Judgment of the Lords of the Judicial Committee of the Privy Council on the Appeal of D. Henderson and Company, Limited, and Others v. *Daniell and Others, from the Court of Appeal of New Zealand; delivered the 23rd March* 1904.

Present at the Hearing:

LORD MACNAGHTEN.
LORD ROBERTSON.
LORD LINDLEY.
SIR ARTHUR WILSON.

[*Delivered by Lord Macnaghten.*]

This is a very idle Appeal by Plaintiffs in a very frivolous action.

Familiar doctrines of Equity are invoked and misapplied in order to lead the Court to upset an honest arrangement made seven years before between the Appellant D. Henderson & Co., Limited, a saw-milling Company, now in liquidation, and its creditors. The arrangement when it was made was all in favour of the Company. When the action was brought, after years of up-hill work, it seemed likely to turn out a good thing for those who then stood in the place of the creditors.

The Company at the time when the arrangement was made was in a state of collapse. It was at its very last gasp, enjoying for the moment that respite or immunity from attack which is the privilege of persons who have nothing to pay and are known to have nothing to lose.

The works of the Company were at a complete standstill. Wages were due. There was no

31021. 100.—3/1904. [12] A

money to pay them. There was no money to pay rent in arrear, or back tithes or royalties due for timber cutting. All the Company's available property was in mortgage to one Charles Dakin. The mortgagee was actually in possession. Outside the mortgage there was nothing but about 300*l.* uncalled on shares, some outstanding debts, some cut timber —about a load or so—some remnants of plant damaged in a recent fire, and a claim for compensation in connection with it. The Company, it seems, at one time carried on operations at four different centres. The mill at Dalefield, one of the four, had lately been burned down. Another mill—at a place called Fernridge—had just been seized by the Appellant Alexander Burnett, under whom the Company held it as tenants or licensees. Besides seizing the mill and the property connected therewith Burnett had distrained on the Company's goods, plant and stock found upon the premises. The other two mills belonging to the Company, Kuripuni and Te Weraiti, with the timber rights attached thereto which were then not far from being exhausted, were in the hands of the mortgagee Dakin.

In these circumstances the directors took the only course open to them as honourable men. They called together the shareholders. They called together the creditors. They consulted the mortgagee, who was pressing for his money, but friendly all the while and forbearing. Every day for a whole fortnight there were meetings of shareholders and meetings of creditors, sometimes separate, sometimes combined, followed by adjournments and re-adjournments. There was plenty of discussion but nothing was done. At last the creditors, at the instance of one of their number—a Mr. Harrison—were bold enough to propose to take over the concern

on their own account, abandoning their claims against the Company and the shareholders. The mortgagee was willing to give up possession to the creditors and allow the experiment to be tried for 12 months so long as his interest was paid and the plant and machinery kept up in good order. It was not a very promising arrangement. But it was the only chance of escape from overwhelming difficulties, and the only possible means of avoiding a call on the shareholders who were for the most part men in a small way of business and could ill afford to pay. So, after a resolution in favour of voluntary liquidation had been carried at one meeting and rescinded at the next, the creditors, by the permission and authority of the mortgagee, with the approval of all the shareholders and to their great relief took possession of everything included in Dakin's mortgage, on the understanding that they were to make no further claim against the Company or the directors or the shareholders. They took possession of the property in mortgage, but of nothing else. The free assets were left in the hands of the Company. No call was made upon the shareholders. The other outstanding assets not included in the mortgage were afterwards collected on behalf of the Company and employed in paying the wages due at the time of the stoppage and discharging an old debt on an overdrawn account at the Company's bankers.

No steps were taken in accordance with the New Zealand Companies Act, 1882, to confirm the arrangement, nor was any instrument executed to evidence its terms. But at the last meeting of the shareholders, which was held on Saturday the 21st of May 1892, a resolution was passed to the effect "that the directors be "authorized to sell to the new Company on "trust for the creditors of Henderson and

"Company all the assets of D. Henderson "& Co., Limited (except the book debts and "stock of timber on hand, and also excepting "remaining portion of saw mill plant at Dale- "field) for the sum of 5*l.* sterling." On the Monday following the directors passed a resolution to the effect "that the offer of Mr. F. "Harrison on behalf of the creditors to pay 5*l.* "for all the assets of the Company (except book "debts, cut timber, and interest in machinery "and plant at Dalefield) be accepted, on the "condition that the Company and the share- "holders and directors are collectively and "personally released from all claims and "demands which the creditors or any of them "now have against the Company or the "shareholders or directors."

Whether one considers the terms of the resolutions of the 21st and 23rd of May or looks at what was actually done, it is obvious that the transaction was very much to the advantage of the Company and its shareholders. They were at once relieved from the claims of all the creditors who joined in taking over the mortgaged property. The claims of the mortgagee were staved off, remaining in abeyance so long as he was satisfied with the exertions of the creditors. The shareholders were left in possession of the unmortgaged assets, and those assets seem to have been sufficient to answer all claims which were made against the Company at the time. The creditors, on the other hand, gave up their rights against the Company, and accepted a precarious position depending upon the forbearance of the mortgagee. For their own protection they had to meet pressing demands for overdue rents and back tithes which ought to have been discharged by the Company. Besides all this, it was open to any shareholder, if he pleased, to take an interest

in the enterprise in which the creditors were embarking. And lastly, whether it was intended or not—probably nobody thought about it—the equity of redemption was left in the Company until such time as the mortgagee might choose to enforce his rights by sale or foreclosure.

During the critical period when the shareholders, the creditors, and the mortgagee were debating the position of affairs, Burnett was treated as a creditor, though there seems to be some doubt whether anything was really owing to him. It was thought he had paid himself. However he was invited to attend the first meeting of creditors, and he was present on that occasion. There were (he says) a lot of people present, and they talked the matter over afterwards. "I did my best," he adds, "to get them "to go on working." He admits that he had the same opportunity of going into "the credi- "tors' syndicate," as it was called, as the other creditors. "He knew they were putting in "money to pay the back tithes," but he would have nothing to do with it himself. That is his own account of his conduct. He kept aloof from the creditors; he would not throw in his lot with them. On the other hand he took no proceedings against the Company to enforce his rights at the time, and so the money collected by getting in the free assets was distributed without making provision for him.

The creditors stood together loyally. The mills were started again under the management of Harrison. But almost immediately afterwards the creditors came to the Respondent Daniell, who had been a director of the limited Company, and begged him to help them. He was a practical saw miller and a good business man. He was not a creditor himself, but at the solicitation of the creditors and having faith in

the venture, and wishing to maintain a local industry, he undertook the management on the terms of being paid a commission, and put his name down for 10*l*. It had been originally intended, as appears from the resolution of the 21st of May 1892, that a new Company should be formed, and it was part of the scheme that the creditors should take fully paid shares in it to the amount of their respective debts, and that working capital should be provided by a rateable subscription from them of 4*s*. in the pound on their claims, and by such further assistance as could be obtained from the public. The creditors contributed their quota and some few subscriptions were obtained, but no Company was formed. Unexpected claims started up. Every penny was wanted to keep the business going, and there was nothing to spend on lawyers and Government fees.

The creditors and the few outsiders who joined them struggled on for about 11 months. By the end of that time the adventurers had lost heart and Dakin, the mortgagee, had lost all patience. The outlook was not encouraging. The result of 11 months' working showed a loss which proved to be about 43*l*. Dakin took possession again, and advertised the property for immediate sale. Daniell still thought he could pull the thing through. The two Chamberlains, who are Respondents, stood by him, but all the rest were anxious to throw up a bad job. They said to Daniell "Well, if you think so much of it, stick "to it and give us our 4*s*. back." Daniell and the Chamberlains arranged to pay out the rest. And so those three were the only persons left with any interest in the concern when the property was advertised for sale. They put their heads together and determined to buy it for themselves if they could. There was no mystery or concealment about their intentions. Daniell

went to the auction openly and made a bid for the property—it was the only bid made—but it was not accepted.

An incident occurred in the auction room which is worth mentioning because it throws light on Burnett's conduct which otherwise would seem to be inexplicable. His real intention appears to have been to wreck the venture if possible. He was present at the auction. He "happened to go into the room," he says, on other business and there he met Daniell and the Chamberlains. They told him what they were going to do, and then, when Daniell was not within hearing, he told one of the Chamberlains he would do no good with it. "He "would do no good with Daniell" he said, "as "he was starting a timber yard and a builder's "business, and he would keep down the price "of timber for his own benefit." To Daniell, talking about the sale, he said he might do as he liked, but he (Burnett) would be in a position to take him to the Supreme Court for his claim very soon. He had "always," he added, "the "intention of taking the directors to the "Court." That was what Burnett stated in his examination in chief. In cross-examination he was even more candid. "I was a saw miller "myself," he said, "I did not like Daniell having "a saw mill—he might cut the prices." However Burnett did not succeed in making mischief between Daniell and the Chamberlains, nor did he succeed in his attempt to deter Daniell from his purpose.

After the abortive auction, Daniell and the Chamberlains entered into negotiations with Dakin and bought the property from him for a sum equal to the amount due on the mortgage, to be paid by instalments. Dakin's solicitor says that Dakin would have taken a good deal less. But Daniell was a willing purchaser. His

faith in the concern was still unshaken, and he thought he could secure further timber rights in connection with the mills. The arrangement with Dakin was carried out by a conveyance to the three purchasers and a mortgage by them to Dakin embodying terms agreed upon for reduction of interest and deferred payment of principal. So the equity of redemption which had been left in the Company was extinguished, and Daniell and his two associates became absolute owners, subject to the fresh mortgage.

Burnett knew everything that was going on. Still he made no move. The time had not come for him to interfere with advantage. If the venture failed, his main object would be gained; if it succeeded, there might be something, some day, worth fighting for.

Daniell and the Chamberlains set to work again. Gradually they brought the business round, paying off the instalments of the mortgage debt as they became due. Then at last, when the concern seemed to be prospering, though not one penny of profit had as yet been made, Burnett intervened. He presented a petition to wind up the limited Company. The petition was not opposed and the order was made. Burnett got his nominee appointed official liquidator. The official liquidator appointed Burnett's solicitor to be solicitor in the liquidation. Then began a system of something like persecution which is not altogether unknown in this country. The liquidator turned inquisitor. He obtained an order to examine Daniell and everybody who had the misfortune to be connected with the Company, including Dakin's representative and one of the Chamberlains. Then came protracted examinations and investigations of the accounts of the trading of the creditors as well as of the trading of the limited Company. Summonses

for misfeasance were issued and prosecuted with the result that they met the fate they deserved. The liquidator now admits that "the creditors' "syndicate did not get anything not included "in Dakin's mortgage," that "the creditors' "syndicate made no difficulty about the "investigation" and that "altogether the in- "vestigation was fairly satisfactory." Burnett (he said) was the only one who complained to him about Daniell's dealings with the matter. They had, as the liquidator observed, "to take his "view to a certain extent." Unfortunately the District Judge, in dismissing the summonses, seems to have suggested that a suit in Equity might be brought with some prospect of success. On that hint the liquidator applied for leave to sue Daniell and his two associates. The Judge in the first instance required that the creditors of the limited Company and the shareholders should be consulted. Accordingly meetings were called. The official liquidator presided. At the meeting of creditors, after the liquidator had explained the business in hand, Burnett proposed, and then, as proxy for one Gray, who does not seem to have been a creditor of the limited Company at all, seconded a resolution to the effect that the liquidator should be instructed to take proceedings against Daniell and the Chamberlains in the Supreme Court "to recover the property of the Company as "indicated in the judgment of the District "Judge." Burnett's vote in person and his vote as proxy were, as the liquidator stated on cross-examination in this action, the only votes in favour of the resolution.

At the shareholders' meeting held immediately afterwards Burnett, who was not a shareholder, was allowed to be present, and as proxy for Gray to propose the same resolution. But he could not find a seconder and the motion dropped.

Then a substantive resolution was passed by the shareholders present (Daniell himself being present but not voting) to the effect that the shareholders relinquished their claim on the assets of the estate.

In the face of this response by creditors and shareholders the District Judge allowed the action to be brought. The present Appellants were made Plaintiffs. The only Defendants were Daniell and the two Chamberlains. Dakin, the mortgagee, was not made a party. The claim was that the purchase from Dakin might be declared null and set aside, or, in the alternative, that it might be declared that the Defendants were trustees for the limited Company and the creditors thereof or alternatively for the creditors, or in the further alternative that Daniell might be declared a trustee for the limited Company. Then followed claims for a confused mass of accounts against all the Defendants.

Having regard to the undisputed facts of the case it is difficult to imagine a more groundless claim or an action more thoroughly misconceived. A claim to set aside a purchase from a mortgagee selling under his power without making the mortgagee a party was so absurd on the face of it that it was abandoned at the Bar. The notion of fixing a trust for the shareholders on the conscience of creditors who were invited by the shareholders themselves to take the property over on their own account seems hardly less absurd, and it is difficult to see why a person accepting employment under the creditors should be treated as a trustee for the shareholders simply because he had been a director of the Company when the undertaking of the Company was a going concern.

The trial came on and evidence was taken before the District Judge, but by consent the

case was removed into the Court of Appeal for argument and judgment. On the 14th of October 1901 the judgment of the Court was delivered by Denniston, J. The action was dismissed with costs. From that decision the present Appeal has been brought.

After carefully reviewing the facts of the case and the arguments addressed to the Court Denniston, J., states the principal ground of judgment in the following terms: "Looking at "the very loose and irregular manner in which "the whole of the proceedings up to the pur- "chase in 1893 have been conducted, and to the "complications and technicalities which have "consequently been created, we are glad to feel "that there is a defence which in our opinion "satisfactorily disposes of the matter on grounds "consistent with good sense and Equity. The "Defendants plead that 'it is now over eight "'years ago since the Defendants purchased from "'the mortgagee as aforesaid, and any rights "'which the Plaintiffs or either of them may "'have against the Defendants have been lost by "'acquiescence and delay.'" To that plea the Court of Appeal gave effect.

Their Lordships agree entirely in the conclusion at which the Court of Appeal arrived. But they think that the case, when stripped of the complications and technicalities to which the judgment of the Court of Appeal refers, is an extremely plain and simple case. And they think that the Defendants have a much stronger ground of defence than that upon which the Court of Appeal relied. In their opinion the position of the creditors, so far as the Company was concerned, was absolutely impregnable from the very moment when they took over the mortgaged property.

It is plain beyond all question that when the creditors in May 1892 took over the

property, they were put into possession by the mortgagee. They got nothing from the Company or the shareholders. The shareholders were only too glad that they should take the mortgaged property and abandon their claims against them. They approved of the arrangement. But they had nothing to do with carrying it out. It was for the mortgagee, and the mortgagee alone, to determine what should be done with the property of which he was in possession. Suppose the shareholders had changed their minds the next day—suppose they had met and unanimously passed a resolution disapproving of the whole arrangement, what could they have done? They could not have ejected the creditors. They would have been mere trespassers if they had entered on the property. If they had gone to the mortgagee and said to him: "We have changed our minds, turn these "people out," the mortgagee would have said: "Pay me off and you can turn them out your- "selves. I have put them there, and, until you "redeem me, there they shall stay as long as I "am satisfied with their proceedings." If the Company had applied to the Court, the Court would have said: "If you want to interfere "with the mortaged property, you must first pay "off the mortgage."

A great deal of argument was spent at their Lordships' Bar in discussing the terms of the resolutions of May 1892. It seems to their Lordships much more important to consider what the parties really meant and what was really done than to dwell on the language of a resolution hurriedly drawn up, not very skilfully framed, and, so far as appears from the evidence, not even communicated to the creditors. The resolution certainly does not express the real intention of the parties. There was no sale. The shareholders had nothing to sell. Their interest

in the mortgaged property was not worth 5*l.* or 5 pence. It is plain enough upon the evidence what the parties meant: the creditors under the authority of the mortgagee were to take the mortgaged property, make what they could of it, and abandon their claims against the Company. The creditors took upon themselves no trust for the Company or the shareholders. But suppose they had done so, the primary and paramount trust must have been for themselves. Their right to protect their own interests would come first. If the relation of trustee and *cestui que trust* subsisted between the creditors and the limited Company for any purpose and to any extent, it could only have subsisted subject to their paramount right to protect their own interests as creditors. Daniell was not a creditor, and no doubt he had been a director of the Company while the business was a going concern. But when the creditors took over the mortgaged property, there was nothing left to be administered on behalf of the Company but the free assets. They seem to have been properly dealt with, and no charge is made against Daniell in respect of those assets. That being so, it is difficult to see why Daniell should not have accepted employment on behalf of the creditors, or why his employment should impose a trust on behalf of the Company on the creditors, or any of them.

When the mortgagee seized the mortgaged property in the occupation of the creditors and offered it for sale, there was nothing to prevent the adventurers or any of them buying the property and buying it for themselves. It was argued that Daniell ought to have called the shareholders together and tried to inspire them with the confidence with which he himself was animated. That seems a most preposterous suggestion. He was under no obligation to do

anything of the kind. If he had made the attempt, the shareholders would have laughed at him. They would have said, "we are not going "to be caught a second time." Even the adventurers with whom and for whom he had worked for a year, all except the two Chamberlains, forsook him. They thought him a fool for his pains. Everybody, he says, thought him a fool. And it looked very like it.

It is of course to be regretted that the arrangement of May 1892 was not carried out in a regular manner in accordance with the provisions of the New Zealand Companies Act 1882 corresponding with the provisions of Section 136 of the U.K. Companies Act, 1862. It would have been so easy, so simple, and so inexpensive. The Act says that "any arrangement entered into "between a Company about to be wound up "voluntarily or in the course of being wound up "voluntarily and its creditors shall be binding "on the Company if santioned by an extra- "ordinary resolution and on the creditors if "acceded to by three-fourths in number and "value of the creditors," subject to a right of Appeal given by the Act. The arrangement in question seems to have been just such an arrangement as the Act intended to validate if the directions prescribed had been followed. And indeed if the resolution to wind up the Company voluntarily had not been rescinded, it might have been difficult for the Company or any creditor to maintain that the arrangement was not binding under the Act. But non-compliance with the prescribed forms, though it has given occasion to litigation and vast expense, can have no effect in undoing what was done. The case might have been different if there had been the slighest suspicion of fraud or underhand dealing. But everthing that was done was done openly, honestly, and *bonâ fide*. And the case of the

Section 196.

Appellants fails completely. The Court of Appeal thought that Equity and good sense were altogether on the side of the Respondents. Their Lordships think so too.

Their Lordships will humbly advise His Majesty that the Appeal ought to be dismissed. The Appellants will pay the costs of the Appeal.

Considering the charges made by the Appellants it seems to their Lordships that the Chamberlains were justified in severing in their defence and on the Appeal. They will therefore be allowed a separate set of costs here as they were in the Court of Appeal.