Friday, February 24.

SECOND DIVISION.

[Lord Ormidale, Ordinary.

WADDELL AND ANOTHER *v.* HUTTON.

Right in Security — Company — Trust — Shares Registered in Name of Creditor— New Issue with Option of Allotment in Favour of Existing Shareholders — Failure of Creditor to Intimate Option to Debtor.

Under a written agreement B advanced to A money to enable him to apply for certain shares in a limited company. The shares were held by B until the loan was repaid, any profits being applied in reduction of the loan, and were registered in B's name. The company afterwards made an issue of certain additional shares which under their articles they were bound to offer to existing shareholders. B did not apply for the shares which effeired to those which he held in security, and did not intimate the option of allotment to A. A having brought an action of damages against B for failure to intimate the option, in which he averred that the shares had appreciated so that he could have disposed of his allotment rights at a premium, B pleaded that the action was irrelevant. *Held* that the action was relevant, and proof allowed.

Alexander Waddell, gas engineer, Dunfermline, and Forbes Waddell, manager of the South Queensferry Gas Company, Limited, brought an action against James Hutton, cashier, Edinburgh, in which they craved the Court to decree and ordain the defender to pay them the sum of £1010, with interest at the rate of five per cent. from 3rd December 1906 till payment. This sum was the estimated damage said to have been sustained by the pursuers through the failure of the defender Hutton to intimate to them an offer of an allotment of new shares in the Cowdenbeath Gas Company, Limited, which he had received in consequence of his being the registered holder of certain shares in that company which truly belonged to the pursuers, but which he held in security of a debt by them to him.

The pursuers pleaded, *inter alia*—"(1) The defender, as a holder in security of the shares of the Cowdenbeath Gas Company, Limited, belonging to the pursuers, having wrongfully and to the loss and damage of the pursuers, and without notice to them, renounced the proportion of the shares issued by the said company on 3rd December 1906 which effeired to shares belonging to the pursuers, the pursuers are entitled to decree as craved. (3) The defender having, in breach of his duty as security holder of the pursuers' shares in the Cowdenbeath Gas Company, Limited, and to the loss, injury, and damage of the pursuers, failed to communicate to them the offer of allotment of new shares made by the company to him in respect of the pursuers' shares, is liable in damages. (4) The sum sued for being a fair estimate of the damages sustained by the pursuers, they are entitled to decree in terms of one or other of the alternative conclusions of the summons."

The defender pleaded, *inter alia*—"(1) The averments of the pursuers being insufficient and irrelevant to support the conclusions of the summons, decree of absolvitor in favour of the defender should be pronounced."

The *facts* of the case are given in the opinion of the Lord Ordinary (ORMIDALE), who on 26th November 1910 repelled the first plea-in-law for the defender and allowed the pursuers and the defender a proof of their averments as against him.

Opinion.—"The pursuers of this action and the defender Hutton were all interested as shareholders and otherwise in the Cowdenbeath Gas Company, Limited. The nature and extent of their respective rights are elaborately provided for in an agreement, dated 14th and 18th November 1903, and a memorandum of variations on said agreement, dated 13th and 18th February 1904.

"By article 10 of the agreement it is provided—'In the event of the company requiring new capital for the further development of their undertaking, of which the company shall be sole judges, the said capital shall only be provided by the first party (*i.e.*, the defender Hutton) or his nominees until the number of shares in the company held by the first party and his nominees (including the said Alder and Mackay and John Harper Bennet) reaches equality with the number of shares provided for under this agreement to be held by or for the second parties (*i.e.*, the pursuers) or their nominees.'

"Article 15 is as follows:—'All dividends earned by the second parties on their shares in the company during the subsistence of this agreement, and all consulting fees earned by them during the subsistence of this agreement, shall be applied by them, if required by the first party, either towards the extinction of their indebtedness to the first party, or in the event of the company requiring new capital for further development of their undertaking, in the purchase by them of new shares in the company.'

"The capital of the company, originally £2000 divided into 200 shares of £10 each, appears to have been increased to £20,000, and at the date of the agreement the shares were allocated in the following proportions: to the pursuers 611; to the defender Hutton 354; and to neutral parties 57—1022 shares in all.

"The pursuers had to borrow money to enable them to pay for the great bulk of the shares allocated to them. The defender came to be the creditor in the debt thus incurred, and the fourth clause of the memorandum already referred to, to which Hutton was the first party, is as follows:—'The total shares in the said Cowdenbeath

Gas Company, Limited, provided under the foregoing agreement to be allotted to the Messrs Waddell and their nominees (six hundred and eleven or thereby), to be issued to or held by the first party or his nominees until complete repayment of said loan of £2000 sterling, and also the other loans of £285, 13s. 7d. and £2940, referred to in the foregoing agreement, the first party having a power to apply the dividends to be received on said shares in reduction of the indebtedness of the second parties to the first party.'

"On 14th October 1905 a further issue of 178 shares was made by the company, and these were all issued to the defender Hutton and to a nominee of his, bringing up the total holding of Hutton and his nominees to 532 shares, or 79 short of the 611 which had been allocated to the pursuers. Of these 611 the pursuer Forbes Waddell had sold 12, so that the holding of the pursuers in the company was at and after this date 599 shares.

"On 3rd December 1906 a further issue of 300 shares was made, and it is in connection with this issue that a question has arisen. The pursuers aver that these shares were, in terms of the articles of association of the company, in the first instance offered to the then members of the company in proportion to the existing shares held by them, and in particular that there were offered to the defender Hutton 283 shares, that number being in proportion to the number of shares of which he and his nominees were the registered proprietors. These shares included the 599 shares truly belonging to the pursuers but standing in Hutton's name. The number which the defender Hutton required under article 10 of the agreement to take up in order to equalise the holding of himself and his nominees with the original holding of the pursuers was, as already noted, 79. Deducting these 79 shares from the 283 offered to him, there remained 204, and these according to the pursuers, as in a question between them and Hutton, then fell to be offered, and if the offer was accepted, to be allotted in the proportion of 103 to Hutton and his nominees, and 101 to the pursuers in respect of their several holdings of 611 and 599 shares. In point of fact, Hutton declined to take up more than the 79 shares required to bring his holding up to 611. This he did without consulting the pursuers as to whether they wished to take up the shares to which they were entitled, and without informing them of the offer of the shares or of the intended issue thereof. The pursuers say that they were not aware of the issue and offer, and they also aver—'In consequence of the failure of the defender James Hutton to acquaint the pursuers of the allotment offered to him as holder of shares belonging to them, and of his wrongously taking upon himself to renounce the allotment, the pursuers were thus deprived of the opportunity of taking up at par 101 shares of £10 each of the said company or of disposing of their rights to the said allotment, of either of which alternatives the pursuers would have been able and willing to avail themselves. Had the pursuers been made aware of the allotment in respect of the shares held by the defender James Hutton for their behoof, they would have taken up the shares offered or disposed of their rights therein. The defender Hutton was at the date of the issue chairman of the company. The value of the shares was at least £20 for each fully paid share of £10, and the pursuers could have disposed of their allotment rights at a premium of £10 a share.'

"If these averments are true, as I must assume them to be, it is obvious that the pursuers suffered a heavy loss by their not having an opportunity of taking up the shares.

"The question is whether Hutton—the 599 shares being registered in his name although he truly held them only in security of a debt—was under any obligation to notify to the pursuers that an allotment of new shares had been offered to him in respect of these shares. It was argued that he was not, that as security holder he was not bound to take any steps towards furthering his debtor's interests, that he was entitled to sit still until his debt was paid, that there was no duty on him to take up the shares himself, that the pursuers could not have sold their rights without his subscribing the transfer, and that the pursuers could not have compelled him to do so. There is much force in this contention. But, on the other hand, a creditor must have some regard to the interest of his debtor, and what the particular duty is which a creditor owes to his debtor must depend on the nature of the security which he holds. He may be under no obligation to take active steps to enhance the value of the security subjects, but he is not entitled in my opinion deliberately and wilfully so to act or abstain from acting as to bring about any loss or damage to his debtor merely because he has at the moment an exclusive title to what is admittedly not his but his debtor's property. Now the relation which subsisted between Hutton and the pursuers, as I read the agreement, was not just the ordinary relation of a debtor possessed of certain shares and an outside creditor to whom he has transferred these shares in security of his debt. I think that it was certainly an implied term of that agreement that as between Hutton and the pursuers the latter were to be treated as continuing shareholders of the company, and that the possibility of new shares being offered to them was within the contemplation of parties. I think that article 15 of the agreement is evidence of this. When the shares were offered to Hutton it was certainly in his power to take them up, but he could not have taken any personal advantage from their allotment. He would have been bound to impart the benefit to the pursuers, for the shares in respect of which the allotment would have been made were, as in a question between the pursuer and him, the shares of the pursuers. The real interest in the allotment was in the pursuers. Now I cannot think

that Hutton, keeping in view the relations which subsisted between him and the pursuers as disclosed in the agreement, was entitled without notice to the pursuers and at his own hand to reject the allotment, unless he could show that his own interests would have been prejudiced by his giving such notice. But it is obvious that no injury would have arisen to him. He would to no extent have diminished the value of his security; quite the contrary. He would have taken no burden on himself and he would have incurred no risk if, as the pursuers aver, they were both willing and able to take up the allotment. If, then, it was incumbent on him to give notice to the pursuers of the offer of new shares, as I think it was, I further think that he would have been bound to take such steps as were necessary to make the allotment available, provided always that his own security would in no way have been affected thereby. It seems to me therefore that Hutton is liable to account for any damage that was occasioned to the pursuers by his failure to make them aware of the allotment in question. Accordingly I shall repel the first plea-in-law for the defender Hutton and allow the pursuers a proof so far as their action is directed against him."

The defender Hutton reclaimed, and argued—This was an action of damages for breach of contract, but pursuers had not made any relevant averment of breach, as the contract imposed no duty of intimation. The fundamental error of the Lord Ordinary was in supposing that the pursuers were shareholders in the company. As a matter of fact they were not and might never be shareholders, though they had the right to become such if they paid up the loan. These shares were not therefore a security in the proper sense of the term, and the defender was not a security holder. But even if the shares could be regarded as a security, defender was only liable for any act of commission or omission which would depreciate the value of the property, and he was not bound to do more than hand it back in the same condition as he had received it—Bell's Prin., sec. 206. To give effect to the pursuers' contention would be to impose an entirely new and onerous obligation on the holder of a security. For example, it would oblige a heritable creditor in possession of the security subjects, if he were offered adjoining land at a low price, either to buy the land for his debtor or to communicate the offer. In this particular case the pursuers had no option rights. They were not connected with the company, and the company could take no notice of the fact that the shares were held by defenders in security only. Even if defender had intimated the offer to pursuers and they had tendered the money, there was no duty on defender to apply for the shares.

Argued for the pursuers (respondents)—Defender's argument that he was not a security holder was inconsistent with his pleadings, and in particular with his second plea-in-law. The present was clearly a case of a security held by defender for advances made by him to the pursuers, and the result was the same as if the shares had been registered in the pursuers' names and transferred by them to the defender in security. The three main characteristics of a security were all to be found here, viz.—(1) a debt due in respect of which the subject of security had been left in the creditor's hands; (2) an obligation to repay; (3) an obligation to account for profits. If this were so, defender could not make the case out to be a special one, but must meet the legal position as stated by the Lord Ordinary, viz.—What were the duties of a security holder in the event of a new and valuable right emerging? The security holder was really a *quasi* trustee—*Beveridge* v. *Wilson*, January 17, 1829, 7 S. 279 (at p. 281, "Our opinion"); *Stewart* v. *Brown*, November 17, 1882, 10 R. 192, 20 S.L.R. 131; *Stevenson* v. *Wilson*, 1907 S.C. 445, 44 S.L.R. 339; Fisher on Mortgages, 5th ed., sec. 916. The creditor's duty was not merely to preserve the subject intact, but to preserve it with eventual accretions. In the present case the right to participate in new issues was an inherent part of the right to the shares themselves. In so far as it was of value it formed part of the security subjects, and if realised followed the subjects in accordance with the maxim *accessorium sequitur principalia*. The duty of a security holder in such cases was to account for the security with these incidents and with profits flowing from it. If there was an obvious profit or advantage that could only be realised by incurring personal liability, it was the duty of the security holder, without being obliged to incur such liability, at least to intimate to the debtor, so that the value of the security might not be impaired. In the present case, on the pursuers' averments there was an instantly realisable profit of 100 per cent. It was said that pursuers' contention would impose onerous obligations on security holders and especially on banks, but such an obligation was already recognised by banks in cases of this kind—*Dougal* v. *National Bank of Scotland*, October 20, 1892, 20 R. 8, 30 S.L.R. 52. There were many cases where such a duty of intimation must clearly be implied, *e.g.*, shares partly paid on which a call had been made subject to a penalty of forfeiture. The case of a heritable creditor in possession figured by defender was not *in pari casu*, because there the offer would be accidental and not inherent in the security.

At advising—

LORD ARDWALL—On 14th November 1903 the defender as the first party thereto, and the pursuers as the second party thereto, entered into an agreement regarding the issuing, allocation, and allotment of shares in the Cowdenbeath Gas Company Limited. Under that agreement 599 shares in all of the said company came to be held by the defender as security for certain advances he and others had made to the pursuers, and I think the *prima facie* view upon the

agreement is that the radical right to these shares was with the pursuers, at all events on their fulfilling certain conditions. While these shares were in the defender's name, an issue of 300 new shares was made by the said company in terms of its articles of association, and proportional quantities of these new shares were offered to the persons then on the register of the company's shareholders in order that they might consider whether they should accept or reject them, and in particular a certain allotment of new shares was offered to the defender in respect of the 599 shares which stood in his name, the radical right to them being in the pursuers. In these circumstances it is alleged that he did not inform the pursuers of the offer made to him, and it is said that they did not otherwise know of it. The defender applied for only 79 shares, which he took up in his own name in terms of the tenth clause of the agreement. It is averred further that these shares were worth at the time £20, being at a premium of at least £10 per share over the par value, and that the pursuers have lost the profit that would have accrued to them by disposing of their allotment. In these circumstances the Lord Ordinary has allowed a proof regarding the whole case so far as regards the pursuers and the defender James Hutton.

The questions which were argued to us in a reclaiming note against that interlocutor were, first, whether the whole rights and obligations *hinc inde* of the parties had to be sought for in the said agreement and in the agreement alone, it being said that in the agreement there was no obligation on the defender to intimate to the pursuers the fact of any allotments of new shares being made, and that therefore there was no obligation on him at all regarding the matter; and second, whether under the agreement and at common law there was or was not any fiduciary duty on the defender to give the pursuers, as having the radical right to the 599 shares in question, notice that the allotment had been made, so that they might have an opportunity of taking up the shares. A question, possibly of considerable importance, was also raised as to the relevancy of the averments of damage.

I am of opinion that at this stage of the case it is not necessary to decide finally any of these questions, as something may turn upon the manner in which the allotment was made, the time at the disposal of the defender and pursuers for taking up the allotment of shares, and whether they were entitled to insist on the defender's giving them a transfer therefor. I am of opinion, however, that on the record as it stands there is a relevant case to go to proof, and that we ought to affirm the interlocutor of the Lord Ordinary.

LORD SALVESEN—I concur in the opinion just delivered by Lord Ardwall. There can be no doubt, on the facts as averred by the pursuers, that owing to the defender's failure to communicate to them the offer of the new shares made by the company to its shareholders, they were deprived of an opportunity which they otherwise would have had of applying for and obtaining an allotment of 204 shares, and so lost a profitable investment for which they say they were able and willing to supply the necessary funds. It was urged on the defender's behalf that his relation to the shares belonging to the pursuers and registered in his name was contained in a written contract between the parties; and that the pursuers were unable to point to any term of that contract which had been violated. While this is true of the express terms of the contract, it does not follow that there was not the implied duty on the defender for which the pursuers contend. Shares in public companies are often made the subject of securities with banks and others who advance the money to enable their clients to purchase the same, and obtain themselves registered as shareholders so as to complete the security title. The contract so constituted is, in fact, just a form of pledge; but the peculiarity of it consists in the pledgee having the only property title in the subject of the pledge, and being, accordingly, the only person recognised by the company as having right to the shares. It follows that notices with regard to a fresh issue of shares offered to existing shareholders, or as to payment of calls where the shares are not fully paid up, or the like, may never reach the true owner's knowledge, as they fall to be sent by the company to the person who *ex facie* of the register appears to be the owner. It would be a strong thing to hold that in such circumstances there is no duty on the creditor to inform the true owner of the shares of a valuable right which he possesses in respect of them, or an obligation which he must meet under penalty of the forfeiture of his property. I am unable to affirm this as an abstract proposition of law, and I am accordingly of the same opinion as your Lordship, that the attack on the relevancy of the action fails, and that we ought to adhere to the interlocutor of the Lord Ordinary.

The LORD JUSTICE-CLERK concurred.

LORD DUNDAS was absent.

The Court adhered.

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