THE LIABILITY OF CORPORATION PROMOTERS TO ACCOUNT FOR PROFITS.

The question of the rights and liabilities growing out of the sale of property to a newly-formed corporation by those who have taken part in its creation is one of great present-day interest. In describing such persons the word "promoter" has been used constantly, and, as is to be expected, in senses which are not always harmonious. The phrase that "a promoter stands in a fiduciary relation to the corporation" is met with constantly in the books. On the other hand, the word has been applied also to those who were admittedly in no fiduciary relation. The result is that the term has come to have, at best, but a hazy and indistinct significance.

In Twycross v. Grant, 2 C. P. D. 469 (1877) at page 541, Cockburn, C. J., gives this definition:

"A promoter, I apprehend, is one who undertakes to form a company with reference to a certain project, and takes certain steps to accomplish that purpose. That the defendants were the promoters of the company from the beginning there can be no doubt. They framed the scheme. They not only provisionally formed the company but were, in fact, to the end, its creators. They found the directors and qualified them; they prepared the prospectus, they paid for printing and advertising, and the expenses incidental to bringing the
undertaking before the world. * * * All of the things I just referred to were done with a view to the formation of the company, and so long as the work of formation continues, those who carry on that work must, I think, retain the character of promoters."

In *Emma Silver Mining Company v. Lewis*, 4 C. P. D. 396 (1879) at page 407, Lindley, J., says:

"As used in connection with companies, the term 'promoter' involves the idea of exertion for the purpose of getting up and starting a company, and also the idea of some duty towards the company imposed by it arising from the position which the so-called promoter assumes toward it."

In *Whaley Bridge Printing Company v. Green*, 5 Q. B. D. 109, (1879) at page 111, Bowen, J., says:

"The term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence."

It is submitted that whether a person is in a fiduciary relation to a corporation to be formed depends on the facts of each case. Now it is perfectly logical that one may be a projector of a corporation before becoming the promoter of it. He may conceive the idea of forming a company to purchase property he already owns, or of forming a company to purchase from him property which he intends to buy; he may decide whom he will approach with his scheme, he may plan more detailed propositions, but so far as he is acting for himself only, he is a projector and not a promoter. He becomes a promoter only when he has approached others who are to be members of the corporation, and he acts as a promoter only when he acts as an agent for himself and such others. So also two or more persons may agree to do the above things. The fact that two or more persons conceive the idea of selling to a corporation to be formed, and act in unison, does not of itself make them promoters until they take the step which places them in the position of agent of others. When they become such, they are in a fiduciary relation; and are bound to act with due regard
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for the interests of the proposed subscribers of stock, but *non sequitur* that they cannot sell to the corporation at a profit property which they owned prior to the time they held themselves out as agents, even though they bought it after they had formed the idea of forming a corporation, and made the purchase with a resale in view. It is in that sense that the words "projector" and "promoter" will be used *infra*, and it is believed that despite the confusion arising out of the less restricted use of the word "promoter," the cases sustain the main proposition, that there is a liability to account for profits only where at the time of the original purchase the defendant (the vendee of the original purchase and the vendor to the company) was actually the agent of those who proposed forming the corporation, and that if he was not such, he may resell to the corporation at any fair profit, and that without disclosing it. In each case it is a pure question of fact whether the acts complained of occurred at a time when the defendant was independent or at a time when he owed a duty to the plaintiff.

The decisions on the question of the law to account for profits are more numerous in England than in America, and, on the whole, the English judges have presented their conclusions in more precise and logical form.

In considering the origin of the English law on the subject, the earliest reported case seems to be that of *Carter v. Horne*, I Equity Abridgment 7, (1728). There two persons agreed to purchase an estate in moieties between them, which estate was subject to several encumbrances, which were to be discharged out of the purchase money. One of them had abatements made to him by the encumbrancers to his own use, but on a bill to account the Court said "that he must account for them, the purchase being made for their equal benefit, and on a mutual trust between them." Evidently the abatements were made after the purchase had been agreed upon, and at the time of the transfer of the purchase money. This was not a case of promotion of a corporation, but its principles under-
lie the later cases in which the Courts have ordered an accounting of any secret profit made by those in a fiduciary relation.

The following division into classes is submitted to be a logical arrangement of the principles as deduced from the facts of the cases cited:

I. There is no liability to account where the contract of purchase of property, on the resale of which the profit is made, is made at a time when no fiduciary relation exists between the purchaser and the corporation. Obviously this is true where the purchase is made simply as an investment, with a view of a possible future sale to a party not ascertained. If that is so, it is immaterial whether the resale takes place ten years later or whether the purchaser turns up the next day. In either event the person selling is entitled to as much as he can get, and if the purchaser is a corporation he is entitled to be paid in cash or stock if he chooses.

Take a case less simple. Suppose A. buys a property with a view of selling it to a corporation to be formed. If he negotiates with one acting as trustee for the corporation he may sell at the best price obtainable and need not disclose the price he originally paid. The mere purchase of property outright with intent to sell the same to a corporation to be called into existence to buy it, does not constitute the purchaser a promoter of the corporation to which the property is subsequently sold. Alger on Promoters and Promotions of Corporations, §17.

The leading authority on this proposition is Gover's case, which is first reported in L. R. 20 Equity, 114 (1875). In July, 1873, M. agreed to purchase a patent from S. for £65,000 payable partly in cash and partly in shares of a company to be formed. In October, 1873, M. agreed with W., as trustee for an intended company, to sell the patent for £125,000 in cash and shares, with M. as managing director. In November, 1873, the company was formed, with a prospectus stating the contract of October, but not mentioning the contract of M. with S. in July. The action
was by G., who had applied for shares, to have her name removed from the register, on the ground that the omission in the prospectus of the contract of July was a fraud under the Companies Act of 1867, §38, the plaintiff alleging that M. was at that time a promoter. §38 of the Companies Act of 1867 states that every prospectus shall specify the dates and names of the parties to any contract entered into by the company, or by the promoters, directors or trustees thereof, before the issuance of such prospectus, and any prospectus not specifying the same shall be deemed fraudulent on the part of the promoters, directors, officers knowingly issuing the same, and resulting in persons taking shares in the company on the faith of such prospectus.\(^1\) Bacon, V. C., held:

"At the time he (M.) entered into the agreement, of course he could not be called a promoter of the company, if the company was not in existence. * * * The shareholders' counsel undertakes to prove that he must be considered to have been a promoter, first, because in the agreement with S., M. intended to form a company; and, next, because he is the vendor to the existing company. In my opinion that is inconclusive reasoning. * * * He had acquired a commodity by contract between himself and S. It was his to sell or deal with in any way he thought fit. Was it incumbent on M. when he dealt with the company for the sale to them of the patent, which he had contracted for with S., to tell them the price at which he had agreed to buy it? I can conceive no reason why he was under such obligation. * * * The seller is under no obligation to state the price at which he purchased. The purchasers are the best judges of whether the thing offered for sale is worth the money which is demanded for it, and the shareholders know when they apply for shares, having read the prospectus, that the price which the company are to pay is that which is expressed in the agreement referred to in the prospectus."

As to the agreement between M. and S. that a company was to be formed, the Vice Chancellor said:

"The provisions in the agreement with S., do point unequivocally and distinctly to the formation of a company, and as between S. and

\(^1\) L. R., Statutes, vol. ii, part 2 (1867), page 1383, sec. 38. This section has been repealed by the Companies Act of 1900, L. R., Statutes, vol. xxxviii (1900), page 100, section 33 and schedule.
M. the agreement makes it incumbent on M. to do his best to form the company, but that obligation might have been discharged without his doing anything to promote the formation of the company. He might have formed a company by plausible advertisement pointing out how well it was worth a company's while to buy from him the patent he had to sell, without taking a single step toward promoting the company itself."

The case was appealed and affirmed in 1 Ch. D., 186 (1875). James, L. J., and Bramwell, B., said that the contract of July did not need to be set out under §38 of the Companies Act. Brett, J., thought that it did, and that the plaintiff could rescind against the company. Against this proposition the Court stood three to one. Mellish, L. J., took the ground that the action did not apply against the company but that the statute meant to include contracts of those who afterwards became promoters. But all four judges agreed that at the time M. purchased from S. he was not a promoter. James, L. J., said:

"At the time when this agreement (contract of July) was made there was no company in existence and no promoter, trustee or director. The company had not even an inchoate existence except in the brain of M.; and the utmost that could be said of M. was that he was a projector of a company which he intended and had agreed to promote. * * * The making of that provisional contract (October, 1873) was in my opinion the first period of time in which it could be said that the company had even an inchoate existence; and it was from and after the making of that contract that any fiduciary or other relation between M. and the company begun. In the making of that contract, in presenting his own terms and conditions, he was, according to my judgment, in the position of any ordinary vendor with any ordinary purchaser. Everything anterior was a matter relating to himself and to his own title as vendor."

To the same effect is Ladywell Mining Company v. Brooks, 35 Ch. D. 400 (1887). In that case five persons on the 1st of February, 1873, purchased a leasehold mine for 5,000£, with a view of reselling it to a company to be formed, but they had at that time taken no steps to form a company. They completed their purchase on the 17th of March, 1873, the purchase money being paid out of their
own moneys, and on the 4th of April they entered into a provisional contract with a trustee for an intended company for the sale of the mine to the company for 18,000£. Four of the vendors were named as directors. The prospectus did not disclose the contract of February 1. The vendors received the 18,000£ from the company as purchase money. Upon the winding up, the company, having discovered the facts relating to the purchase, began an action to recover the secret profit. It was held that there could be no recovery. Cotton, L. J., at page 409, said:

"It is undoubted that at that time—the first of February, and even before that—P. and his friends contemplated forming a company and did contemplate not themselves working the mine, but dealing with it in the way of selling it at an increased price to the company to be formed. But no part of that purchase was to be provided for out of the funds of the company, or to consist of shares of the company. In my opinion it is not sufficient for the appellants to show that it was contemplated that the company should be formed, or even that it was contemplated at the time when P. bought this mine, that he should sell it to a company, and that he should not work it himself."

A similar decision is In re Cape Breton Company, 29 Ch. D., 795 (1885).

Nor is the original vendee made responsible to the corporation by the fact that his purchase is conditional on the subsequent formation of the corporation, or by the fact that his vendor is to be paid in part in stock of the proposed company. On this point James, L. J., said in Gover's case, at page 187:

"I cannot draw any distinction between a legal right and an equitable right,—between a confidential right and an absolute right,—between a defeasible right and an infeasible right; all that was still matter of title, and his obligation in any case would have been the same to make a valid conveyance at the proper time of the thing which he undertook to convey."

The fact that later such vendor to a corporation becomes a director of it does not render him liable to account for the profit he acquired, if he acted openly and honestly and as an independent vendor. For this, again see Gover's case.
II. But suppose that in addition to purchasing a property with the view of selling it to a corporation, the party actively engages in organizing such a corporation—i.e. add to Class I the fact of active operation in organizing.

If the purchase is made before any acts of incorporation are attempted, or before any prospectus is issued, or before any other inducements are made to the public, and all that has been done is that the purchase has been made in expectation of resale to the projected corporation, then such parties when the corporation is formed, even though they helped to promote it, may sell to it at the best price obtainable, provided they in no way misrepresent to the corporation material facts in connection with the property; and provided that the contract is entered into on behalf of the corporation by directors who are capable of acting independently, and who are not merely puppets of the vendors. Their duty to truthfully state material facts does not mean that they must disclose the price they gave for the property, but it does mean that, as in the case of any ordinary bargain and sale, the vendor must not represent the facts so as to create a false impression of the value of the premises. This is the decision in the leading case of *The New Sombrero Phosphate Company v. Erlanger*, first reported in 5 Ch. D. 73, (1877).

In that case the lease of an island in the West Indies possessed by a defunct company was on August 30, 1871, contracted to be sold to a syndicate for 55,000£, the syndicate being represented by one Evans. The syndicate got up a company and on September 20, 1871, a trustee acting for such company to be formed contracted with Evans as vendor to buy the leasehold for 110,000£. The company was duly registered. The syndicate selected five directors, of whom Evans was one and a majority of whom were under control of the syndicate. Three directors, including Evans, held a meeting and ratified the contract of September 20. The contract of August 30 was not produced at the meeting. The prospectus contained misleading statements as to the survey and value of the phosphate deposits, and also stated that the directors had made a provisional con-
tract to buy for £110,000, but failed to state that the promoters were also the vendors. No reference was made to the contract of August 30. Shares were eagerly bought and soon the shareholders discovered that the company had not purchased directly from the official liquidator, but that there had been an intermediate sale, and that Evans, a director, had been one of the vendees from the liquidator at £55,000 and one of the vendors to the company for £110,000. The bill prayed that the contract of September 20, 1871, be set aside and repayment to the company of £110,000, and it asked in the alternative that the vendors be ordered to repay £55,000 as alleged secret profit.

Malins, V. C., held that there could be no recovery on the authority of Gover's case. In the Court of Appeals Malins, V. C. was reversed on the ground that the prospectus was misleading and fraudulent, both as to the reported value of the deposits, and as to the way in which the contract was entered into, in that the alleged contract by the directors was in reality procured by the syndicate and ratified by three directors, two of whom were under the control of the syndicate, and all of whom failed to exercise any independent judgment. Jessel, M. R., at page 112 said:

"It is stated (i.e., in the prospectus) that the directors have entered into a provisional contract to purchase the property from Evans. Was this true? I think it was a very material misstatement. * * * The directors had nothing whatever to do with the provisional contract. * * * It was nothing more than a mere sham contract, a thing entered into by one agent of the promoter to sell, with another agent of the promoter to buy; there really was nothing more when it had been adopted than when it was entered into, and it was not a transaction that in any sense could bind the company."

James, L. J., at page 113 says:

"In this case the vice chancellor appears to have proceeded, to a great extent, upon what was supposed to have been said in Gover's case. Now I adhere entirely to what I said in Gover's case, that is to say, it is quite open to a man to buy any property, at any price he likes, with a view or in the hope of reselling that property to any company that he can get to buy it, if that is the mode in which he intends to dis-
pose of it. A man may buy at any price and may sell at any price that he can fairly get for it, but that has nothing whatever, as it appears to me, to do with the question in this case, which is whether a man who has bought at a low price has obtained a higher price fairly and properly, in accordance with the view which the Court of Equity takes of such transactions."

Baggallay, J. A., says at page 123:

"I treat the transaction as an honest purchase of the property by the syndicate with the intention of realizing a profit either by reselling it or by working the mine themselves, but with no intention of forming a company they subsequently promoted. They had this mining property, and they had a perfect right not only to sell it to a company, but also, provided that they did it in a proper manner, to form, or join in forming, a company for the purchase of it. * * * We could then consider the circumstances under which the company was formed and the contract entered into and adopted. It was adopted and the syndicate were, in substance, not only the vendors of the property but also the promoters of the property and in such case the syndicate as promoters, being in a fiduciary relation to the company, it was essential that the public who were invited to become and who were expected to become the shareholders of the company, should have the fullest information as to all the surrounding circumstances."

What Justice Baggallay means is that when the syndicate bought they were independent and not agents and were free to resell at profit, but that when they did negotiate to resell to a company of their own formation they became promoters and were under a duty not to make false representations. This decision was affirmed in the House of Lords, Erlanger v. New Sombrero Phosphate Company, L. R. 3 Appeal Cases 1218 (1878), the contract was rescinded, the purchase money ordered repaid, and the property turned back to the syndicate, Lord Cairns dissenting solely on the ground that he thought the company was guilty of laches. That the decision was solely on the ground of false and misleading statements and as to the method of adoption of the contract, and not at all on the ground that a profit had been made by the projectors on their resale to the company, is evident from the language of the House of Lords.
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Lord Cairns, L. C., at page 1234 says:

"My Lords, I stop at this point for the purpose of saying that I think it to be clear that the syndicate in entering into this contract (that is, the contract of August 30) acted on behalf of themselves alone, and did not at that time act in, or occupy, any fiduciary position whatever. It may well be that the prevailing idea in their mind was not to retain or work the island, but to sell it again at an increase of price, and very possibly to promote or get up a company to purchase the island from them; but they were, as it seems to me, after their purchase was made perfectly free to do with the island whatever they liked, to use it as they liked, and to sell it how and to whom and for what price they liked. The part of the case of the respondents which, as the alternative sought to make the appellants account for the profit which they made on the resale of the property to the respondents, on an allegation that the appellants acted in a fiduciary position at the time they made the contract of the 30th of August, 1871, is not, as I think, capable of being supported, and this, as I understand, was the view of all the judges in the courts below."

In the same vein Lord Hatherly says at page 1242:

"In the first place, the plaintiffs endeavored to set aside this contract on the ground that the persons who sold the property having filled a fiduciary position as actual trustees for the company which was formed, and being disentitled to participate in any profit which could be made in the sale in consequence of that trusteeship. The court below, as well as, I believe, all your lordships, have been of the opinion that they were in no such sense as that trustees for the company. * * * Consequently, any authority derived from those cases which insist that no profit can be derived by a trustee out of that which is the property of his cestui que trust has no application to the present case, inasmuch as the syndicate never constituted themselves as trustees, but intended to sell, and did sell, this property to the new company or association which was about to be formed, and for the purpose of making which sale they desired that the company should be formed, and took an interest in its formation. The property was sold for 55,000£ to the syndicate, who thereupon became absolute owners of it and were at liberty to sell it to whomsoever they pleased and for whatsoever they pleased."

Lord O'Hagan at page 1255 says:

"The original purchase of the island of Sombrero was perfectly legitimate, and it was not less so because the object of the purchase was to sell it again, and to sell it by forming a company which might afford them a profit on the transaction."
Lord Blackburn considered it to be unnecessary to discuss this point.

Lord Selborne at Page 1260 thus epitomizes the situation:

"If there had been an independent purchaser and a real bargain, the vendors would have been at liberty to ask what price they pleased, and if that purchaser had agreed to pay more than the property was worth, he could not complain. But there was, in fact, no such purchaser and no such bargain. The vendors themselves managed the whole thing, and they made those who, through their means, undertook a trust for others, their passive instruments."

In short, the basis of the decision is that Erlanger et al. were at liberty to buy with intent to resell at a profit, to then promote a corporation to buy of them, but that when they did so, it was their duty to truthfully represent the facts, including the fact that they were the vendors, and to allow a competent directorate to agree to buy of them after forming an independent judgment, and that, as they had not done so, the company was entitled to rescind.

The result was that the defendants were not liable to refund the profit by virtue of the fact that they bought on August 30 for 55,000£, and sold to the company on September 20 for 110,000£, but the company was permitted to rescind the contract on the ground that the prospectus was false in fact as to the value, as indicated by the survey, and that, as emphasized in the House of Lords, the company was not bound by a contract entered into by a "packed" directorate.

Mr. Thompson in his work on corporations, under the heading, "Purchase and Then Selling to Corporations at a Higher Price," §458, cites the Erlanger case as authority for the proposition that promoters being trustees cannot make a secret profit. It is submitted that the case does not sustain that proposition, as is abundantly shown by the foregoing extracts from the opinions in the House of Lords.

The court in the recent case of Yeiser v. The United States Board and Paper Company, 107 Fed. 340, (1901) C. C. A. 6th Circuit, also misreads the Erlanger case. In the Yeiser case five defendants secured an option on July 17 to
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purchase the property of the L. Company for $75,000. On July 23 they incorporated themselves, and elected themselves directors, they being at that time the entire corporation. They decided to sell to the corporation for $100,000. Then they issued a prospectus inviting subscribers, and stating that the property could be purchased by the corporation from B. and S. (who were two of the directors) for $100,000. Outsiders subscribed to the extent of $45,000. On December 16 B. and S. modified the option with the L. Company, so that the latter agreed to take $40,000 in cash and $35,000 in bonds of the new corporation. On the same day the directors of the corporation voted to buy the property from the L. Company for $100,000. The action was against the five promoters to cancel the stock held by them, representing their $25,000 profit.

The court, by Severens, J., cites the Erlanger case and says that it is on all fours with the case at bar. After giving the facts of the Erlanger case, the court says:

"A large number of subscribers were induced to take and pay for shares in ignorance of the profit which had been made by Erlanger and his associates in selling the lease to the company. The truth finally leaked out, the board of directors was reconstituted, and a new board was authorized to bring suit to recover the amount of profit which the promoters had made on the sale to the company of the lease. * * * The same fact, upon which so much reliance has been placed by the appellants here, existed in that case, namely, that the promoters had already acquired the right to the benefits of their purchase from their former owners, and were in a position to sell their purchase to any one who would buy."

It is submitted that the learned court overlooked the fact that the main relief asked in the Erlanger case was for the rescission of the contract, the return of the property to Erlanger, and the winding up of the company, and that the accounting of profits was asked as an alternative remedy and refused. It is further submitted that if the prospectus in the Erlanger case had not contained false statements as to the value of the property and to the method by which the company acquired it, no recovery at all would have been had. A careful reading of the opinions, both in the
Court of Appeals and in the House of Lords, shows that the judges were unanimous in holding that Erlanger and his associates were at perfect liberty to resell at a profit, provided they did it fairly.

While the premise in Yeiser v. The United States Board and Paper Company, formed from the court's view of the Erlanger case, is erroneous, the decision is correct and may be upheld on the ground that after incorporation, on December 16, B. and S., who were then directors, made a new contract with the original owners to buy for $40,000 cash and $35,000 bonds, which contract should have enured to the benefit of the corporation, as made by its agents. They, however, still allowed the corporation to remain under the belief that it had to pay $100,000 and on the same day the directors again collusively agreed to pay $100,000. These fraudulent acts, whereby the defendants obtained a secret profit after they had induced the public to come in, are quite sufficient to sustain a recovery. But the fact that the defendants bought on July 17 for $75,000, before any step was taken to form a corporation or to bring in the public, and then, after incorporation, offered to sell for $100,000, is not by itself a ground for recovery. The court, however, seems to think that it is, so that the case is by dicta at least (since it may be supported on the other ground above stated), opposed to the doctrine laid down at the beginning of Class II supra.

The fact that the Erlanger case is recognized in England as a decision allowing the rescission of a contract on the ground of misrepresentations, and not as an authority for the recovery of profits made by those who projected the corporation, is further made clear from the observations of Cotton, L.J., in Ladywell Mining Company v. Brookes, 35 Ch. D. (1887) at page 410; Lord Watson in Salomon v. Salomon (1897) A. C. 22 at page 37; and Lindley, M. R., in Lagunas Nitrate Company v. Lagunas Syndicate (1899) 2 Ch. at 424.

In many facts similar to the Erlanger case is the case last referred to, Lagunas Nitrate Company v. Lagunas
Syndicate (1899) 2 Ch. 392. In that case the defendant syndicate purchased nitrate lands in Chili in 1889 for 110,000£. In 1894 the syndicate promoted and formed the plaintiff company to purchase a part of the lands for 850,000£. The directors of the syndicate prepared and signed the articles of association of the company, the articles nominating them as directors and stating specifically that they were also the directors of the syndicate. They also prepared the company's prospectus and purchase contract, and affixed the seal of the syndicate and of the company to the latter. Two years after the date of the purchase the shareholders of the company, believing that their property had been purchased at an over-value, and that there had been misrepresentations in the contract and prospectus, appointed an independent board of directors who brought this bill against the syndicate for general relief, praying among other things for a rescission of the contract of 1894 and also for an accounting of the profits made by the syndicate. Lindley, M. R., and Collins, L. J., approved of the Erlanger case but refused a rescission on the ground that there were no such material false representations as there were in the Erlanger case, and that although the prospectus was in some particulars misleading the condition of the parties had been so changed by the working of the property, and by the alterations made thereon by the company, that a rescission could not place them in their original status. Rigby, L. J., dissented. The remedy asked for the return of the profits does not seem to have been pressed by counsel, probably in view of the decisive statements as to profits made by the House of Lords in the Erlanger case. On the question of profits on the resale Lindley, M. R., said:

"Having regard to what was disclosed and to the avowed object of the company, I do not consider the non-disclosure of the price paid by the syndicate for the Lagunas and of the profit made by the sale to the Nitrate Company as fatal to the validity of the sale."

In such case, therefore, the prospectus should state the
truth as to the business situation relative to the proposed undertaking, the value as nearly as can be ascertained of the property to be purchased, or for which provisional contract has been made, the price to be paid for it, and the fact that the corporation is buying it from those who are its promoters. As to what a prospectus should contain Vice Chancellor Bacon in Bagnall v. Carlton, 6 Ch. D. 371 (1877) at 383 used this language:

"It is obvious that such a document ought to be expressed with perfect veracity and issued in good faith and the suppression or withholding of the statement of any fact materially relevant would be as plain a failure of that perfect veracity and as plain a departure from good faith as the assertion of a positive falsehood. To sanction or permit any violation of these essential conditions, would be to encourage proceedings which might soon prove intolerable, and would expose that numerous class of persons who are but too willing to invest their money in undertakings which seem to hold out a fair prospect of reasonable and honest profit, to the arts of projectors desirous of taking advantage of their credulity."

In the case of Lady Forrest Gold Mining Company, Ltd. (1901) 1 Ch. D. 582, a syndicate of which S. was a director and member was formed in February, 1895, and acquired the work of a mine, and in the same month issued a prospectus stating that the directors were aware that similar properties were often resold "to the public" at a profit, and were "not unmindful of the benefit that" might "arise by converting the syndicate into a very much larger company within a short period." In October, 1895, the directors promoted and got up a company to purchase the mine at an increased price. The same persons were the directors of both the syndicate and the company. The company issued a prospectus, offered some of its shares to be subscribed and stated the names of the directors, that they were the directors of the syndicate selling to the company, and the date of, parties to, and the consideration for the sale to the company. Inspection of the contract was also offered. The amount of profit of the resale to the company was not stated, and subject as aforesaid there was nothing in the prospectus to show that the sale was at a
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profit. It was held, first, that the syndicate and its directors were not promoters of the company when the syndicate acquired the property in February, 1895, and, second, that the disclosure in the proposition of the company of the fact that the directors of the syndicate were the directors of the company was a disclosure that some profit was being made.

In re Leeds and Hanley Theatre of Varieties, Ltd. (1902) 2 Ch. 809, was a case where a company bought property to sell to a corporation to be formed. The property was nominally conveyed to a trustee for the company and sold by him to the corporation at an advance. The prospectus made it appear that he was the real vendor. It was held that it was the duty of the promoters to disclose the fact that they were the real vendors and that their failure to do so was a fraud, and that thereby they were liable for damages to the company, and that the true measure of the damage was the profit which the promoters had obtained upon the purchase and resale of the property. At the same time the court quoted approvingly from the Erlanger case.

Assuming that such a disclosure is made in the prospectus of the proposed corporation as answers the requirements laid down, is it necessary that the projectors who have by this time become promoters disclose to the corporation the price which they originally paid for the property; that is, in order to resell must they state that they are reselling at a profit and at what profit? It would seem not, if those requirements be met. In the Lagunas case a profit of 55,000£ was made. This was not disclosed. In that case in the court below, Romer, J., held:

"The first complaint by the company is that the purchase price fixed by the syndicate was excessive and that the directors of the syndicate, acting for a vendor in a fiduciary position, had no sufficient ground to justify them in fixing that price, or in making the favorable representations contained in the prospectus as to the value of the property and the company's prospects of success. Now, so far as the price is concerned, it is difficult to say how this alone could form a just cause of complaint if fixed by the directors of the syndicate in good faith, and bad faith is not alleged, but it appears to me that the directors at
the time not only believed but had reasonable means for believing, that the company had acquired the property at a favorable price."

In the court above, as already stated, it was said, at page 431:

"Having regard to what was disclosed, and to the avowed object of the company, I do not consider the non-disclosure of the price paid by the syndicate for the Lagunas and of the profit made by the sale to the Nitrate Company as fatal to the validity of the sale."

It is to be noted that in this case the directors of the company were all members of the vendor syndicate, and while the court thought that the company could have rescinded the contract owing to misrepresentations in the prospectus, chiefly as to the water supply at the nitrate fields, provided it had not been guilty of laches, the court did not say that the failure to disclose the profit would be a ground for rescission.

On the other hand, Wright, J., in *In re Lady Forrest Gold Mining Company* (1901) Ch. at page 590 states that even though the original purchase was made at a time when no fiduciary relation existed, so that a profit on resale is legitimate, yet, if the projector who owns the property has become a director and votes to carry out the contract of purchase, he ought to disclose his profit, and if he fails to do so, it is ground for a rescission by the company, if it acts in time, but that even so, the failure to disclose is no ground for an action to recover such profits.

To the same effect are:

*In re Cape Breton Company*, 29 Ch. D. 795 (1885), and *Ladywell Mining Company v. Brookes*, 35 Ch. D. 400 (1887).

That is, if the projector has become a director he should disclose to his associates his connection with the property, but failure to do that is not sufficient to support an action to account for his profit. He is under no liability to account for his profit, since at the time he originally bought he was acting solely for himself and not for the company which was later formed to purchase of him.

As already stated the basis of the decision in the Erlanger
case in the House of Lords is that under such circumstances, in addition to rightfully representing the facts, it is the duty of the promoters to provide for the corporation a board of directors who are not mere men of straw but who will act with independent judgment for the best interests of the corporation, in dealing with the promoters for the purchase of the property. Lord Cairns said at page 1236:

"It is incumbent upon the promoters to take care that in forming the company they provide it with an executive, that is to say with a board of directors who shall both be aware that the property which they are asked to buy is the property of the promoters and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of a property may not promote and form a joint stock company, and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to a company through a medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to a promoter, but to some other person."

This view is adopted in Plaquemines Tropical Fruit Company v. Buck, 52 N. J. E. 219 (1893) and in Dickerman v. Northern Trust Company, 176 U. S. 181 (1899).

The Lagunas case modified this to the extent of holding that the directors may be the same parties as the vendors provided that fact is disclosed.

Lindley, M. R., at page 426 says:

"After Salomon's case (1897) A. C. 22, I think it impossible to hold that it is the duty of the promoters of a company to provide it with an independent board of directors, if the real truth is disclosed to those who are induced by the promoters to join the company. Treating promoters of companies as in a fiduciary relation to them, and as having a power of appointing trustees (namely, directors), I cannot treat companies or their shareholders as so many cestuis que trust under disability, nor even as cestuis que trust for whom trustees are appointed without their consent. No one need join a company unless he likes, and if a person knows that if he becomes a member he will find as directors persons who, in his opinion, ought not to be directors, he should not join the company. If he does he has no right to redress on the ground that improper persons were appointed trustees. * * * the principles on which Salomon's case was decided
by the House of Lords are quite consistent with those on which
_Erlanger v. New Sombrero Phosphate Company_ was decided, but are
quite inconsistent with such an extension of such principles as would
be necessary to give the Nitrate Company relief against those who
formed it, on the ground that they formed it with an objectionable
constitution."

Just as in the Erlanger case the contract of sale to the
corporation was vitiated by the false representations, so
a projector who has acquired property which he has the
right to sell at a profit, may be made to account for such
profit by reason of his making false representations as a
promoter, on faith of which the corporation buys. Thus,
where the purchase is made before any acts of promotion,
the right to resell at a profit is undeniable. But if, after
promotion, the promoter represents that the corporation can
buy from him at the original cost price, and he in fact sells
to it at a secret profit, he becomes liable to account for such
profit because of his fraud.

Thus, in _Getty v. Devlin_, 54 N. Y. 403 (1873) (S. C.
70 N. Y. 504, 1877) four defendants bought oil lands
for $40,000. They then organized a corporation and in-
formed the subscribers that the original cost was $125,000,
for which price the corporation could purchase. In an
action for the fraud it was held that the defendants could
be made to account.

In _Cortes Company v. Thannhauser et al._, 45 Fed. 730
(1891) the defendants secured options on mining land
in Lower California for $80,000, and sent an agent east
to sell it to a corporation at a minimum of $110,000. The
agent succeeded in inducing various parties in New York
to form a corporation to buy at $150,000, representing that
that was the price of the original purchase plus a few
expenses. On an appeal by the corporation to rescind the
contract, Judge Wallace held:

"Upon these facts the right of the complainant to rescind the sale
is clear. Irrespective of any other element of fraud in the transac-
tion, the false representation of B. (defendant's agent) that the
price at which he offered the property was the price which the owners
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were to receive, and that neither he nor the defendants were to receive any profit by the sale, sufficed to annul the contract made by one who was about to enter into the fiduciary relation of a copurchaser with those to whom he made it. The materiality of such representation as an inducement for the contract is obvious."

In Burbank v. Dennis, 101 Cal. 90 (1894), the defendants purchased land and had options on other lands. They then promoted a corporation and represented to the shareholders that they would sell to the corporation at cost price. It was clear that the defendants, not having been promoters at the time they bought, could have sold it at any price they could induce the corporation to pay, but they represented that they were reselling at the original price. This was false, and on faith of it the plaintiff subscribed. At the time of this representation they were promoters and were bound not to misrepresent to their associates. Their secret profits were recovered. A similar case is Ex-Mission Land and Water Company v. Flash, 97 Cal. 610 (1893).

The gist of these decisions is, that while the owner has a right to dispose of his property at any figure upon which an agreement may be reached, yet such sale must be free of false representations on his part, and any profit made on the resale becomes illegal only because of such false representations.

The same principle applies where an option is purchased, and the promoter then represents to others that the property can be purchased at a given figure, whereas, in fact, he has contracted to buy it himself at a smaller sum and intends to pocket the difference. For this state of affairs see Pittsburg Mining Company v. Spooner, 74, Wis. 307 (1889); Hebgen v. Keoffler, 97 Wis. 313 (1897), and Zinc Carbonate Company v. the Bank et al. 103 Wis. 135 (1889). In the last mentioned case the court said:

"True, if defendants or the bank owned the mine either one or all of them had a right, acting in good faith, to sell it at an advance, but the mischief of the matter was that neither the bank nor either of the defendants acted in good faith."
Here, again, the parties purchasing the option would have the right to form a corporation to buy it of them at a profit, but the mistake is made when they represent to the subscribers that the original owner demands the price they ask of the corporation, thereby positively inferring that they make no profit. This is the fraudulent representation which vitiates an otherwise legitimate profit.

In the case of *Plaquemines Tropical Fruit Company v. Buck*, 52 N. J. E. 219 (1893), B. agreed to buy land in Louisiana of W., the owner, partly for cash and partly for stock of a corporation to be formed. He formed a corporation, having first issued a prospectus which stated that W. was to be the grantor to the corporation, and which included a map of "the proposed purchase." He then had a dummy board of directors vote to purchase for $150,000. The evidence was conflicting as to who was named as grantor, B. claiming later that he was, but it was evidently his intention, to judge from other evidence and from the language of the prospectus, to leave the corporation under the impression that W. was the grantor. The directors issued 12,000 shares to B. "for property purchased" and then B. went to Louisiana and purchased from W. for $27,000, pocketing the difference. The court held with great clearness that it was open to B. to buy the property on his own account, for any price he could, with the intention or in the hope of selling it at a higher price to a company to be formed, and, dealing individually, to sell it for such higher price to such company so long as he obtained his higher price fairly. That is, it was open to B. to say, "I have this property, or this option, which I, having purchased for myself, will sell to you." But B. did not obtain his higher price fairly. Instead of stating that he was the real vendor, he represented that W., the original owner, would sell directly to the corporation. This representation was made both in the prospectus and in the directors' meeting which authorized the contract, and on the strength of that, B. as agent of the corporation now formed, made the purchase. By these representations he led the corporation
to believe that it was purchased from W. for $150,000. If he had made known that he himself held the contract of purchase on his own account, he could have sold to the corporation for $150,000 or any other price, and the transaction, like that in Gover's case, would have been unimpeachable.

It would seem that it is immaterial whether the original contract is an out-and-out purchase (for the purpose of resale to a corporation) or whether it is an option. In either case, if the purchaser is acting for himself alone, whatever his secret intentions may be, and bona fide secures the purchase or the option, he should be at liberty to resell at a profit, whether he has in himself the fee or whether his interest is merely a right to demand the fee. The opposite view, namely, that one who purchases an option, having an intent to form a corporation to purchase the land, cannot sell to the corporation at a profit, is one of the grounds of the decision in Woodbury Heights Land Company v. Loudenslager, 55 N. J. E. 78 (1896) by Vice Chancellor Pitney, based chiefly on an expression of the same view by Lord Justice Mellish in Gover's case. Woodbury Heights Land Company v. Loudenslager was affirmed by a divided court in 56 N. J. E. 411 (1898). (A later opinion on the same case in 58 N. J. E. 556 is entirely on the measure of damages.) The evidence in this case is quite sufficient to support the decision on the ground of fraud, similar to the Class III infra, apart from the question of option.

Additional cases falling within Classes I and II are:

*In re Ambrose Lake Tin and Copper Mining Co.,* 14 Ch. D. 390 (1886).
*McElhenny's Appeal,* 61 Pa. St. 188 (1869).
*Densmore Oil Co. v. Densmore,* 64 Pa. St. 43 (1870).
*Higgins v. Lansingh,* 154 Ill. 378 (1895).
*Forest Land Co. v. Bjorkquist,* 110 Wis. 551 (1901).

(To be continued.)