleson, and is shown by a minute of agreement between the parties.

Such being the view I take of the nature and probable effect on the mind of a purchaser of the misrepresentations in the balance-sheet, the next question for consideration is, whether it is proved that the misrepresentation was made with the knowledge of the defenders, and for the purpose of misrepresenting and concealing the true condition of the company's affairs as alleged by the pursuer.

Upon these two points I am of opinion that the evidence is insufficient to instruct the pursuer's allegations. With reference to the last of them there is really no evidence at all. The leading defenders are examined, and they all state distinctly—and I see no reason to doubt the truth of any of their statements in these respects—that they never had any intention or thought of misrepresenting the amount of the deposits or heritable securities, or of misleading the shareholders or any other person by their balance-sheets; and they also state that if they had known that the balance-sheets contained misstatements of the description to which I have referred they never would have passed them, and there is no evidence that I can find to a contrary effect.

As regards the defenders' alleged knowledge of the incorrectness of the balance-sheets, I do not think it is proved that at the time those documents were issued the defenders knew, or had any reason to believe, that they had been improperly prepared. They knew, as explained by the Lord Ordinary in his note, that the company had made advances from time to time by way of loan on open account, and that to a considerable amount, to the Edinburgh and Glasgow Heritable Company, and some of them appear to have also known that some of their heritable bonds had been assigned in security for money advanced by other parties. But it is not, I think, proved that they knew or had reason to suppose that those advances, or that the assigned bonds, had been included in the balance-sheets as "Loans on heritable security." So standing the facts, the main question which remains for consideration is, whether the defenders had reasonable grounds for believing that the statements contained in the balance-sheets were correct?

Now, the ground on which the defenders maintain that they were justified in trusting to the correctness of the balance-sheets is that these documents were duly prepared from the books of the company, which are proved, if not admitted, to have been correctly kept by the officials of the company whose duty it was respectively to prepare and check the balance-sheets. They say that they relied, and were entitled to rely, on the reports of the manager and auditor, who were appointed by the shareholders, in these respects, more especially as no matter of difficulty was ever referred to them by the auditor under the powers given to him by the 93d head of the provisions of Schedule I, Table A, of the Companies Act of 1862; and they say that if any such reference had been made they would have directed the entries to be made under some separate heading from that of "Loans on heritable security." All this is very clear from the evidence of Mr Tod, whose evidence in that respect is confirmed by the other defenders.

This check of an auditor appointed by the shareholders to act in their interests in the preparation of the balance-sheet, and so to test, as it were, the accuracy of the manager's work, is in my opinion a very important element on this part of the case. He is in fact a statutory officer appointed for the express purpose of ascertaining the correctness of the balance-sheets. I was at first under the impression during the discussion that this was a matter left to a very considerable extent with the directors, but on carefully examining the rules and regulations I have come to be of opinion that it is the auditor who is mainly responsible in the matter of the balance-sheet. These rules are quoted in the condescendence—[*His Lordship here read sections* 81, 83, 92, 93, *and* 94].

By the statute, therefore, the auditor is made not merely to check the accounts, but he has power given to him to deal with the directors themselves if he should be of opinion that there is anything wrong in the accounts which the directors require to be questioned or examined about. Well, the auditor appointed by the shareholders went through, or professed at all events to go through, the duty laid down for him by Act of Parliament, and having done so, he lays before the directors, through the manager, with a view to its being submitted to the shareholders, the balance-sheet for the year. It was under these statutory rules that the audit of the balance-sheet in question was made in the interests of the shareholders by the auditor appointed by them to check the balance-sheet prepared by the manager of the company; and on each occasion the auditor, without having occasion to refer any matter to the directors, appended a docquet in the following terms:—"*7th Feb.* 1878.—Having examined the accounts of the Caledonian Heritable Security Company (Limited) for the year ending 31st December 1877, I have found the same to be correctly stated, and sufficiently vouched and instructed; and I certify that the foregoing abstracts exhibit a true state of the company's affairs. (Signed) ALEX. T. NIVEN, C.A., *auditor*."

Such being the nature of the defence maintained on the part of the directors, it only remains to be considered whether it is in law a good defence—and upon this it appears to me that the

opinion of Lord Colonsay in the case of *Addie* has a very direct and important bearing. It appears from what his Lordship said that the directors' duty is to see that the parties who are employed to keep the books understand bookkeeping. That was done here, because the books are proved to have been regularly kept in every respect, the mistake being in the way in which the information from the books was carried to the abstract balance-sheet. Then he says it is not to be supposed that the directors individually are to take any steps by examining the books themselves. That is done by the parties whom they appoint; and he says they are entitled to rely upon the information furnished to them by the officers as to how these matters stand; and if they receive reports from those officers which they believe to be correct, they are to be held as having reasonable grounds for supposing that the balance-sheets are correct. But in this case we have not only the officials of the company reporting to the directors that the balance-sheets and books are correct, but we have a statutory officer—an individual not referred to in the opinion of Lord Colonsay—whether in the case he was dealing with there was any such statutory officer or not I do not know; if there was, no allusion is made to him. Therefore, in addition to the ordinary officials of the company—one of whom (the manager) is an expert in the matter of accounts—we have here an auditor—a Chartered Accountant (an expert in accounts)—who puts that authoritative docquet at the end of the balance-sheets which his duty under the Act of Parliament requires him to do, and who tells the directors that everything in the balance-sheet is correct. This opinion was, no doubt, questioned by Lord Cranworth in the House of Lords, but not in a direction adverse to its bearing on the defences maintained in the present action. His Lordship's objection to the opinion was that it went too far in holding that the directors must have reasonable grounds for believing the statements to be true, and stated that in his opinion *bona fide* belief was enough. On this difference between two great authorities I do not think it necessary for the disposal of the present case to offer any opinion of my own; because assuming Lord Colonsay's opinion, which has been already read, to be the rule, it humbly appears to me that it has a direct bearing on this case, and that as the defenders had reasonable grounds for believing the balance-sheets to be correct, they had, in fact, additional grounds to those mentioned by Lord Colonsay, because they were duly prepared by the manager of the company from books admitted to have been properly kept, and were afterwards submitted to the examination of the auditor appointed under the provisions of the statute, and docqueted by him as correct. I am of opinion, therefore, that the interlocutor of the Lord Ordinary should be adhered to.

Lord Shand—I agree in thinking that the judgment of the Lord Ordinary should be affirmed.

The case presents certain features of an unusual nature, which appear to me, for the reasons I shall immediately explain, to have an important bearing on the result. Cases by purchasers of shares in joint-stock companies founded upon alleged false and fraudulent representations have hitherto, I think, been very much of two classes—the first being those in which it is alleged that the reports issued by the directors represent the company to have been in a sound and prosperous condition, when in truth it was insolvent, or nearly so, and bankruptcy ensued; the other, those in which the complaint is that the directors in their reports had represented some great advantage as having been secured by the company—for example, the benefit of a patent right or concession, or a favourable purchase of some subject, inducing the purchase of the shares, when, in point of fact, the company had not truly the right to this valuable inducement. This case is not of that latter class. As put by the pursuer, it is represented as being of the former. For I find that in one article of the condescendence—and I take that as an illustration of an averment repeatedly made throughout the record as referring to the reports of different years—it is there stated in regard to the report of 1877, "that the said report and balance-sheet did not exhibit the true state of the company's position at that date, but were false and misleading, in respect that they represented the company as being in a sound and satisfactory condition, and as earning profits admitting of a good dividend being paid, and its shares as being a good and sound investment." While that is the representation founded on in the condescendence, it is averred that the pursuer, after the embarrassed condition of the company became known, made inquiry as to its condition, and it now appears, and he avers, "that for several years prior to the company's going into liquidation it had been in a state verging upon insolvency, if not altogether insolvent." But while the case in averment is one of this class, in argument no such view of the facts was presented. It was not said by the counsel for the pursuer that the general condition of the company was unsound at the time when the directors made the reports founded on. It is not said now upon the evidence that the business was not at that time prosperous; nor is it maintained upon the evidence that the large dividends and bonus which were paid were not truly paid out of profits. On the contrary, the only evidence that we have on that subject, given by Mr Molleson, is to an entirely different effect—to the effect that the company's business was sound and prosperous, and its affairs in a position that warranted the dividends paid. That evidence stands uncontradicted, and it seems to be very strong from one fact to which Mr Molleson has spoken. It is obvious in reference to a company of this kind, which has large funds deposited with it, and then lent out upon security, that the soundness and probable prosperity of the company will depend upon the nature of its investments; and we have in a state prepared by Mr Molleson full particulars on that subject. I take the results which he has brought out in the year 1877 as showing how matters stood at the date of the report which has mainly formed the subject of complaint. He gives a statement, the correctness of which is not disputed, with the particulars of the names of the borrowers, the amount of the advances, the valuations of the properties, and the sums remaining due on the loans, with the name of the valuators whose valuation had been laid before the directors. The result is this, that the value of the heritable properties held in security of the sums due by borrowers was at the end

of 1877 £452,326, while the sum due by borrowers at that date was £225,230, giving a surplus value of £227,095—that is to say, a surplus value of that amount to cover sums due of only £225,000. This latter sum is the amount of the original advances to the borrowers, but in the meantime there had been repaid a sum of £17,272 of instalments upon the loans given to these persons, and so the company, according to the valuation in their books of the properties on which their money was lent, had that sum in addition to the margin of £227,000 to which I have referred—that is, a margin or surplus value of security of £244,272 on loans amounting to £225,000 only. That plainly shows that the company was, according to all reasonable expectation, and in the judgment of those who were then carrying it on, in a sound and prosperous condition; and in addition, as I have said, the payment of dividends from the interest payable on these loans is no longer challenged as objectionable. The case of the pursuer cannot therefore be that the company was not sound and prosperous, as it was represented to be, but is narrowed to this, that in certain specified particulars affecting the soundness and prosperity of the company representations were made to him which were material and misleading.

Now, it is clearly settled that representations in the reports of directors must not only be proved to be false and fraudulent, but to be material. The issue which is settled in cases of this class is, Whether by false and fraudulent representations the pursuer was induced to make the purchase of which he complains? It is incumbent on a pursuer, in order to success, to show that the particular representations which he founds on really induced his purchase. I do not say that these were the sole inducing cause of his purchase, but that they were a material element in his mind in leading him to resolve to make the purchase of which he complains. In such a case, therefore, as we are here dealing with, it appears to me to be very important to have in view the general position of the company in order to ascertain whether it has been established that the particular representations which are complained of were material, and to an inducing cause of the purchase in the mind of the pursuer. Again, it is clear, on the evidence, which has been fully stated by my brother Lord Deas, that the directors of this company thoroughly believed in the soundness of its business. I have said enough to show that they were warranted in this belief. But in addition to that we find in the earlier period of the history of the company—down I think to 1874—that they and their friends were almost exclusively the proprietors of the capital. They and their friends were large depositors to the last; and it appears that when additional capital was given off from time to time they took their share of that capital with the other shareholders. In the result I think it appears that when the company went into liquidation the directors of the company were themselves holders of upwards of a quarter of the whole capital. That, I need not say, is a fact which bears most materially on the question of their belief in the soundness of the company. It goes a long way towards showing their entire honesty in any representations they were making, and to negative the view that they had any improper purpose to serve, or any motive to deceive the public into becoming shareholders. On the other hand, I think the case is also somewhat unusual in reference to the circumstances in which the pursuer's purchases were made, for the consequences of which he seeks to make the defenders responsible. The first purchase was made after the report of 1876—50 shares—and the price paid was £2, 10s. per share. The larger purchases were made at a much later period in the history of the company, and when things were entirely changed. The second purchase was made in December 1878, at a much reduced price—£1, 10s. per share; and the third at a later time, when the shares had fallen to 10s., and when the pursuer purchased 100 shares. It is clear that in the end of 1878 a very great change had occurred in the position of the company, which had been prosperous up to that time. It is well known what the cause of that change was, and it is very clear on the evidence. In October of that year, before the two late purchases were made, the City of Glasgow Bank had stopped, and the result was a very general depression in securities of every class. There was an immediate and great depreciation in the value of the properties upon which this company had lent its money; there was an immediate and large withdrawal of deposits by persons who had entrusted the company with money; and the shares of those who had been shareholders in the bank—and a considerable number these were—were thrown upon the market to be sold at what they would bring. A crisis of that kind could not possibly fail to have a very serious effect upon a company founded on principles such as this company was; indeed, I think the history of this case goes very far to show that such companies are founded upon a principle altogether faulty and unsound. In the first place, it is evident that a company receiving large sums of money on deposit, for which they undertake to pay very fair rates of interest—rates always in excess of the bank rate of the time—must, on lending the money, in their turn require payment of larger rates of interest in order to carry on a remunerative business; and I shall only say that it appears to me that the natural tendency or effect of this as a system must be that somewhat doubtful securities must frequently be taken. Borrowers on thoroughly secured loans will not pay a high rate of interest. But, in the next place, as was pointed out very clearly by Mr Molleson in his evidence, if a company receives money on loan or deposit which they are bound to repay at call or at short notice, while they have lent that money for a period of years, tying it up so that they cannot receive it back except by instalments at distant dates, it is impossible that such a company can stand the sudden strain of a withdrawal of deposits such as came on this and other similar companies in the end of 1878. I dwell on these circumstances for the purpose of making two observations:—In the first place, that it is not said—and it is certainly not proved—that the ultimate insolvency and liquidation of this company was caused to any extent by the matters of which complaint is made in this case—by the representations as to certain specific matters which are founded upon here as being material. The company was in prosperity in 1877 when these reports were issued. It was in great difficulties—in adversity—in the end of 1878—in em-

barrassment, at least, which was unlooked for till that time. But this arose entirely from the causes to which I have now alluded, and which were entirely beyond the control of the directors. But, in the next place, I must observe that it appears to me that the pursuer's later and larger purchases were made, not with any particular reference to the representations now complained of, but were really a speculation upon his part. I do not say that they were in any sense or degree an improper speculation. I think Mr Lees might very fairly form the opinion that the depression which existed then, and which had resulted probably in an undue depreciation of property of considerable value, would be short-lived, and that matters would right themselves and heritable properties immediately rise in value again to what they had been before, or to something near it. But the question brought up here being with reference to representations that are now founded upon as being material, I think it important to look to what must, from the nature of things at the time, have been in the pursuer's mind when he made his purchases. It seems to me to be clear that what anyone in his circumstances must have had mainly in his mind as the inducing cause of purchases at such a time was not whether representations on particular matters as to comparatively small sums in the reports of the directors from 1874 to 1877 were correct or not, but this question, whether it was likely that this business would right itself, that the prices of property would rise, the instalments be paid by those who had borrowed, and above all, that the deposits would be continued, so as to enable the company to go on till the securities again rose in value. All this, I think, bears very strongly and very directly on the question to which I have now, in the first place, to direct my attention—of the materiality of the representations relied on; for in order to success in this case it must be made out that these representations were material in inducing purchases.

Now, coming to those representations themselves, the case as finally presented by the counsel for the pursuer really rested upon two points. One of these cannot have been brought prominently under the Lord Ordinary's notice, because I find his Lordship has taken no notice of it in his judgment. I mean the statement in the report that the calls had been paid, while to the extent of £9000 this was contrary to the fact. The other relates to the entry in the balance-sheet of the loans to the Caledonian Provident Co. and the Edinburgh and Glasgow Investment Society of £10,000 odds and £16,748 respectively, as having been heritable security, which it is said was also contrary to the fact. On the other points of the case I mean to say very little. I agree with the Lord Ordinary and with your Lordships in regard to them. The transactions with the Scottish Provident Insurance Co., and one or two others of that class, seem to me to have been correctly enough entered in the books of the company, and also in the balance-sheet. If the case had been one in which the company being in embarrassment had been obliged to borrow money from other companies, and to part with their heritable securities to a substantial amount, and the directors knowing that the company was embarrassed had concealed that fact in their reports, I should have thought that a case in which responsibility might have been made out. But in the present case there is no such element. The transactions with the Scottish Provident Co. were entered into entirely to enable the company at the time to take advantage of what they thought was a favourable loan, and they applied a portion of the money to that purpose, as I think quite legitimately. Then in regard to the transactions with Lamb, I agree also in thinking that these cannot avail the pursuer here. For a time undoubtedly the state of matters between the company and Lamb was unsatisfactory. For some weeks Lamb had shares transferred to him, and was merely a debtor for the price, and during that time I think the transaction was in a most improper position. But it was apparently a part of the same arrangement that he should give heritable security or pay for the price of these shares, and within a few weeks after he got the shares such security was given. The only other objection that is stated with reference to the dealings with Lamb—and I think it applies to one or two other persons to whom money had been lent on the security of their properties—is that as the money was repaid by the sale of properties held in security it should have been treated as wiping out the loans. I do not think that upon the evidence before us that position has been made out. So far as I can see, the company were entitled to do as they did—to wipe out the loan by instalments, and treat the rest of the money received as money deposited in their hands, giving them a considerable benefit in regard to interest; and certainly that was very much the best course for the company if the parties with whom they were dealing were willing to leave it.

So the case really seems to depend entirely on the two matters of representation—1st, that in the report and balance-sheet of 1877 £9000 of calls are said to have been paid while they had not been paid; and secondly, that the two sums that I have mentioned—of £10,000 and £16,000 odds—were in the hands of two other companies, and not heritably secured. Now, in regard to the last of these points, which I shall take first, I think it is clear the sum of this charge becomes reduced when you examine it. There were two sums—one a loan to the Caledonian Provident Co. of £10,000 odds. In regard to that loan it appears to me that the directors were fairly entitled to regard it as a loan heritably secured. It may be that the security they held was open to question, but I think they might fairly and honestly believe that the heritable properties which they had stipulated should be set aside to meet that advance were effectually dedicated to that purpose; and they were therefore, in my judgment, in that view entitled to treat the advance as heritably secured. So, then, this point becomes reduced to an objection to the balance-sheet that £16,000 was not heritably secured, whereas it was represented to be so. Now, what was the amount of money then standing on heritable security? £257,700. And accordingly the representation we have here to deal with is a misrepresentation of £16,000 odds out of £257,000—that is to say, £240,000 was heritably secured, but the remaining £16,000 was not. Referring to what I have already said, it appears to me that the statement complained of, when so put, cannot be regarded as

material, so as to be "an inducing" cause in the purchase of these shares. I think when you have regard to the amount of £16,000 as contrasted with the very large sum which the company had on heritable security, the misstatement cannot be taken as material or an inducing cause in the mind of the pursuer when he made these purchases under the circumstances I have already mentioned, and when the other considerations and reasons to which I have already referred must certainly have been present in his mind. But it is further to be observed that it was a well-known practice in regard to such companies—proved to have been so by Mr Turnbull, a witness for the pursuer, and himself the manager of one of these heritable security companies if I am not mistaken, and by Mr Molleson, who has had great experience with relation to such companies—that in place of putting money in banks it was the ordinary practice to place surplus funds for which the company had not ready means of disposal in the hands of another company of the same class at call. That was a proceeding not authorised by the constitution of this company. But I put the question, knowing that to have been the practice, supposing this report had on its face stated the company has £240,000 on heritable security and £16,740 at call in the hands of the Caledonian Provident Co., can any one for a moment believe that the fact of such a sum being so deposited or lent at call could possibly have affected the pursuer's mind in the purchase of these shares? It humbly appears to me, therefore, that when this matter is examined it cannot be successfully maintained that a misrepresentation in the balance-sheet on a material point has been established.

The other point founded upon is the statement in the report that the calls had been paid, when in fact £9700 were still outstanding. The balance-sheet states the capital of the company correctly enough as capital "called up." It is obviously wrong in not having on the other side of it a statement of capital still unpaid; and it was obviously wrong to include that sum, as I understand it is included, in the item of debts heritably secured. But it is to be observed in regard to this capital, and as bearing on the materiality of the representation, which is the point I am now dealing with, that while in the ordinary case of mercantile companies a purchaser is particularly anxious to see that the capital is paid up, because he knows that the business being carried on depends on the capital being available in the daily conduct of the business, and that the paid-up capital will be extant to meet losses by the company, in this particular class of business it is otherwise. The capital of a company of this kind forms a comparatively small item of the funds used for carrying on the business; and I may say that, generally speaking, it really is an inducement to people to give deposits and credit to a company of this kind that there is a good deal of capital not paid up. In this particular instance the capital, if it had been paid up, was about £20,000 altogether, but the money with which the company was trading, and which they had got on loan, was no less than £250,000. The item of capital paid up was therefore, it appears to me, not so important as in the case of other companies. I do not doubt that had it appeared in this case that this misstatement, affecting even a sum of £9706, was made when the directors knew not only that the calls were unpaid, but that the shareholders were unable to pay them, the point might have been material, as in that case it would be shown the company was being kept up by men of no means—by men of straw. But there is no such case here. The parties were quite able to pay their calls, and most of them had not done so simply because the manager had said he did not then want the money, on which five per cent. interest was running. A conclusive answer to the complaint is further to be found in the fact, which may account for the absence of any notice of this point by the Lord Ordinary, that before the pursuer purchased his shares the £9000 outstanding had been in point of fact all paid with the exception of a sum somewhere under £2000. The first of the purchases following the report of 1877 was made in December 1878, and before that date the whole of these calls with the exception now stated had been paid, as appears from a detailed state produced by Mr Molleson, and the only reason why the greater part of even the unpaid sum had not been paid up was that unfortunately four or five of the directors of this company were shareholders of the City of Glasgow Bank, and of course after October 1878 they had no means to pay their calls. In that state of matters it appears to me that this matter of the unpaid calls fails in its materiality. When the pursuer made his purchase in December 1878, and in the following year, can it be said that he was relying on this £9000 of calls being paid up? If so, the answer is that it had been all paid up when wanted except £2000, and that is conclusive. But it appears to me that looking to the class of business of this company, and to the whole circumstances of the case, the pursuer has failed in making out materiality in this part of it. Suppose the report had stated that calls to the extent of £9000 had not been paid because the manager had requested the parties to retain the money at five per cent. until he could find a suitable investment for it—for that was the true state of the facts—and suppose the precise state of the facts had been set forth in the report, I again say that it appears to me that the truth of the case being so stated, it could not in any way have affected the mind of a purchaser of these shares.

In the view I have thus fully stated it appears to me there is enough for the satisfactory disposal of the case. But I think it right to say that I agree also with Lord Deas and Lord Mure in thinking that even if the representations relied on had been on points material to the purchase, I should affirm the judgment of the Lord Ordinary. After the full opinions already delivered I shall be brief on this part of the case. And first, in regard to the knowledge that the directors had upon these matters. It appears that the directors, or most of them, knew of the system under which moneys were kept at call in the hands of the other two companies. They knew at the same time, however, that under that system the advances were fluctuating from day to day, and I see no evidence to lead me to the conclusion that they were aware that at the dates of these balance-sheets there were sums of very considerable amount due by the one company to the other. Therefore so far as knowledge of the sum in the hands of the Edinburgh and Glasgow Investment Company at the

date of the balance is concerned, I do not think the case is made out. But further, I agree with what has been said, that even assuming that they had such knowledge, I think the defenders having the abstract balance-sheet laid before them were fairly entitled to rely upon this, that the manager of the company, who knew all the details, and the auditor of the company, who professed to have checked all the details, would take care, and had taken care, that such an item as this had been classed under its particular head in the balance-sheet. The case upon this branch of it raises the question whether directors getting a balance-sheet containing, as this balance-sheet does, a correct abstract of the books, are bound thereupon themselves to go into the details either of the books or of the trial balance-sheet, which contains all the particulars taken from these books, or are not entitled for such details to rely on the officials of the company. For my part I am not prepared to say that directors are bound to go over the manuscript details of many pages of a trial balance-sheet of that kind. If they have a manager in whom they have confidence, and if his report is supported by the auditor appointed by the company—the statutory officer whose special duty it is to attend to these matters—I think they are fairly entitled to accept the statements of these persons as sufficient, and so to adopt the balance-sheet. If in the conduct of the business they were aware of irregularities or serious losses, or any cause of anxiety or risk to the shareholders, there might in such special circumstances arise a duty to see that these matters were properly represented, but nothing of that kind had occurred in this case. Then with regard to the amount of calls unpaid, as to knowledge, it appears no doubt that several of the directors knew of their own calls not having been paid up, the manager having, as they explain, said to them that he did not want the money, and would prefer that it should lie at five per cent. I see nothing to show, however, that they knew that the calls generally were unpaid. There is a contradiction in the evidence between the statement made by Mr Niven as to the subject of the calls as affecting the balance-sheet having come up for discussion. His evidence on this point is entirely contradicted by everyone else who was present on that occasion, and I do not hesitate to say that I prefer the evidence of the directors to that of Mr Niven on this point. The explanation may be that Mr Niven is mixing up this matter with some other discussion he had with the directors. No one can fail to observe that the manager and auditor of this company were in a very different position from the directors in regard to the matters which are founded on by the pursuer. I cannot speak too strongly of the impropriety of the way in which the balance-sheet was made up in reference to both of these matters. It is obvious that it was the duty both of the manager and of the auditor of this company to have shown in the balance-sheet exactly how the payment of the calls stood, and to have at the same time clearly shown that a sum of between £16,000 and £17,000 was at call in the hands of another company and not upon heritable security, that being the fact. But however that may be as affecting these gentlemen and their failure properly to perform their duty to the company, I do not think that circumstance can affect the defenders in the present question.

These general views of the case preclude the necessity for any member of the Court looking at the case of individual directors, but I think it right to say that if one were called upon to do this, it is evident that there are several of these directors who were in entire ignorance—one or refer, who were in entire ignorance that the calls more of them certainly—and I may mention Mr Milne as an illustration of the class to which I had been fully paid, and also in ignorance of the system on which the money was being lent to other companies, and of the fact that such loans were made. As against persons in that position certainly in any event the pursuer must fail, but I think it unnecessary to go into individual cases, because on the broad grounds I have stated I am of opinion that the case fails.

I have not thought it necessary to say anything of the law applicable to alleged false and fraudulent representations in questions of this kind, or to refer specially to the charge of Lord Colonsay in the case of *Addie*, which has been so much referred to. The case does not appear to me to raise any question on this branch of law, and having already in the case of *Brownlie* v. *Miller* expressed my view on that subject, I content myself with referring to what I have there said. Upon the whole, I am of opinion that the case fails, because the pursuer has not made out that material representations were made which induced him to enter into his purchases. I am further of opinion that the directors acted honestly and in good faith, having made no representations which they did not believe to be true. I am satisfied they made no representations for which they had not reasonable grounds of belief, although I must add that I agree with the view of Lord Cranworth as stated in the case of *Addie*, that in such a case as the present it is not incumbent on the defenders with an honest belief to show further that they had what a judge or a jury would say were reasonable grounds for that belief in order to avoid liability for representations made. I am of opinion that the judgment of the Lord Ordinary should be affirmed.

Lord President—In all the cases of this kind which have been previously before us, so far as I recollect, in which directors of a company have been charged with making false statements in their annual reports and balance-sheets, the allegation against them has been that they represented the company as being in a state of prosperity, while in point of fact it was either insolvent or in such a state of embarrassment as almost inevitably to lead to insolvency. A case of that kind was to a certain extent stated on this record, but it has entirely failed in evidence. The company in question, at the time when the reports and balance-sheets complained of were issued to the shareholders, was undoubtedly in a state of prosperity. It was as prosperous as it could ever expect to be, looking to the nature of the business. It was doing a large amount of business of a kind which it was incorporated for the purpose of transacting. The directors were paying reasonably good dividends out of profits actually earned—for the attempt to show that any part of these profits was paid out of capital has entirely failed—and so long as the market for their securities continued favourable their prospects were perfectly good. That they were liable

to great risks from any sudden change in the state of that market was a vice inherent in the constitution of the company and in the nature of their business, and when the bad times actually came the insolvency of the company was produced by the nature of the securities which they held, and not by misconduct in the management. It is quite obvious therefore that in the absence of any general statement of the kind which I have referred to, and which was made in all the previous cases, the allegations of the pursuer must be confined to matters of detail, and he must substantiate that in these matters of detail there was upon the part of the directors false and fraudulent misstatement calculated to deceive, and which did mislead the pursuer in acquiring the shares of this company.

Now, I am not going through the details of this case. I have had the benefit of reading Lord Mure's opinion, and I entirely concur in the view that he takes of the facts and the evidence. I shall therefore confine myself entirely to stating shortly the legal principles upon which I think this and all similar cases fall to be disposed of.

The directors of a company have access to knowledge of the company's affairs which is not enjoyed by the shareholders and the public, and therefore when they address the shareholders, and the public through the shareholders, they are bound to be cautious in the statements they make. But the office of director is very different from that of manager or of auditor of a company. These last-mentioned officers are bound by the nature of the duties devolving on them to be fully acquainted with the real state of the company's business and the contents of the books. This is not, and cannot be, expected from the directors. They cannot be expected to devote so much time and attention to the business as this full knowledge would require. They rely, and are entitled to rely, on the honesty of the paid officials, and on the accuracy of the statements they receive from them. Further, a man becoming a director of a company does not necessarily hold himself out as a person of exceptional intelligence—indeed there is no guarantee or assurance that he is a person even of average intelligence. He may be selected as a director by the shareholders not because of his intelligence or business capacity, but because, though perhaps a man of very little intelligence, he is from other causes influential or popular, and therefore likely to promote the business of the company. When, therefore, directors are charged with making false and fraudulent statements to the shareholders regarding the affairs of the company it is not sufficient to say that they might by ordinary diligence, or even with very little further inquiry, have satisfied themselves that the statements were inconsistent with fact. If they make the statements in the *bona fide* belief that they are true, they are not guilty of fraudulent misrepresentation merely because in the judgment of the Court or of a jury they had not reasonable—which I understand to mean sufficient—grounds for believing the statements to be true; for this would be to make them answerable for the erroneous inference which they draw from the facts within their knowledge, which is only an error of judgment. A man making a statement on any subject which he believes to be untrue, though he does not know it to be false, is dishonest, but if he merely makes a statement which he does not actually believe to be true, that is a negative state of mind, and his honesty or dishonesty will depend on his relation to the facts which he states, and to the persons whom he addresses. A statement on a matter of indifference both to the speaker and the listener, even though the speaker has no actual belief in the truth of the statement, provided he does not believe it to be false, will not infer dishonesty on his part. He is not seeking to mislead anybody. But a statement of facts made regarding a matter of interest both to speaker and listener stands in a very different position. If the speaker, having no actual belief in the statement, though not believing it to be untrue, volunteers the statement, inconsistent with facts, to a person interested in the statement, and likely to act on it, he is dishonest and guilty of deceit, because he produces, and intends to produce, on the mind of the listener a belief which he does not himself entertain. It has been said that if a person in such a position, having full means of information within his reach, turns his back on the light, and wilfully abstains from acquiring the requisite information he ought to be answerable for the statement which he makes if it be contrary to fact. To this proposition I assent, because the person making the statement in the circumstances supposed can have no actual belief in its truth. The legal proposition which I desire to state will apply to no man who has not a *bona fide* belief in the truth of the statement. But if there be such belief, then, in my opinion, there is no occasion to refer to the sufficiency or insufficiency of the grounds of that belief unless they be so slender or flimsy as to destroy the idea of *bona fides*. Upon that ground, therefore, I concur with the judgment which your Lordships pronounce, being of opinion on the evidence that the directors in this case entertained a *bona fide* belief in the truth of the statements which they made.

The Lords adhered.

Counsel for Pursuer and Reclaimer—Lord Advocate (Balfour, Q.C.)—Trayner—Wallace. Agent—David Hunter, S.S.C.

Counsel for Defenders and Respondents—Solicitor-General (Asher, Q.C.)—Mackintosh—Pearson. Agents — Carment, Wedderburn, & Watson, W.S.

Friday, March 17.

SECOND DIVISION.

[Sheriff of Forfarshire.

ROBERTSONS *v.* M'INTYRE.

Bankruptcy—Sale—Bona fides—*Reputed Ownership—Mercantile Law Amendment Act* (19 *and* 20 *Vict. c.* 60), *sec.* 1.

The tenant of a factory having been sequestrated, the proprietors claimed the machinery, on the ground that it had been sold to them, and was at the date of the sequestration let to the tenant. *Held* that as the evidence showed a *bona fide* contract of sale, and as possession by the tenant had been continued after the sale on a separate contract, viz., a contract of hiring, the trustee in bank-