locutor:—"The Lord Ordinary, in respect of the obligation by the pursuer, decerns against the defenders in terms of the conclusion of the action for denuding."

Counsel for Pursuer—Harper. Agent—R. A. Brown, S.S.C.

Counsel for Defenders—J. A. Reid. Agent—George Barrie, L.A.

Friday, December 23.

OUTER HOUSE.

[Lord M'Laren.

STRONACH AND OTHERS (LORRAIN'S TRUSTEES) AND THE CITY OF GLASGOW BANK LIQUIDATORS *v.* BRODIE AND ANOTHER.

Process—Undefended Cause—Wakening—13 *and* 14 *Vict. cap.* 36—31 *and* 32 *Vict. cap.* 100.

It is incompetent to waken a cause in which appearance has not been entered by minute of wakening.

This was an action which was brought by the trustees under the late Walter Scott Lorrain's trust-disposition and settlement dated 4th June 1857, and codicils relative thereto, and the Official Liquidators in the City of Glasgow Bank Liquidation, against Patrick Brodie, a minor, one of the beneficiaries under the said trust-disposition and settlement, and his father as his curator, and was supplementary to another action brought by the same pursuers against Gavin Ralston, writer in Glasgow, a purchaser of part of the heritable estate of the late Mr Lorrain, sold under the said trust-disposition and settlement. No appearance was made for the minor or his curator, and as the summons was signeted on 16th July 1880, and decree on the undefended cause had not been taken, the cause had fallen asleep, and the pursuers now moved the Lord Ordinary to allow them to waken the cause by minute under the 95th section of the Court of Session Act 1868 (31 and 32 Vict. cap 100).

The Lord Ordinary refused to allow them to waken the cause by minute as craved, on the ground that this case was not covered by the provision in the said 95th section, nor by the 30th section of the Court of Session Act 1850 (13 and 14 Vict. cap. 36), on the provisions of which the former section was framed, as both those Acts contemplated only the case of wakening defended actions, and where there were parties in Court to whom intimation could be given in terms of the statutes. It was the opinion of the Lord Ordinary that the only means of wakening an undefended cause was by raising a summons of wakening.

Counsel for Pursuers — Lorimer. Agents—Davidson & Syme, W.S.

Friday, December 23.

FIRST DIVISION.

JAMIESON AND OTHERS (LIQUIDATORS OF THE CITY OF GLASGOW BANK) *v.* MACKINNON.

Public Company—Dividend—Payment of Dividend out of Capital—Director—Breach of Trust—Liquidator—Title to Sue as representing Creditors or Shareholders—Mora—*Companies Act* 1862 (25 *and* 26 *Vict. cap.* 89), *sec.* 165.

M. became a director of a bank in 1858. At that date the bank had advanced to a customer £117,000 on the security of first mortgage bonds of an American railway company which was then in course of construction, the nominal value of the bonds being £134,000, and shortly afterwards the debtor to whom the advance had been made having failed, the bank took over the bonds as its own property. M. continued in office till 1870. During the intervening period the bank made repeated advances towards the completion of the railway, the advances being partly on mortgage bonds and partly on stock. The interest due on these advances amounted to £315,897, but of that sum only about £20,000 was paid in cash as it fell due. The directors of the bank nevertheless debited the railway advances with the interest, carried that interest to the profit and loss account, and paid it away half-yearly as dividend. In 1878 the bank failed with very large liabilities, but before long it appeared certain that the creditors, the bank being a company of unlimited liability, would receive payment of their debts in full. In 1880 the liquidators of the bank presented a note against M., founded on the 165th section of the Companies Act 1862, in which they prayed that he should be ordained to repay to them the amount of the interest debited to the American railway account, and paid away as dividend during the years 1858 to 1870 inclusive. M. lodged answers. It appeared that although from 1858 to 1870 no interest had actually been received by the bank, nevertheless the railway had always made over its own bonds or stock of a sufficient nominal amount to cover the interest; that the agents of the bank in America had advised the directors to advance money to complete the line in order to save the advance standing in 1858 from being almost wholly lost; that when the line was completed the bank had received offers to purchase their (the almost sole) interest in it, at a price which on a par exchange more than covered the advances at the date of the offer, but that owing to the depreciation of the United States currency through the civil war then raging the loss on exchange would have been very large; that the effect of that war was to lower the value of railway as of other property, although there was no reason to believe that this state of matters would be permanent; that in 1869 the railway made an arrangement with another company, the result of which was that

the interest on the bonds was thereafter regularly paid, although no interest was ever paid on the stock; and that after 1870 down to its stoppage the management of the bank became highly imprudent. On the other hand, it appeared that when the liquidators realised the bank's interest in the railway in 1880 there was a deficit of over £400,000 on the advances—principal and interest. This realisation, however, took place without notice to M., who impugned it as being a forced realisation—necessary in a liquidation—but no test of the real value of the line, or of what he himself might have been able to get for it had the liquidators given him an opportunity. There was no doubt that M. was well aware of the state of the American account, and, from 1867 at least, of the practice of debiting it with interest and paying away the interest as dividend, for in that year he protested against the practice, though his objections were overruled by his fellow directors. *Held* that M. was not bound to repay the dividends in question, because he and the other directors of the bank had reasonable ground for believing that the interest was well secured, and would ultimately be recovered; because the claim was barred by lapse of time, combined with the action of the managers and directors of the bank between 1870 and 1878, and the conduct of the liquidators in disposing of the railway securities without any communication with M. or notice to him; because the liquidators had, at the stage to which the liquidation had reached, no title or legitimate interest to maintain the claim either on behalf of the creditors of the bank or its shareholders, for the creditors had been satisfied, and the shareholders having themselves received, or representing those who had received, the dividends improperly paid, were bound to replace them, and action on their behalf was therefore barred by the principle *frustra petis quod mox restituturus es.*

Process—Appeal—Leave to Appeal to the House of Lords—Proof before Answer—Liquidation.

In the liquidation of an extensive banking company the liquidators presented a note, under the 165th section of the Companies Act 1862, against one of the directors, seeking to have him ordained to restore to them certain dividends amounting to over £300,000, which it was alleged had been paid out of capital during the respondent's period of office. Besides denying these averments, on the merits the respondent pleaded that the application was on various grounds irrelevant. The Court having allowed a proof before answer, the respondent petitioned for leave to appeal, urging that inquiry would necessarily be unusually expensive. The Court *refused* to grant leave.

Process—Summary Petition—Want of Notice—Proof—Companies Act 1862 (25 *and* 26 *Vict. cap.* 89).

The liquidators of a banking company presented a note against a former director, charging him under the 165th section of the Companies Act 1862 with having (along with his fellow directors) misapplied the funds of the company by paying dividends out of capital. The director in question in his answers replied, *inter alia*, that during his period of office there existed a reserve fund nearly equal to the capital alleged to have been paid away. The liquidators did not amend their note so as to answer this averment, but at the proof on the other points at issue they sought to lead evidence with the view of showing that among the nominal assets of the bank there were bad debts sufficient to swallow up the reserve fund. The respondent objected to this line of evidence. *Held* that the evidence might competently be led, the respondent being entitled to have the proof adjourned in order that he might obtain and lead counter evidence.

Observed (*per* Lord President Inglis) that in an inquiry under the 165th section of the Companies Act 1862 it is not necessary to resort to the Court of Session Act of 1868, or to any of the other Judicature Acts, for the purpose of complying precisely with the forms of process in ordinary actions.

This was an application by the Liquidators of the City of Glasgow Bank under the 165th section of the Companies Act 1862 (25 and 26 Vict. cap. 89), which provides—"Where in the course of the winding-up of any company under this Act it appears that any past or present director, manager, official, or other liquidator, or any officer of such company, has misapplied or retained in his own hands, or become liable or accountable for, any moneys of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of any liquidator, or of any creditor or contributory of the company, notwithstanding that the offence is one for which the offender is criminally responsible, examine into the conduct of such director, manager, or other officer, and compel him to repay any money so misapplied or retained, or for which he has become liable or accountable, together with interest after such rate as the Court thinks just, or to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust, as the Court thinks just."

The following were the principal averments of the liquidators:—

"(1) [After narrating the constitution of the company, its insolvency, and the progress of the liquidation]—The creditors of the bank have not yet been paid the full amount of the debts due to them, in consequence of the liquidators not having yet realised sufficient funds for the purpose.

"(4) By the contract of copartnery of the bank it was provided (art. 12) that 'At every annual general meeting the ordinary directors shall exhibit a statement or abstract of the preceding yearly balance-sheet, and such farther statement or report of the affairs of the company as the ordinary directors may deem expedient or proper for the interests of the company to be made public, as is provided for in article 44 hereof; and the annual dividend of profits shall be then declared; and every such abstract shall be binding and conclusive on all the partners, but without prejudice to the provision hereinafter contained as to the appointment of auditors.'

"(5) The said contract contained the following provisions (art. 44) regarding the books of the company:—'There shall be regular books kept for the business of the company, and the various departments thereof, and all the transactions, affairs, and obligations of the company shall be duly inserted in such books; which books shall be balanced on the first Wednesday of June in each year, at which period statements or abstracts of the company's affairs shall be made out and regularly examined, docqueted, and subscribed by the said ordinary directors previous to the foresaid annual general meeting to be held in Glasgow on the first Wednesday of July thereafter, and at the said meeting the said statements or abstracts shall be reported for the satisfaction of all concerned; and as it is of great importance in conducting the affairs of a bank that the business and transactions of the bank should be kept private, on which account all directors and other persons connected with other banking establishments are disqualified from being directors of this company, and as the same reason applies to the examination of the books or documents of this company by other partners than the ordinary directors, it is hereby declared that the partners other than the said ordinary directors shall on no account or pretence have right to examine the books and documents of the company, but shall be bound to rest satisfied with the statements and abstracts above provided for.'

"(6) The said contract contained the following provisions (art. 45) regarding dividends and reserved fund:—'Whereas it is of importance to the permanent welfare and prosperity of any banking establishment, and may tend greatly to raise the value of the stock of this company, that the profits made for a considerable time after commencing the business should not be divided, but should be allowed to accumulate as a reserved or sinking fund to meet future contingencies, and to secure a more permanent and large division of profits in future years than could otherwise safely be made, it is hereby agreed that no dividend of the company shall be made for or during the first year of the company unless the ordinary directors shall in their discretion deem it expedient, but such profits, or such part thereof, as may not be appropriated by the said directors for a dividend shall be retained and form part of a fund to be called "the Reserved Fund," and in each succeeding year during the continuance of this company the nett profits which shall arise and accrue to the company shall (after setting apart such proportion of the said nett profits as the ordinary directors shall think requisite for forming and maintaining the said surplus fund) be divided amongst the partners in proportion to their respective shares and the surplus fund for the time being shall be carried to a separate account in the books of the company; and the said fund is hereby declared to be also a reserved fund of capital to meet any emergencies, losses, or extraordinary demands upon the company, and also to prevent as far as may be a fluctuation in the amount of dividends of succeeding years: Declaring that the said surplus fund may be applied for the several purposes aforesaid by the ordinary directors in their discretion; and it shall be lawful for the ordinary directors besides, and in addition to the dividends annually payable to the partners from time to time, to take not exceeding one-third part of the surplus fund and to apply the same in the way of bonus amongst the partners in proportion to the number of their shares; and the said reserved surplus fund shall on the dissolution of the company belong to and be divided amongst the partners then entitled to the capital stock, in the same proportions as they shall be entitled to such capital.'

"(7) Mr William Mackinnon, merchant in Glasgow, now of Balinakill, Argyleshire (hereinafter called the respondent), was a shareholder of the bank from the year 1857 till 1874. He was appointed an ordinary director on 5th July 1858, and acted as such thereafter till his resignation on 28th July 1870. During that period, and for a considerable time before he became a director (having been a member of an investigation committee as after mentioned), he was intimately acquainted with the affairs of the bank, and took a prominent part in its administration.

"(8) It was the duty of the respondent, as one of the directors of the bank, to take care that not more than the nett profits arising and accruing to the company should be divided each year among the partners, and that dividends should only be paid out of the nett profits of the company, or out of the reserved or surplus fund accumulated from profits. The respondent during the period that he was a director of the bank failed in the said duty, and in violation of the bank's contract authorised or permitted the division among the partners of funds which were not nett profits which had arisen and accrued to the company, and were no part of the reserved or surplus fund, but formed part of the capital stock of the company. (9) In particular, the respondent and the other directors of the bank, at the annual balances in June, in the years 1858 to 1870 inclusive, placed to the debit of certain accounts of advances to or for behoof of certain American railway companies interest at rates varying from 5 per cent. to 10 per cent., and they carried these sums of interest to the credit of the annual profit and loss account. The interest so charged, and appearing at the credit of the profit and loss account, was treated by the respondent and the other directors during these years as profit which had arisen and accrued to the bank, and they declared and paid away the same among the partners as part of the dividends of the company. The respondent and the other directors well knew that the interest so charged was not profit which had arisen and accrued to the bank, and that, on the contrary, the interest or return received on account of the American railway advances was of trifling amount. During the twelve years that the respondent was director (1858–1870) the amount of interest charged to the said railway account was £315,897, 7s. 8d., whereas the amount actually received was £4230, 10s. 11d., leaving a balance of £311,666, 16s. 9d., which sums were from time to time entered in the profit and loss account as 'interest received,' and in the reports and balance-sheets published by the directors as profit which had arisen and accrued to the bank, and were paid away as such, although the profit had not arisen and accrued to the company, and the dividends of these years were to that extent paid out of capital.

"(10) The advances referred to in the preceding article by the City of Glasgow Bank on account of the said American railway com-

panies began to be made by the directors in April 1856 (before the defender became a director), and continued to be made from time to time till 1870, when the respondent ceased to be a director. For the purposes of this application it is only necessary shortly to explain the nature of these advances.

"(11) The Racine and Mississippi Railroad Company (hereafter called the Racine Company) was formed in 1852 to construct a railway from Racine City on Lake Michigan westwards to Savanna on the Mississippi, a distance of 138 miles. By the autumn of 1855, 68 miles of the line had been constructed, reaching Beloit. In order to complete the remaining 70 miles to Freeport, the company on 1st September 1855 issued mortgage bonds for 680,000 dollars over the part of the line already made. These bonds were for 1000 dollars each, bearing 8 per cent. interest, and having a currency of about 30 years; a sinking fund of 1½ per cent. was to be annually set aside to reduce principal, and the bonds were convertible into ordinary stock. (12) In the spring of 1856 Mr William Gemmell, a partner of the firm of Thomas Gemmell & Company, wire-rope manufacturers and merchants, Glasgow, contracted with the Racine Company for the acquisition of 370 of these bonds. The rate appears to have been 80 per cent., in the expectation that they could be disposed of at a higher figure. On 26th March 1856 Gemmell had a meeting with Mr Robert Salmond, then manager of the City of Glasgow Bank, regarding the Racine bonds, and on 27th March 1856 wrote to him inquiring whether the bank would be willing to hold the bonds intended for sale in this country, pay the coupons when supplied with funds, and grant temporary advances, if required, to the Racine Company on the security of the bonds. The bank was offered 8 per cent. interest for advances, and a commission for other duties. On 28th March 1856 Mr John Low, then secretary of the bank (now deceased), wrote to Gemmell that the bank would take charge of the bonds and pay coupons when put in funds, but declining to give advances, at the same time hinting that when the undertaking was better known the matter might be again brought up. (13) Notwithstanding this refusal, credit accounts began immediately to be authorised and advances to be made by the bank at the request of Gemmell on the security in whole or in part of Racine bonds and stock. These advances were made to Gemmell and to the Racine Company, or to others on their behalf, and continued from 15th April 1856 till the temporary stoppage of the bank in November 1857. The total amount of credits to or on account of these parties authorised by the bank during that period was £139,450, and the total amount of cash advanced and bills current, for which the bank was liable in November 1857, was £117,608. Against this sum the bank held Racine bonds of the nominal value (*i.e.*, at par) of about £141,540, and other American securities and stocks of the nominal value of about £19,367. The real value of these securities was greatly less, and did not exceed one-half.

"(14) The City of Glasgow Bank on 11th November 1857 found it necessary to suspend business owing to its embarrassments, and did not resume business till 31st December 1857. Immediately on the stoppage of the bank in November 1857, a private meeting of shareholders was held, at which a committee of shareholders was appointed, of which the respondent was one, to act with the directors. On 1st December 1857 a general meeting of shareholders was held, when it was resolved to authorise the directors and said acting committee to appoint an investigation committee, to consist of two shareholders, two accountants, and three merchants not connected with the bank. The respondent was one of the shareholders placed on the investigation committee by the directors and acting committee. The respondent acted on both these committees, and with the directors made an investigation into the affairs of the bank, upon which a report was made to an adjourned meeting of shareholders on 8th December 1857. The respondent then or subsequently became fully informed of the nature and extent of the credit accounts and advances mentioned in the preceding articles. (15) At a meeting of the directors and investigation committee held on 29th December 1857, at which the respondent was present, a set of rules and regulations for the conduct of the bank was adopted, and directed to be inserted in the minute-book, which was done. The 5th rule provided that no discounts or advances should be made without the sanction of at least two directors, and then not to exceed £50,000. The 8th rule provided that no additional advances should be made to any customer except under sanction of at least two directors, and then only within the said limit. The 13th rule provided that 'in order for the future to prevent the inconvenience arising from the bank's funds being locked up, permanent loans, and loans upon securities not easily or immediately convertible, shall be discouraged and discontinued and wherever such loans have been made they shall be gradually called up as being in their nature opposed to sound banking principles.' It was provided by rule 19th that until next annual meeting (July 1858) six shareholders, of whom the respondent was one, should 'act in concert and be deemed to be a part of the board of directors;' and by the 20th rule that the shareholders acting on the committee should be 'subject to the same penalties and regulations as the directors.' At the annual meeting of the shareholders held on 5th July 1858 the respondent was appointed a director of the bank, and acted as such from that time till his resignation in July 1870.

"(16) In February 1858 the Racine Company was in embarrassed circumstances, and unable to pay the interests on its bonds. The second part of the line was formed to the extent of only one-fourth. The company had meantime made an issue of 700,000 dollars of bonds over that part, and had contracted with a Mr George A. Thomson, stockbroker, London, afterwards of New York, to place the said bonds, which he had failed to do. The bank, on the security of 163 of these bonds of 1000 dollars each, and a promissory note for £20,700 by the president of the company (Durand), had discounted drafts of Thomson upon Watson & Company, of Glasgow, to the extent of £20,000. Thomson and Watson & Company were quite unable to pay, and the Racine Company had no prospect of meeting their president's promissory note by the time it fell due on 29th April 1858. The promis-

sory note was accordingly dishonoured, and a month later an arrangement was made under which it was handed back to the company in exchange for 194 more bonds of 1000 dollars each over the second part of the line, and means were taken to help forward the completion of that part to Freeport. (17) In autumn 1858 Thomson and Watson & Company, who were liable with the Racine Company for a large part of the advances made by the bank, but were quite unable to meet their share of liability, relinquished in favour of the bank all interest in the Racine bonds held in security, and obtained discharges from the bank. In autumn 1859 a similar settlement was made with Gemmell, who renounced in favour of the bank (with certain exceptions) all the Racine bonds and other securities held by the bank, and in which he was interested in connection with the advances before mentioned; the bank thus became the sole parties in right of the said Racine bonds and other securities, and entitled to foreclose or realise them in consequence of the Racine Company's failure to repay the advances. (18) On 10th May 1859 the Racine Company, in consequence of its inability to pay interest on the bonds for which a suit for foreclosure on the eastern division of the line was pending, and in order to enable the bondholders to provide for the extension of the road to Freeport, and to manage the line till their bonds, with interest, should be paid, surrendered the whole line to the Farmers' Loan and Trust Company as trustees for the bondholders. The line was to be redeemable within five years after its opening to Freeport. Thereupon the Trust Company, at the request of the bank, through their agents Messrs Richard Irvin & Company, of New York, appointed the said Mr George A. Thomson and two others to manage the road for the benefit of the bondholders, of whom the bank were the principal. The bank held at this time bonds over the east or finished part of the line to the extent of 361,000 dollars, and over the west part to the extent of 194,000—in all 555,000 dollars.

"(19) In addition to the advances previously made, the bank directors, from the beginning of the year 1859, from time to time authorised large advances to be made to the said George A. Thomson and to the Racine Company, and purchased additional bonds of the company, none of which were yielding interest. They also subscribed largely to the stock of, and made advances to the Northern Illinois Railway Company, whose line was a continuation of the Racine Company's. They further authorised advances to be made on credit accounts opened in the name of other parties for the purpose of aiding the said undertakings. The said accounts were closed with large debit balances before the respondent ceased to be a director, and the balances were carried to the debit of the railway account. Of these separate accounts, one called the iron rail credit account No. 26/7, in name of 'William Mackinnon & Company' (the respondent's firm), 'and James N. Fleming,' was on 1st June 1870 carried to the railway debenture account with a debit balance of £11,821, 15s. 4d. Another iron rail credit account No. 27/4, in name of 'Wm. Mackinnon & Company' (the respondent's firm), 'J. N. Fleming, and Smith Fleming & Company,' was on the same date carried to the railway debenture account with a debit balance of £26,806, 1s. 8d. Another credit account in connection with speculations in grain, in name of the said G. A. Thomson, called grain credit account No. 2, was on the same date carried to the railway debenture account with a debit balance of £12,382, 5s. 3d. The other separate credit accounts were opened in the individual names of the directors of the bank (including the respondent) and others, who formed a combination for the purpose of purchasing bonds of the Racine Company. The debit balances on these accounts were on 1st June 1870 and prior dates carried to the debit of the railway debenture account, amounting in all to upwards of £40,000. (20) In 1866 George A. Thomson entered into a scheme for the formation of a company to construct an elevator and warehouse at Racine, to be worked in connection with the grain carried on the line to that terminus. In 1867 he came to this country and applied to the bank for 200,000 dollars to defray the expense connected with the scheme; and on 18th July 1867 the bank directors resolved to authorise Irvin & Company, their American agents, 'to take up stock in the Elevator Company' (now called the Racine Warehouse and Dock Company), 'to the extent of 200,000 dollars, and to place it in the name of Messrs Mackinnon' (the respondent), 'Potter, and Fleming, or in the name of Irvin & Company in trust.' Of this 200,000, 40,000 dollars advanced to Thomson in March 1867, and 54,743 dollars advanced to him in June 1867, were reckoned as payments to account, leaving a balance of upwards of 105,000 dollars to be advanced. The money was accordingly advanced by the bank, and the stock purchased and taken in name of Irvin & Company in trust. The respondent, though not present at the said meeting, was fully aware of and approved of what was done, and throughout took a prominent part in the negotiations with Thomson. The amount of stock purchased was 300,000 dollars, which was held by the bank at the time of its stoppage in 1878.

"(21) In 1867 the Racine and Mississippi Railroad Company and the Northern Illinois Railroad Company were consolidated into one company, bearing the name of the Western Union Railroad Company, and in 1869 the bond and stock holders thereof, of whom the bank was the principal, sold the securities they held to Alexander Mitchell, banker, Milwaukee, State of Wisconsin, on behalf of himself and others. The offer made by Mitchell to the bond and stock holders of the Western Union Company was addressed to a committee of bond and stock holders of the company which met in London, and was agreed to by them on 28th April 1869. It was thereafter considered by the bank directors on 29th April 1869, and approved of by them, the respondent being present. The approval was communicated to the London committee. It was an offer to purchase the securities over the Western Union Railroad, extending from Racine to Port Byron (about 181 miles), on the conditions therein mentioned. (22) Mr C. S. Leresche, London, who afterwards became secretary of the bank, was, in May 1869, sent out by the bank directors and the London committee to settle the bargain, to adjust matters with Thomson and Irvin & Company, and to hand over the securities in the hands of the latter

in exchange for the new securities of the Western Union Company. In carrying out the arrangements the bank elected to repurchase ordinary stock of the company, and the full amount, 1,999,000 dollars stock, was purchased at the sum of 325,000 dollars, the rate fixed in the contract. . . . . .

"(25) On 18th of July 1870, shortly after these transactions were settled with the various parties interested, the respondent resigned his office of director of the bank, and it was accepted by the board on 28th July 1870. At that time the balances at the debit of the two accounts in the bank books, which contain a record of these railway transactions, were as under. They include the liabilities arising out of the two iron rail credits, the grain credit, the combination account, the elevator account, and other items which were originally entered in the names of others, but which in the final settlement were carried to the debit of the railway accounts with the bank:—

" Balance at debit of 'railway debenture account,' .	£600,695 17 0
Balance at debit of 'railway stock account,' . .	304,470 16 4
	£905,166 13 4

"(26) When the sale to Mitchell and others was concluded, the bank received the following securities instead of the old securities held by them:—

" Western Union Railroad bonds,	$2,931,170
Western Union Railroad stock, .	1,992,160
Racine Warehouse and Dock stock (elevator), . .	300,000

"After deducting 5000 dollars bonds, given to the London committee, there remained 2,926,170 dollar bonds. The odd 170 dollars in bonds were, for convenience, converted into 180 dollars stock, making the accounts as follows:—

" Bonds, ...	$2,926,000
Stock, ...	1,992,340
Racine Warehouse, &c., stock, .	300,000

"These securities remained in the possession of the bank till it stopped in 1878.

"(27) During the whole period that the respondent was a director (July 1858 to July 1870) the said railway accounts were practically unproductive. The companies were quite unable to pay dividends on their stock, and in rare instances was there even a partial payment of interest on the bonds held by the bank.

"(28) Notwithstanding this, as above stated, interest at rates varying from 5 per cent. to 10 per cent. was added to the amount of the debt in the books of the bank at the yearly balances in June, and carried to the credit of the profit and loss account. The following is an abstract shewing that the amount of interest so charged to the railway accounts between the years 1858 and 1870 is £315,897, 7s. 8d., while the amount of interest actually received during the same period is £4230, 10s. 11d.

For year ending	Interest Received.	Interest Charged.
June 1858	..	£ 1,705 12 1
Do. 1859	..	7,552 7 5
Do. 1860	..	7,536 3 10
	Carried forward	£16,794 3 4
	Brought forward	£16,794 3 4
June 1861	£ 40 17 3	15,282 1 4
Do. 1862	18 0 0	16,046 0 6
Do. 1863	148 5 6	20,516 1 7
Do. 1864	3,023 8 2	26,720 6 5
Do. 1865	..	31,017 14 2
Do. 1866	..	33,965 17 5
Do. 1867	1,000 0 0	37,318 4 5
Do. 1868	..	36,468 13 5
Do. 1869	..	33,657 17 0
Do. 1870	..	48,110 8 1
	£4,230 10 11	£315,897 7 8
Deduct interest received, .		4,230 10 11
Excess of interest charged over interest received, .		£311,666 16 9

"The practical result of this was to make it appear from the published balance sheets of the bank that during these years profits had arisen and accrued to the bank to the extent of £311,666, 16s. 9d. beyond what had actually arisen and accrued.

"(29) The respondent, throughout the whole time he was director, was well aware of the nature of the transactions with the said railway companies, and of the amounts advanced and expended as above set forth, and he took a leading part in the management. He knew that little or no return was being derived from the said advances, and that interest was notwithstanding annually charged and carried to profit and loss account, and that dividends were declared and paid upon the footing that the said interest represented profits which had actually arisen and accrued.

"(30) It was the respondent's duty, as one of the directors (in terms of article 44 of the contract), to have statements or abstracts of the bank's affairs made out at the annual balance in June, and regularly examined, docqueted, and subscribed by himself and the other directers, and thereafter reported to the annual meeting of shareholders. The said statements or abstracts were prepared, and were afterwards examined and docqueted by the directors at their meetings. The respondent approved of the balance-sheets and statements, and he signed those of 1859, 1860, and 1861; and they included, among other misstatements, as part of the profits received or earned, the interest charged on the said railway accounts as aforesaid. The annual reports were prepared from the said statements or abstracts, and recommended the declaration and payment of dividends from the profits so represented as received or earned. The dividends were accordingly paid in conformity with said recommendation, and the total amount of the payments made out of capital on this account alone exceeded £311,666, 16s. 9d. The shareholders had no means of knowing, and did not know, that any part of the profits so represented as received or earned was not so, and they approved of the reports in the belief that the profits were truly received or earned. The dividends so declared and paid during the said years were (so far as they bore to be made up of the interest before mentioned) paid out of the capital stock of the company. The liquidators reserve all action

competent against the respondent in respect of other misapplications of the bank's funds and misstatements of its books and accounts.

"(32) The respondent has, in the circumstances above set forth, misapplied and become liable or accountable for moneys of the bank to the extent of the said sum of £311,666, 16s. 9d., and has been guilty of misfeasance or breach of trust in relation to the bank. The liquidators therefore submit that he should be compelled to repay the said sum, with periodical interest at 5 per cent. per annum. The respondent is liable for the said sum, or for certain parts thereof, jointly and severally along with others who were directors for the whole or part of the period from 1858 to 1870; and all action competent against these co-obligants is hereby reserved."

The liquidators therefore prayed the Court "to decern and ordain the said William Mackinnon to make payment to the said George Auldjo Jamieson, John Cameron, and James Haldane, as liquidators foresaid, of the sum of Three hundred and eleven thousand six hundred and sixty-six pounds sixteen shillings and ninepence sterling, or such other sum as shall be ascertained to be the amount of the interest debited to the accounts in the books of the said City of Glasgow Bank, titled railway debenture account and railway stock account, and paid away as dividend, in accordance with the reports of the directors of the bank adopted at the annual meeting of the shareholders held in the month of June in the years 1858 to 1870, both inclusive, with periodical interest at the rate of five per cent. per annum from the respective dates of payment of the said dividends till payment; or otherwise to decern and ordain the said William Mackinnon to contribute such sums of money to the assets of the bank, by way of compensation in respect of the misapplication, misfeasance, or breach of trust libelled, as the Court may think just."

The respondent lodged answers, in which he submitted that the note ought to be refused as incompetent and irrelevant, and unfounded in fact and law; and he entered into a full explanation of his position both as regards the facts and the law. The following were his most important statements:—"The respondent desires to inform the Court that the liquidators on 30th June 1880 raised an ordinary action in the Court of Session, in which they claim from the respondent payment of a sum of £122,565, 2s. 8d., being the alleged loss sustained by the City of Glasgow Bank in connection with the American railway securities, which also form the subject of the present note. The statements of fact made in that action are to a large extent identical with, though more complete than, those made in the present note, and the claim there made against the respondent is based, as in the present note, on the allegation that he failed to perform his duty as a director with reference to the said securities. The respondent is advised that the effect of a decision against him in said action would be to satisfy in whole or in part the claim made in the present note, and that a decision in his favour in said action might affect the question of his liability to said claim. The respondent submits to the Court that, apart from the answer to be immediately stated, this note is an unfair and oppressive proceeding, and that the liquidators ought to have included in the said action their whole claims against the respondent, and particularly those in connection with the said American railway securities.

"The respondent further submits that the present note is not a competent application under the 165th section of the Companies Act 1862. It is incompetent in respect—(1) It involves a serious question between the parties, which is the subject of a depending ordinary action; (2) it does not allege any misapplication, retainer, misfeasance, or breach of trust, nor does it crave a decree for repayment or contribution within the meaning of section 165; (3) it alleges a wrongful payment of dividend by all the directors of the bank, some of whom are dead, but it is directed against the respondent alone.

"The respondent further says, that assuming its competency under section 165, the liquidators are not entitled to make this application. The liquidators represent the general body of shareholders, whose estate they are appointed to recover for behoof of creditors, yet here they seek repayment of money which has been paid to the shareholders, and for which therefore the shareholders have no claim against the respondent. Further, the liquidators are not entitled to recover the dividends paid on those shares, amounting to £750,965, which have during the liquidation been surrendered to the liquidators, and the surrenderors of which the liquidators represent individually; and as regards the dividends declared on the large amount of stock held by the bank, or in trust for the bank, amounting to £160,313, the claim made is unintelligible. Further, the liquidators do not say that the unrealised assets in their hands are insufficient for the payment of creditors in full. They merely say that they have not yet realised assets sufficient for that purpose. The fact is, that the creditors of the bank have already been paid in full, and there is no deficiency but a surplus of assets, and the sums claimed in the present note are therefore not required for that purpose. Or, if the creditors have not yet been paid in full, that is because the liquidators have not yet realised the whole assets, or have failed properly to realise some portion of the assets. Whatever therefore the rights of the liquidators in other circumstances might have been, the present application is made, not in the interests of creditors who are paid or provided for, or for the purpose of recovering the expenses of liquidation, but in the interest of a small section of shareholders who still retain their shares, or who have acquired shares during the liquidation for purposes of speculation, and who, if they did not receive payment of the dividends in question, represent the shareholders who did. According to the report of the liquidators to the contributories for the year ending 22d October 1880, issued 15th December 1880, after making provision for all claims, and also laying aside £100,000 to meet prospective income deficiencies, there is in the hands of the liquidators a surplus of assets over liabilities amounting to £286,677. From the same report it appears that the shares held by solvent contributories, and not surrendered to the liquidators, amount to £88,722.

"The respondent further says, that assuming the competency of the application under section 165, and the title of the liquidators to make it, it is brought too late. It is now more than ten years since the respondent ceased to be a director of

the bank. The latest of the transactions complained of occurred before July 1870 (when the respondent ceased to be a director), and the earliest more than twenty-two years ago. This delay has seriously prejudiced the respondent's defence. The responsible manager of the bank during nearly the whole period of the respondent's directorship was Mr Alexander Stronach, who is now dead. Owing to lapse of time numerous documents and vouchers relating to the present question have been lost or destroyed. The delay has also prejudiced the right of relief which, in the event of his being held liable, the respondent would have, and would seek to enforce, against the shareholders who received the dividends alleged to have been improperly paid, most of whom are dead or insolvent, and others of whom it would be impossible to trace.

"The respondent further says that the necessary parties have not been called to this application. The liability sought to be enforced against the respondent is based on a series of acts jointly done by the board of directors, and the respondent not only disputes his several liability for such acts, but denies that he joined in certain of these acts. The other directors or their representatives ought therefore to be made parties to this application.

"The respondent further says that this note is irrelevant. The note contains no relevant averment of breach of duty as director by the respondent. What is stated is that the respondent treated as profit sums of interest earned which had not at the time been received in cash. In the case of advances or investments temporarily unproductive, or where the interest earned was not from year to year received in cash, the directors or the manager of the bank were, it is submitted, entitled to debit such accounts with the current rate of interest, or the rate agreed upon, or an ordinary and reasonable amount of interest —the directors believing that sufficient security was held for payment of the account. Debiting interest in this way is according to the custom of bankers, and the provisions of the contract of copartnery founded on which refer to the payment of dividend out of nett profits earned and fairly stated according to the usual practice of bankers, or out of the reserve fund. It is not said that the respondent acted in bad faith or from a corrupt regard to his own interest.

"The note is also irrelevant in respect it seeks to make the respondent severally liable under section 165 for dividends paid by the board of directors. The 27th article of the contract of copartnership provides that—'The said ordinary directors shall not be liable for omissions, nor shall they be liable for the responsibility of persons dealing with the company, nor for the sufficiency of the securities in which the funds of the company may be invested; nor shall the directors be liable for the acts and intromissions of the manager or other officers of the company, or of any other persons entrusted with the business or funds of the company, nor shall they be liable *in solidum*, nor for the actings, intromissions, or negligence of each other, but each of them for his own actings and intromissions allenarly: Declaring that from and after the 1st of March 1839 there shall be set apart as an allowance to the six ordinary directors for their trouble and services (exclusive of the manager) the sum of £6 weekly, to be distributed among them in such a manner as they shall from time to time appoint, by a minute entered in their sederunt-book; and further declaring that it shall be competent for the partners at any annual general meeting to increase the said allowance to the ordinary directors.'

"The note is further irrelevant in respect that while it discloses the existence of a reserve fund into which a portion of the profits of each year was or behoved to be carried, it takes no account of the sums carried to the said reserve fund during the period of the respondent's directorship. It does not allege that the whole profits were divided among the shareholders, but yet it nowhere states or indicates to what extent the said profits were divided or to what extent they were reserved."

The respondent then denied that he had misapplied or become liable or accountable for the moneys of the bank mentioned in the note, or that he had been guilty of any misfeasance or breach of duty in relation to the bank, or that he had authorised the division among the shareholders of sums forming part of the capital of the bank.

He explained further that "When the respondent left the board in 1870 the railway securities held by the bank formed a sufficient cover for the advances made up to that date, both principal and interest. More particularly, the securities specifically received on account of interest formed a sufficient cover for the interest debited as at that date. These securities have since been exchanged away and realised by the liquidators, but no credit is given in this note for any portion of the amount realised. If loss has been sustained on the particular securities in question it is entirely due to the hasty and negligent realisation effected by the liquidators. In any view, the liquidators having adopted and exchanged away the securities in question without notice to the respondent, are not entitled to charge him with any loss arising on the ultimate realisation of those said securities."

Counsel were first heard on the respondent's preliminary pleas.

Argued for the liquidators — This was an application under the 165th section of the Companies Act 1862, to have Mr Mackinnon ordained to replace certain funds belonging to the City of Glasgow Bank which had been misapplied by him in breach of his duty as a director. The funds in question were certain sums of interest which were debited to an account for advances to certain American railways. These sums amounted in all to £315,897, but the liquidators alleged that, with the exception of £4230, these sums were never earned, the accounts being unproductive, and that in so debiting these sums to the accounts and dividing them as dividend among the shareholders, the directors were in fact paying away the capital of the bank; and the liquidators said further that Mr Mackinnon as a director knew that the accounts were unproductive, and that the dividends were paid, and consequently that he was liable to replace the money thus misapplied by him. The motion which the liquidators now made was for a proof; but the respondent argued as preliminary objections that the application was incompetent, that it was irrelevant, that the liquidators had no title to make it, besides the minor objections.

It was necessary to distinguish the present application from the action which was in dependence in the Outer House. They both related to the same advances, but in the Outer House action the liquidators contended that these advances were illegitimate, and should never have been made, and that in consequence £122,565 was lost to the bank; and they asked that Mr Mackinnon should be ordained to repay that sum. In this application, on the other hand, no question was raised as to the legitimacy of the advances; all that was said was that on these advances no interest had been earned, and yet that nevertheless interest had been paid to the bank shareholders as part of their dividend. Coming to the respondent's objections, it was not easy to separate the question of competency from that of relevancy. They seemed to be two names for the same question, which was this, whether the liquidators had a case under the 165th section? That question was fully considered in the *Merchantile Trading Company—Stringer's* case—April 26, 1869, L.R. 4 Chan. App. 475, where an application like the present was held to be competent; so also in the *County Marine Insurance Company—Rance's* case—December 15, 1870, L.R. 6 Chan. App. 104. These cases only went the length of showing that the 165th section was applicable to the case of a managing director who had himself received a portion of a delusive dividend, to the effect of making him refund his share of the delusive dividend. The case of the *National Funds Insurance Company*, November 30, 1878, L.R. 10 Chan. Div. 118, went further, and directors were held liable to refund not only the dividends they themselves had received, but those they had paid to others illegally out of capital. That was no doubt a limited company. So in another case—*Evans* v. *Coventry*, April 15, 1856, 25 L.J. Chan. 489, *aff.* March 27, 1857, 26 L.J. Chan. 400—that was also practically a creditor's question. The cases were commented on in Lindley on Partnership, 4th ed. ii. 1334, also 595. Then there were the cases of *Joint Stock Discount Company* v. *Brown*, July 5, 1867, L.R. 8 Eq. 381; the *Land Credit Company* v. *Lord Fermoy*, March 24, 1869, L.R. 8 Eq. 7, and July 21, 1870, 5 Chan. 763, and the *British Guardian Life Assurance Company*, March 15, 1880, L.R. 14 Chan. Div. 335. [Lord Shand—Have you any case in which a single party is called and a point of that kind taken? In the cases you have mentioned all the directors were said to have been liable.] No. Not under the 165th section. But there were instances of actions—*Western Bank* v. *Baird*, March 20, 1862. 24 D. 859. [The Lord President referred to *Tulloch* v. *Davidson*, February 23. 1860, 3 Macq. 783, and the *Earl of Kinnoul* v. *Presbytery of Auchterarder*, February 27, 1838, 16 S. 661, and March 10, 1843, 5 D. 1010.] It was said that this was not a creditor's question, as the bank was not a limited company and the creditors would in the end be paid in full. Now, there was still an outstanding debt of upwards of £1,800,000; but it must be conceded that ultimately that would be fully paid with interest. The liquidators, however, at present represented formally both creditors and shareholders, and the interest of the creditors to insist in this application was this—that they were not bound to wait. They were entitled to payment at once if it could be got. Now, Mr Mackinnon had misapplied these sums, for that must be assumed at the present stage, and there was therefore a fund for instant payment which ought to be made available to the creditors, reserving to Mr Mackinnon whatever right of relief he might be entitled to. Even as representing shareholders, however, the liquidators had a title. The shareholders ultimately liable for this deficit were the shareholders of 1878, when the bank stopped. Some of these were shareholders during the period of Mr Mackinnon's directorate, others were not. But Mr Mackinnon said—"You or your authors have received these dividends alleged to have been illegally paid, and therefore I, the person who have committed this breach of trust, am not liable to repay as in a question with you." Surely the shareholders, who under the articles of the company could not investigate for themselves, were entitled to answer—"We received this money *bona fide*, believing it to be proper interest, not capital, and have spent it. You, who knew the contrary, must, if you have the means, indemnify us from the consequences of your breach of trust. At all events, you must *ante omnia* restore things as as far possible to the position they would have been in but for your breach of trust, reserving your rights if you have any"—*Bates* v. *Hooper*, July 18, 1855, 5 De Gex. Mac. and Gord. 338. If things were restored to that position they could then consider whether any distinction was to be drawn between the various classes of shareholders—between those still on the register who were so in 1870 when Mr Mackinnon retired, and those who had come on since 1870. It might be that the former class were not entitled to repayment from Mr Mackinnon, but shareholders becoming so after 1870 were entitled to stand on their contract which involved this among other things, that the capital was wholly extant—*Waterhouse* v. *Jamieson*, March 13, 1868, 6 Macph. 591, *rev.* May 24, 1870, 8 Macph. (H. of L.) 88. [Lord Shand—The argument against you on this point will be that although you did not get this money, your predecessor, the holder of the shares, did.] The clause of the contract of copartnery regulating the sale and transfer of shares was the 33d, which provided that every person acquiring shares, whether by inheritance or purchase, "shall take and assume the place and liability of his author, ancestor, or other cedent, and become subject to all the obligations incumbent on him." But that referred solely to questions between the outgoing and incoming shareholders and the company; it did not touch the relative rights of an incoming shareholder and a director who had improperly paid away capital. [Lord President—I want to know whether the great variety of positions in which different shareholders may be placed does not suggest that this claim can only be enforced by each individual shareholder for his own interest in separate actions of damages. There is a good deal of light to be had upon that subject in the series of cases regarding the Aberdeen Bank and the Western Bank.] *Davidson* v. *Tulloch*, June 3, 1858, 20 D. 1045, *aff.* February 23, 1860, 22 D. (H. of L.) 7; and *Gordon* v. *Davidson*, February 26, 1864, 2 Macph. 758, were actions of damages by an individual shareholder against an individual director for mis-

representation, inducing the pursuer to become a shareholder. But in the *Western Bank* v. *Baird*, January and March 1860, 22 D. 447, the liquidator sued an action against an individual director for losses caused through his breach of duty as a director. The present case was not of the nature of an action of damages at all. It was a summary demand upon a director to replace money which he had misapplied. Besides the present proceedings, there might quite well be actions of damages by individual shareholders against Mr Mackinnon. The shareholders' loss was by no means exhausted by success in the present application. In regard to the action against Mr Mackinnon, that was for money illegally invested and lost, with interest at five per cent. on what was lost. If Mr Mackinnon paid the whole sum sued for in the action, the interest so paid would be applicable *pro tanto* to diminish the amount asked for here. On the whole matter the liquidators were entitled to a proof.

ROBERTSON for the respondent—The following were the preliminary questions—(1) the substance and nature of the case against Mr Mackinnon (*a*) as not being within the 165th section of the Act, and (*b*) as being irrelevant irrespective of the form of application; (2) whether the liquidators had a title either as representing shareholders or as representing creditors? (3) whether the present demand could be enforced against a single director in the absence of his fellow directors? (4) whether the remedy now sought was not barred by lapse of time and change of circumstances? (5) whether the substance of the present demand was not made in the other action? (6) whether having dealt with the principal of those advances without notice to Mr Mackinnon, and in such a way as to deprive them of their remedy against him as regards the principal by exchanging original properties for other and distinct subjects, the liquidators were not also barred from insisting in their claim for interest? Now, in the note there was not one word to suggest that these advances were not legitimate investments — merely that they were unproductive. That was to say, they did not produce interest which could as such be entered in the bank's books, although the bank received an equivalent in the form of bonds or stock of the railways. Were not the directors, therefore, in such circumstances within their duty and the exercise of their discretion when they debited the account with interest, and—for that seemed to follow—appropriated the amount so debited to dividend? If they believed the advances in question to be bad debts, which was not contended here, their duty was to write them off the bank's books. If they did not write them off, they had no alternative but to debit them with overdraft interest; *Stringer's* case, *supra*, was an authority. [LORD SHAND—There must have been inquiry there. Here you are stopping inquiry.] But the liquidators did not allege more than was proved and held insufficient in *Stringer's* case; therefore why inquire here? In that case the directors actually borrowed money to pay the dividend, yet they were held free. *Rance's* case, *supra*, was also an authority. [LORD SHAND—What do you say would have made the case relevant in the way you are taking it?] To have said that the investment was an illegitimate investment, and that not only had no interest been earned, but that notoriously and in point of fact none could have been earned. The respondent's construction of section 165 was much more limited than that attempted by the liquidators. Its primary and ordinary application was to the case of directors who had misapplied money to their own personal benefit. Taking the question of *mora* next, Mr Mackinnon ceased to be a director in 1870, and the liquidators had been three years in office; they were therefore on that ground barred from insisting in this claim—*Mammoth Copperopolis of Utah, Limited*, Nov. 18, 1880, Law Times, 754. The next point was this—that the present company was one of unlimited liability, whereas in all the English cases cited the companies were limited, with the exception of *Evans* v. *Coventry*, which was only an apparent exception, as the plaintiff had a right under his contract to interfere to prevent encroachment on capital. The distinction was clear—in an unlimited company creditors contracted on the faith of the partners; in the case of a limited company they contracted on the faith of the capital—*Grissell's* case, August 10, 1866, Law Rep. 1 Chanc. App. 528; Companies Act 1862, sec. 183, subsec. 3. Creditors had no interest therefore, it being admitted that the shareholders here were able to pay the debts of the company in full. Further, the rights of creditors were no higher than those of the company and its shareholders. The interest of creditors did not entitle a liquidator to over-ride positive contracts *inter socios* that the capital had been fully paid up when in fact it had not — *Waterhouse* v. *Jamieson*, *supra*. In *Tennant's* case in this liquidation, Jan. 22, 1879, 6 R. 554, all that was laid down was that the rights of the company were to be determined as at the date of the liquidation. The present question consequently was a shareholders' one only. Now, there were various classes of shareholders. There were first the shares held by the bank itself before the liquidation, and the shares surrendered to the bank in course of the liquidation was payment of a portion of the money here asked for to be paid in respect of such shares. Then there were the shareholders who were such during Mr Mackinnon's period of office, and still were so. Were they to receive payment of what they had already got as dividend? Lastly, there were the shareholders who had become so after Mr Mackinnon's retirement. Such shareholders could not claim repayment of dividends which had been received by their authors—*Hunter* v. *Carron Company*, June 25, 1868, 6 Macph. (H. of L.) 106; *Turquand* v. *Marshall*, April 18, 1868, L.R., 6 Equity 112, and Feb. 11, 1869, 4 Chanc. App. 376; *Mayhew's* case, May 27, 1854, De Gex, Macn. and Gord. 837. The case of all the shareholders therefore was within the rule *frustra petis quod mox restiturus es*. Assuming, however, that the money was repaid to the liquidators, they would have to determine to which of the shareholders, and in what proportions, it would have to be distributed, which made it practically a question which each shareholder should raise and settle for himself. It was said, further, that Mr Mackinnon was simply in the position of a trustee who by breach of trust had paid to a beneficiary money which ought to have gone to some one else interested in the trust, and it was contended that the trustee who had done that could not demand that the

beneficiary should repay what he had received in over payment. But that was not necessarily the case—*Hood* v. *Clapham*, Nov. 20, 1854, 19 Beav. 90. There was next the question of all parties not called. Where there was delict or *quasi* delict, there was joint and several liability; but where the action was founded on contract, all those who collectively were guilty of the breach of contract must be made parties—*Western Bank* v. *Baird*, January and March 1860, 22 D. 447, Lord Justice-Clerk (Inglis), p. 476. Here the application was based on breach of contract, not on delict. The remainder of the argument related to the competency of their application pending the action in the Outer House.

Replied for the liquidators—The 165th section was intended to be very comprehensive. Provided there was a misapplication of funds the Court might inquire into it, and it was no answer that there might be criminal responsibility as well. There was undoubtedly a misapplication of funds averred in this note. What was averred was not that the directors had paid dividend when in fact they had no cash in their coffers; that would be no misapplication; but it was that they had knowingly for a period of twelve years paid dividends out of interest which they had not received at all. *Stringer's* case was not adverse. The company there was a blockade-running company—a very risky adventure—the period impugned was one year only; the shareholders had not changed, and knew personally the nature of the investments; and the only creditor did the same, having contracted on the faith of the company's balance sheet. Nobody, therefore, had an interest. Now, had the liquidators any title to enforce this application? That involved two questions—first, had anybody such a title? and secondly, were the liquidators entitled to represent such persons. The duty of the liquidators was to collect the assets in order to distribute them among those in right of them. Creditors who but for the Companies Acts might have enforced their claims against individual shareholders were bound to wait only in so far as these Acts made that necessary. But no distinction in this matter was drawn in the statute between limited and unlimited companies. Section 183 was explained by section 196—see also sections 25 to 29. *Waterhouse* v. *Jamieson* settled that creditors had no title and interest to complain of any transaction between shareholders and directors which was not in violation of the contract of the company; but acts in violation of the contract were different. Then, as regards shareholders, the rule *assignatus utitur jure auctoris* did not apply to them. The *Carron* case really turned on the construction of a will. The transfer of a share was the transference of a right of property, as of land or of corporal moveables; and did not, like the transference of a debt, give the debtor the same defences as against the assignee as he had against the cedent. As regards the directors' right of ruling against the old class of shareholders, and the way to operate it—*Salisbury* v. *Metropolitan Railway Company* June 29, 1870, 22 Law Times, 839. Assuming, then, that some shareholders at least had an interest, had the liquidator a title to enforce that interest or must each injured person sue for himself? That the liquidator had such a title followed from the previous argument. He was on behalf of the company making a single and indivisible claim for breach of duty by which the company had been injured. Next, as regards the question of all parties not called—If this was an action upon a contract against one of several *correi debendi*, it could not be maintained against him alone, because the *correi debendi* being laid together as co-obligants by the provisions of the contract which was sought to be enforced, could not be separately sued for performance. But here the application was not founded on a violation of the contract—not upon that merely; it was founded on a breach of duty maintainable at common law, though it might be embodied in the contract of this bank—*Baird*, July 14, 1866, 4 Macph. 1070; *British Guardian Life Assurance Company*, March 15, 1880, 14 Chanc. Div. 335. Then as to the alleged acquiescence, who had acquiesced? The parties wronged, *i.e.*, the shareholders, had never done so. The succeeding directors might have done so, but their delinquency in not calling their predecessor to account could not bind the shareholders who had under the contract no access to the company's books—*Randall* v. *Errington*, Feb. 15, 1805, 10 Vesey 423; *Orr* v. *Glasgow, Airdrie, and Monkland Railway Company*, April 24, 1860, 3 Macq. 799.

Replied for the respondent—It was within the discretion of the Court to grant or refuse a remedy under the 165th section. Here the Court ought to refuse to try a question of such magnitude, not on a closed record, but by petition and answers—*Feltom's* case, Nov. 18, 1865, 1 Eq. 219; *Bank of Gibraltar*, Nov. 17, 1865, 1 Chanc. App. 69. The liquidator represented a variety of interests—the shareholders being in different positions—and it was not intended that he should by this summary method get back money, leaving the rights of individual shareholders to be settled afterwards. Each of them ought to sue his own action—*Mayhew's* case; *Mann* v. *Sinclair*, June 20, 1878, 6 R. 1078. There none of the shareholders were damnified, on the principle *assignatus utitur jure auctoris*. There were other cases on this point which had not been cited—*Ffooks* v. *South-Western Railway*, Jan. 14, 1853, 1 Sm. and Giff. 142; *Peek* v. *Gurney*, Nov. 6, 1871, L.R., 13 Eq. 79, *aff.* July 31, 1873, L.R., 6 H.L. Eng. 377. It might, however, be that shareholders coming in after 1870 had done so on the faith of the entire capital being extant. Their remedy, however, was an action of damages against those through whose representations they had been induced to become shareholders.

At the suggestion of the Court a minute was lodged, from which it appeared that there were 208 solvent shareholders of the bank at the date of the present application, with a total holding of £88,722. Of these 69 with £38,324 acquired their shares prior to Mr Mackinnon's retirement in 1870, and 139 with £59,395 acquired them after that event. Of shareholders who had surrendered to the liquidators, £337,227 stock had been acquired before, and £420,515 after 1870; and the bank held £153,536 stock itself.

The Lords made avizandum.

At advising on the 28th January 1881—

Lord President—We have given very careful attention to the extremely able argument which was presented to us upon the preliminary objections to the note presented by the liquidators.

These may be ranged, I think, under the following heads:—that the note is incompetent under the section of the statute on which it proceeds; that the liquidators have no title to prosecute the claim which this note embodies; that the requisite parties have not been called as respondents; that the claim comes too late; and that the statements made in support of it are irrelevant. Now these, or at least some of them, are *prima facie* of a clearly preliminary character, but, at the same time, we have felt that it is extremely difficult altogether to separate them from the merits of the question involved, and we do not entertain much doubt that they can be much more satisfactorily dealt with when the whole facts are before the Court. This opinion also is very much fortified by a consideration of the very serious and large interests which are involved in this litigation, and the great probability that the case may go elsewhere. If that should occur, it certainly would be far more desirable that the case was presented as a whole, and with the entire facts upon which it depends ascertained; and therefore we propose before disposing of any of these preliminary questions to allow a proof.

Lord Mure and Lord Shand concurred.

Lord Deas was absent.

The Lords allowed a proof before answer.

The respondent thereafter petitioned for leave to appeal, and argued—Where there were grave questions of law involved, separable from the merits, the Court would grant leave—*Adam* v. *Allan*, July 3, 1841, 3 D. 1147; *Skinner* v. *Dunbar*, March 9, 1849, 11 D. 1014. In the *Western Bank* v. *Douglas*, January and March 1860, 22 D. 447, the Court had no hesitation in rejecting the pursuer's dilatory pleas and on that account refused leave. Here they had not expressed an opinion at all. In *Western Bank* v. *Brand's Trustees*, July 14, 1866, 4 M. 1071, it was conceded that inquiry of some sort was necessary. In *Gordon* v. *Davidson*, Feb. 26, 1864, 2 M. 758, the question was considered one of great delicacy and involving a balance of advantages. Here the questions of law were raised sharply. There would be no undue delay, which it was the interest of the respondent, as a mercantile man in large business, to avoid as much as the liquidators. A final judgment might be obtained from the House of Lords.

The liquidators were not called on.

At advising—

Lord President — The respondent's counsel has very properly said that this is an appeal to the discretion of the Court, and I am sure we all feel the painful position in which Mr Mackinnon is placed as a mercantile man. The considerations arising from that have been very powerfully urged, and if it were not for some considerations on the other side, which I think are perfectly conclusive, these arguments might have great weight. We appointed an inquiry to take place in this case before disposing of the preliminary questions which the respondent had raised in his answers, and our reason for doing so, as stated at the time, was that we did not think these questions could be satisfactorily disposed of without the whole facts being before the Court; and still further, that it would be in the highest degree inexpedient that the case should go to the House of Lords without the facts being ascertained. I do not suppose any of your Lordships have altered your opinion in that respect; and if that be so, the opinion then expressed seems to me to be conclusive against the granting of this petition. There is this further consideration also, which is still stronger to my mind as a reason for refusing this application, and that is, that the object of the respondent in asking leave to appeal now is, if possible—I say if possible, for I do not think it probable,—to obtain a judgment of the House of Lords upon questions on which this Court has not pronounced any judgment. I am for refusing the prayer of the petition.

Lord Mure—I sympathise very much with the position that Mr Mackinnon is placed in, but having given this case very attentive consideration by myself, and also in consultation with your Lordships, I came to be of opinion that there were none of these points which were raised of an apparently preliminary character which could be satisfactorily disposed of without some investigation, and I have seen no reason to change that view; and I therefore concur in thinking that the petition for leave to appeal must be refused.

Lord Shand—I am entirely of the same opinion. In cases of this class, where the respondent alternately pleads, as excluding the claim, certain grounds of law, and separately founds upon facts about which the parties are not agreed, it is always a question of discretion for the Court whether any decision should be given upon the mere question of law, or whether the facts should be first ascertained and the case kept together so as to be disposed of once for all upon the merits. Having heard a very full argument in the case, the Court very carefully considered whether it was advisable to dispose of these questions of law, and in the interest of both parties, and I might almost say particularly in the interest of the respondent, we came to the conclusion that it was most desirable that the facts should be ascertained in the first instance. It was obvious throughout the discussion, and it certainly weighs with me in this question, that the ascertainment of the facts may very seriously affect the decision of a number of the questions raised; and without going into detail I may point to one matter about which the parties are at variance. The liquidators, on the one hand, state that for a long period of years interest amounting to a total sum of £300,000 was charged upon accounts when interest was not received; and their averment does not stop there, because they go on to say in the petition that the respondent and the other directors well knew that the interest so charged was not profit which had arisen and accrued to the bank. The respondent, on the other hand, disputes that averment, and states that in point of fact considerable sums of cash and large amounts in securities were received year after year which did represent interest, and that therefore he was entitled to treat it in that way. Even on the question of title it appears to me that the case would present a very different aspect upon one or other state of the facts as thus represented. If the case be as represented by the liquidators, that the

directors had no funds or property which they could possibly treat as profits, the question as to the liquidators' right to insist on the repayment of these funds may be in a very different position from what it must be if the respondent makes out his averments upon that matter. There are other matters of fact—for I mention that only by way of illustration--which also enter deeply into any judgment upon the law of the case; and therefore, upon the ground which I have now indicated, that this matter has received full consideration, and that practically this is simply a reclaiming note against the judgment which we have already pronounced, I agree with your Lordship that the petition for leave to appeal should be refused. But I must add, that so far from thinking that time will not be saved by the course which we have adopted, I think that time will be absolutely thereby gained. I have already indicated that the parties in the future stage of the case should endeavour to abridge inquiry by admissions so as to avoid going over unnecessarily a very large field of inquiry by multiplying witnesses on the points of fact on which they differ. There is no reason why these facts should not be ascertained early in May, after the meeting of the Court, and no reason why this case should not be disposed of probably in the following month of June; and, if that should be so, it would appear to me quite a possible thing that the case may be disposed of, as the respondent desires, in the course of the next summer session in the House of Lords, assuming, as I may rightly do, that both parties are anxious to obtain despatch in obtaining the final judgment of the Court of last resort.

Lord Deas was absent.

The Lords refused the application.

A proof was taken before Lord Shand, and also by commission in America, the total evidence, oral and documentary, occupying over 2000 printed pages. The following is an abstract of the arguments, from which it will be seen what the nature of the evidence led and the contentions of parties upon it were :—

Argued for the liquidators—In this application the liquidators contended that the evidence established, *first*, that during Mr Mackinnon's directorate interest of the amount alleged by the liquidators was debited to the American railway account; *secondly*, that the interest so debited was divided amongst the shareholders as dividend; *thirdly*, that, except to the extent of about £20,000, no part of that interest was received by the bank during Mr Mackinnon's directorate, either in cash or in an equivalent for it; *fourthly*, that, except to the extent of that sum of about £20,000, no part of this interest was ever recovered, but was an ultimate loss to the bank; *fifthly*, that Mr Mackinnon knew that that interest was being debited and divided, that he knew it was not being received by the bank, and he knew that there was no reasonable prospect of its ever being recovered.

Mr Mackinnon became a director on 7th July 1858, and he continued in office till 28th July 1870. In 1858 the balance at the debit of the railway account was £106,197, in 1870 it was £905,166. For the year 1858 the interest charged in the bank's books and credited to profit and loss was £2758, for 1870 it had risen to £48,110. This interest was annually paid away as dividend, or otherwise appropriated as the shareholders directed; but during the whole period the entire sum of interest which the bank's books showed to have been actually received was only £2448, 5s. 4d., although a further sum, making with the £2448 a total of about £20,000, might fairly be treated as received, having been reinvested in the extension of the line. The advances by the bank in connection with American railways began in the early part of 1856, when the bank made advances to a person named Gemmell, to Henry Watson & Company, and to Durand, the President of the Racine and Mississippi Company, receiving in security of these advances bonds over that line. The bank suspended payment for a short time on 11th November 1857. At that date they had made advances to the amount of £117,508, and held as securities for these advances bonds of the nominal value of £134,000. The first connection of Mr Mackinnon with the business of the bank appeared to have been after the suspension in 1857, when he was one of several shareholders appointed to co-operate with the directors in reinstating the bank. In that capacity he was a party to the formation of a set of "instructions and regulations for the future conduct of the bank," which the secretary was directed to enter *in extenso* in the minutes for the guidance of the manager, assistant-manager, and secretary. Rule 13 was as follows —"In order for the future to prevent the inconvenience arising from the bank's funds being locked up, all permanent loan or loans upon securities not easily or immediately convertible, shall as much as possible be discouraged and discontinued, and wherever such loans have been made, steps shall be taken gradually to call them up (so as to put an end to them within a definite period), as being in their nature opposed to sound banking principles." Mr Mackinnon in his evidence admitted that "the advances were largely increased from time to time after I joined the board;" and being asked, "How were you able to do that in the face of rule 13 of the regulations of 1857?" replied, "I considered those rules only binding till next general meeting of the shareholders, at which they required to be confirmed." But there was nothing in these rules themselves to warrant that view. They were stated to be instructions for the future conduct of the bank, and rule 13 in terms recognised that advances in contravention of that rule were in their nature opposed to sound banking principles. The rules were the code of management upon which the doors of the bank were to be reopened, as they were reopened, on 29th December 1857. Immediately after Mr Mackinnon's appointment as a director on 17th July 1858 the state of the American railway account was brought sharply under the notice of the board. The agent of the bank in America was a Mr Richard Irvin, and there was also a Mr G. A. Thomson, who had come to be practically the bank's representative in reference to their interest in the railway. Thomson and Irvin brought their opinion of the railway under the notice of the directors. What these views were was thus expressed in a letter from Gemmell, to whom the bank had made the greater part of the advances, and in whose name the bonds held as securities at that date stood. Gemmell writing to Thomson

in a letter which was communicated to the directors, dated 24th September, said—"You and Mr Irvin are now, I believe, quite satisfied that my early opinion was correct, that to replace the bank's money by sale of the securities we pledged with them, either in this country or at home, even if the road is finished to Freeport, is hopeless." In that letter Gemmell himself, as debtor, naturally expressed a more favourable view. But the liquidators did not need to contend that the railway was at a dead-lock. What they required to show was that its state was such that no prudent man could treat the dishonoured coupon as a paid coupon in the matter of dividend. It was not necessary to demonstrate that everybody connected with the line was agreed that it was worthless, but that the information put before the directors was such, as a whole, as not to warrant the reasonable expectation on their part of getting back the interest they were paying away. The result of these communications was that the directors, including Mr Mackinnon, discharged Gemmell, Watson & Company, and Thomson, and took over their entire interest in the bonds, hitherto held as securities, in order that the bank, being thus alone vested in them, might have uncontrolled right of action over them. The bank thus released their debtors, and that, as was plain from the correspondence, without any confident expectation of being able to pay the debts by the sale of the bonds. The transfer and discharge of the debtors was completed in October 1859, and although the advances continued for sometime thereafter to be nominally in the name of the debtors, the bank had from that date truly invested its money in the American railways.

Now, it was at this date and in this state of knowledge as to the value of the investment on the part of the directors, including Mr Mackinnon, that there began the system of crediting the bank with interest which had not been earned. Hereafter it was not the case of an account-current with a debtor not paying interest punctually, but represented as solvent, in which case banks were in the practice of crediting themselves with the interest though unpaid; it was the case of a proper investment in a company, in which there ought to be punctual and periodical payment of dividend, if a dividend was to be expected at all. It was at this time, too, that the bank began the policy of advancing more money to complete the line to a further point, in the expectation that the line, hitherto hopelessly bad, might thereby be made to pay, although as each further point was reached these expectations were not realised. The first extension was the continuation of the line to Freeport. A foreclosure suit was at the time pending, and the means for making the proposed extension were provided by putting the railway company under a trust called the Farmers' Loan and Trust Company, who were to have control of the line, but the line was to revert to the company, provided that the advances necessary to make the extension, and the interest due on the bonds and the other expenses, were fully paid up within five years from the date of completion. The advances necessary to make the extension were to be provided by the bondholders, and it was agreed, Mr Mackinnon being one of the committee of directors which had specially to consider the matter on behalf of the bank, "to postpone the interest accrued and to accrue on the bonds until the road is completed, and the means advanced for such purpose are refunded, with the interest thereon;" and it was further provided that "on completion of the road to Freeport the Company will consent that the nett earnings of the road, or other means that may be furnished by the bondholders, be applied to the extension of the road to Yellow Creek, provided the time of redemption be extended to five years from the time the road is completed to Yellow Creek." That was in April 1859, and in that year, while they were thus consenting to postpone any claim for interest, the directors nevertheless charge £8000 for interest upon the bonds in their possession, and throw it into the amount divisible for profit for that year, although there was the greatest uncertainty whether the coupons then falling due would ever be paid.

The extension to Freeport did not prove a success, Thomson alone taking a favourable view of it, but even he only on the assumption that a further extension was made, by which he calculated that in six or seven years the arrears on the bonds might be paid. In the meanwhile the bank had to make larger advances on account of the Freeport line than they had estimated, other bondholders having failed to pay. In June 1860 their total advances on the American railway account were £191,263. For that they held Farmers Loan certificates for £48,773, and the bonds, nominally for £134,000, but actually estimated by Thomson to be worth in the market only £44,380—in all £93,153. That left an unsecured debt of about £98,000, and yet in the year 1860 the directors credit the bank with and divide interest on the whole £191,263. That Mr Mackinnon was fully aware of the market value of the bonds was evidenced by the fact that he gave an order, ultimately withdrawn, to purchase on his own account a quantity at their depreciated value. It was ultimately resolved to extend the line to the Mississippi, by means of the formation of a new company, to be called the Northern Illinois Company, and on 27th November 1860 the bank directors "resolved and agreed to authorise the surplus funds of the Racine and Mississippi Railway, which ought to come to the bank on account of the construction account, to be lent to the proposed new railway company, the 'Northern Illinois,' for the construction of a portion of that line which is intended to start from Freeport on to the river Mississippi." This was a further dedication of the fruits of the Racine and Mississippi, and postponement of the payment of interest on the bonds, of which Mr Mackinnon was fully aware, for he was present at the meeting. He had written to the bank manager previously, as follows:—"I do not see my way to concur in the proposal that the bank should find the funds. On this point I have great difficulty. The position we would assume as taking stock in a new railroad would be different from that we have hitherto occupied as bondholders, and although, as you know, I am always ready to strain a point in favour of expediency in handling business interests, as opposed to adhering strictly to what might be *legally* accepted as the construction of a doubtful policy." But he concludes—"If the board is unanimous without me, I would not like to stand alone;" and in the

result he concurred with his co-directors. Large advances were soon after made to the Northern Illinois Company, in the form of subscriptions to its capital stock.

Proposals now began to be considered by the directors for the sale of the line; and these proposals were important in determining whether the bank's advances were covered or not. There was a point between the parties as to how far the state of exchange at any particular time was a legitimate element in estimating that. The defender said that he was entitled to have that matter dealt with always upon the footing of a par exchange. The liquidators, on the other hand, said that as payment in America at that time meant paper currency, which was largely depreciated, they never could ascertain what was meant by an offer there without taking into account the state of the exchange at the time—that was to say, the depreciation of the paper currency, at which the offer if accepted would have been paid.

There was another matter which occurred about this time which, as it had a bearing upon the question of exchange, it was right to explain here. That was a credit called the "rail credit," which was opened in the names of Mr Mackinnon and Mr Fleming, another director. The document constituting it was in these terms—"We have to request that you will instruct Messrs Richd. Irvin & Co., of New York, to draw upon you for the sum of not exceeding ten thousand pounds, to meet amount advanced by them on purchase of eight hundred tons railroad iron for the Northern Illinois R. R., and we undertake to provide funds in your hands to meet said drafts at maturity, Messrs Richard Irvin & Co. transmitting to you for delivery to us, on payment of said drafts, the note of the Northern Illinois R. R. Coy. for the sum drawn, payable two years after date, with seven per cent. interest, payable half-yearly, both principal and interest payable in London at the exchange of 4/ to the dollar; and with said note an obligation of the Northern Illinois R. R. Coy. to deliver sterling bonds of the Western Union R. R. Coy. as collateral security for said note to the amount drawn, with margin equivalent to valuation of the bonds at 75 p. c. of the par value, so soon as the Western Union Coy. is organised and the bonds are ready to be issued—the note of the Coy. in the meantime to have a preference over the bonds of the Northern Illinois Coy. now in the hands of Messrs Richd. Irvin & Co. by consent of the bank." That showed, in the first place, the value (75 per cent.) which Mr Mackinnon put on the bonds, which were the same as those held by the bank, and it showed also the importance he attached to cash payment in London. The transaction, which could not fail to be a profitable one, was ultimately taken over by the bank. Another separate transaction to which it was necessary to refer was the combination account. A number of gentlemen formed an association for the purchase of bonds in these American railways to the extent of £35,000, they being all directors of the bank; and the minute of the bank bore—"The manager reported that in order to facilitate the organisation of the Racine and Mississippi and Northern Illinois Roads, under the title of the Western Union Railway Co., the following gentlemen, viz.:—J. N. Fleming, Samuel Irvin, Lewis Potter, Robert Salmond, William Mackinnon, and W. S. Lorrain, had agreed to make a further purchase of East and West Division Bonds of the Racine and Mississippi Railway Co. to the extent of £35,000." And they give an authority to Mr Thomson to buy for them in the proportions attached to their respective signatures. A third subordinate account was the "grain credit account," which was thus authorised in the bank minutes—"It was further agreed to instruct Mr Rich. Irvin & Co., New York, to open a credit for G. A. Thomson, Racine, to the extent of £10,000, say ten thousand pounds, on the deposit with them of warehouse receipts and policies of insurance for grain stored, and to reimburse themselves by drafts on the bank." Mr Thomson explained how that credit was to be manipulated. He said—"The question came up as to how grain could be brought to Racine. There was plenty of grain in the country, and a large freight to be got upon it, but the shipper must be assured of a steady market before we could get the carrying of the grain. By making concession to some shippers, we induced them to send their grain, and ship to an Eastern market from here, but that was not enough. The only way I could accomplish what was needed was to help to make a market, and I did so. For two years now I have kept a man in the market, with instructions to allow no sound wheat to go unsold, and to offer at all times a fair price for it if nobody else wanted it. In that way my agent has bought a very large amount of wheat. As I wrote to you in the beginning of last winter, there was a profit on it in the spring of 1864, but a loss in the autumn." A railway which required to have recourse to such an expedient was not in a hopeful condition.

The negotiations for a sale had hitherto been conducted through Messrs Irvin & Co. and Mr Thomson. The directors now resolved "to request Messrs Henry Dunlop, formerly a director of the bank, and James M. Hall (of Messrs Wm. Mackinnon & Co.), in whose ability and discretion they have full confidence, to go out to America as a deputation to represent the board, and to act for the bank in all matters pertaining to the realisation of the securities referred to, with full powers to conclude a sale on the most favourable terms possible, and to make such other arrangements as to them shall seem most advisable in the circumstances, with the view of rendering the said securities marketable at an early date." And accordingly Messrs Hall and Dunlop did go, reaching America on 30th November 1866. Mr Hall was a partner and the intimate friend of Mr Mackinnon, to whom directly he addressed much of his correspondence relating to the affairs of the bank. Hall and Dunlop carried on considerable negotiations with a Mr Johnson, a financial agent, for the sale of the line, but these ended in nothing. They also continued the negotiations with the Chicago Company already alluded to. With reference to this last Mr Hall thus wrote to Mr Mackinnon:—"If we could get some such terms from the North-Western Co. as Young's conversation led me to think possible, viz. 4 million 6 per cent. bonds and 1½ millions com. stock, there would be a fair chance of all the home interests being realised on terms to some extent satisfactory. 3½ millions of 7 per cent. bonds would be much the same thing to the North-West Co., and would be more negotiable property to the holders of them. I intend, if we

get to negotiations again, to try for 3½ million 7 per cent. bond, ½ million pref. stock, 1 million com. stock. The bonds and preference stock we would purpose to appreciate as follows:—" And then he mentioned his calculations, and concluded—"The proceeds of the bank would pay $2,360,000, a result I should much like to see." Now, the result which Mr Hall would much like to see involved, at an exchange of 6 dollars to the £, the sale of the bank's interest in the railway at a sum of £393,500, while their advances at that date amounted to £629,312.

The Chicago and North-Western Railway ultimately made an offer to purchase, with reference to which Mr Dunlop wrote to Mr Mackinnon that the bank would have to make a great sacrifice if they accepted it. It was now suggested for Mackinnon that by laying aside exchange, and treating this as money to be reinvested in some way in America, and kept there until the exchange righted itself, they then had before them an offer which implied clearing the bank out without any loss at all.

That was the explanation given by Mr Hall in his evidence as to the best means in his opinion of getting the bank out of the difficulty. He said—"We were sent out to get the bank out of their difficulty about those investments. I think it would have taken them out of their difficulty to realise those securities and reinvest in America. (Q) Why did you not do that?—(A) I failed to do it. I brought home an offer which they declined to accept. Before I left for America Mr Stronach and Mr Mackinnon and I had no conversation as to what should be done with the proceeds in the event of a sale of the line. There was no suggestion made by either of those gentlemen that the money received as the purchase price should be invested in America. After I returned bringing an offer, I never heard the matter discussed one way or the other, to my recollection, as to how that money should be treated otherwise than being remitted home at once. I remember no suggestion that there should be an investment in America. I have no recollection of making any such suggestion to Mr Stronach or Mr Mackinnon, or any member of the board." Then Mr Mackinnon said—"If the bank had realised their interest in 1867, or any of the subsequent years, I should have recommended the money to be left in America and invested there. I had a talk on the subject with Mr Stronach, the manager; and I think that upon the matter of exchanges my experience would have considerable weight with the board if it had come to be a practical matter. I think that to a large extent the view which I have expressed was the view on which the board proceeded in these negotiations. To a large extent the offers were not in cash, but in marketable bonds. If we had got bonds of the Chicago and North-Western, or some similar undertaking, I should have recommended them to be held—locked up as it were—or converted into cash at the current rate of the day, and the money put into some good American security, probably U.S. 5-20 bonds. It was in that view that I expressed myself in the letter of 4th December 1868, to which I have been referred, where I say—'Exchange will soon come to par.' There would have been no difficulty in investing the money advantageously in 5-20's. These are gold bonds. At that time they had depreciated in proportion to the depreciation of the currency, and I should say from the same causes or similar causes which had led to the depreciation of the currency. If we had accepted Ogden's offer which Mr Hall brought home, and if we had kept the bonds he offered, which were dividend-paying bonds, we should have got interest all the way through up to the final close of the bank, and then realised considerably over a million sterling for the capital—that is to say, we would have got our interest all through and nearly £100,000 more than our capital, because the advances in 1870 now appear to have been £905,000. I don't remember why Ogden's offer was not accepted."

Now, that was a very extraordinary statement, that after the great struggle which these gentlemen were making to get themselves out of this difficulty Mr Mackinnon should now represent that they had an offer which was to clear them out of it, and that they beyond all doubt declined it, and he could not remember why they did not accept it. But beyond all doubt it was at the time regarded as a highly disadvantageous offer. The correspondence and board minutes abundantly showed that. Thus Mr Stronach, the bank manager, writing to Irvin, said—"The board are resolved to accomplish a realisation of the bank's interest with the least possible delay, consistently with the obtaining of a reasonably fair value for the securities or the property itself, as it may be found advantageous to deal in the premises. . . . The terms proposed by the Chicago and North-Western Company are exceedingly unfavourable, and involve an amount of loss on the bank's interests very much at variance with previous expectations, but the board are so impressed with a sense of duty in bringing an involvement of the character in question to a speedy termination, so much time having already passed in ineffectual attempts to close the account to greater advantage, that they are prepared to have you accept such terms, if you find on full inquiry and investigation of the position of affairs that better terms cannot be obtained."

It was right to mention here that on the return of Mr Hall and Mr Dunlop the American railway affairs of the bank were put into the hands of three persons, called "The London Committee," who were to manage for the bank from London instead of throwing the work as heretofore on the head office in Glasgow; and one reason for this change both Mr Mackinnon and Mr Hall admit was very likely a desire to keep the bank's name from appearing in connection with these railways. Mr Mackinnon was not a member of this committee, but Mr Hall was, and when in London Mr Mackinnon was frequently present at its deliberations. There was no doubt from the evidence that Mr Mackinnon, though much abroad during the later years of his directorate, and otherwise engaged, was kept fully alive to the affairs of the bank, and took an active part in them by correspondence.

In the meanwhile the affairs of the line were going from bad to worse, Thomson asking for further advances in order to pay current expenditure. The following letter from Hall to Stronach showed the state of matters as vividly as anything—"Mackinnon handed me the enclosed letters from Thomson to read, and he has since told me to send them on to you. He asked me also to request you to telegraph Thomson the enclosed message in his name. The contents of Thom-

son's letters are sickening. Every step forward makes the bank's position more and more difficult. You get deeper and deeper into the mire. This constant drain should be—must be—stopped. How often have I said that already? Whether the Chicago and North-Western Coy.'s bonds and stock be good or no for the amount Dunlop and I put upon them, I would earnestly urge that, by accepting them in exchange for your property in the road, you stop expenditure—you cut it off at some point—and if the Chi. and N.-W. bonds are not good, you are nevertheless gainer, because you have stopped the drain and can resume your property. Mackinnon and Salmond both desire me to say that you should bring the subject before your board at its first meeting, and take instructions to close with the Chic. and North-Western Co. at once, if that Co. be still open and willing to buy even on the terms proposed through Dunlop and me. I don't believe there is any use waiting longer for the Pennsylvanian Central Co., but if I am here to-morrow I will see Borthwick."

An arrangement was ultimately come to for the disposal of a part of the bank's interest in these railways. This was termed the Mitchell agreement, from the name of the person with whom it was made. With reference to this agreement it was necessary to keep in mind that under a scheme whereby this Racine and Mississippi Railway was amalgamated with the Northern Illinois Railway in 1856, under the name of the Western Union Railway, the first mortgage bonds of the new company amounted to 4,000,000 dollars, being 189,058 in excess of those of the two amalgamated lines, and the common stock was 2,707,693 dollars, being 1,707,693 in excess. And what the liquidators said was that the bonds and stock were "watered" in this way in order that there might be a nominal security for the bank to show for its advances. Now, keeping that in view, the following were the terms of the Mitchell agreement as contained in a letter from Mitchel to the London Committee, dated 29th April 1869: — "With reference to what has passed at the various meetings which have taken place in connection with the proposal to purchase the securities over the Western Union Railroad, extending from Racine, Wisconsin, to Port Byron, Illinois, (about 181 miles), with a view to our assuming possession of that property, I now with pleasure put in writing what I understand to be the terms and conditions which I have offered, and which you are willing to accept and carry out on behalf of the bond and stockholders whom you represent, viz.:—

"1. You are to warrant the title to the property, and that it shall be made free and clear of all debts and liabilities of every kind, including accrued taxes, except the bond and stock after specified, at the 1st July next, which is to be the date on which we are to enter into possession. It will be necessary, in order to give us such possession, that the present board of directors resign their seats on or before the date mentioned, in order that they may be succeeded by others nominated by us.

"2. The bonded debt of the company we understand to be four million dollars issued, and which you are to reduce to three millions by the withdrawal and cancelment of bonds to the extent of one million dollars. The three millions of bonds, which are hereafter to be the first and only lien on the road, are to be free from interest till 1st January next, for three years thereafter to bear interest at 3 per cent. per annum, and afterwards at 7 per cent. per annum. You are to surrender these bonds with their coupons to us, either to be stamped in accordance with the terms of this paragraph, or to be changed for new bonds of same amount and conditions and security.

"3. We understand that the other burdens upon the road which have been issued or authorised to be issued are as follows, viz.:—

"(1) 2d mortgage bonds .	$1,500,000
"(2) Preferred stock . .	1,000,000
"(3) Common stock . .	4,000,000

It is arranged between us that the second mortgage bonds and preferred stock are to be retired and cancelled, and that the common stock is to be surrendered to us.

"4. The consideration we are to pay is as follows, viz.:—

"In first mortgage bonds, referred to in paragraph 2 . .	$3,000,000
"And cash lawful money of New York	650,000

The property in our hands is to be represented by the three millions of mortgage bonds above referred to, and four millions of ordinary stock; and it is distinctly declared, for the government of the present and future board of directors, and finally understood between us, that these amounts shall not be increased except with the consent of three-fourths in interest of the stockholders.

"5. You are to have the option till 1st July next to subscribe for or repurchase back to the amount of $1,999,000, or any less sum of said ordinary stock, by paying therefor at the rate of $650,000 for four millions of stock."

And then under the 9th head:—

"9. The $650,000 cash mentioned in paragraph 4, less the amount of stock that may be retaken as mentioned in paragraph 5, will be paid by us to an agent in New York authorised to receive it, when we are in possession, and when you shall have complied with paragraphs 2 and 3; it being at the same time understood between us that should any of the outside holders of bonds or stock delay or refuse to come into the arrangements and to surrender their securities, that we shall accept suitable indemnity for such bonds or stock, so that the arrangements otherwise may not be delayed or disturbed."

Now, one plain inference from that agreement was this, that the Western Union line was overbonded. Mitchell said in effect—"You must cancel 1,000,000 dollars 1st mortgage bonds, whole 2d mortgage bonds, and the whole preferred stock (that created by Thomson in 1868), and then I will treat with you." Could it therefore be argued that the directors were receiving security for their arrears of interest when the securities were swept away in this manner? No doubt it would be said that the common stock was increased. But as events proved, the common stock was of little value. Mitchell was president of the Chicago, Milwaukee, and St Paul line. In entering into the agreement with the bank directors he did so on his own account, but before long he transferred his rights to his own company at a greatly enhanced rate. It was the

interest of that company to control but not to develop the Western Union line, and they had the control, having a majority of the common stock under the Mitchell agreement (for the directors exercised their power of repurchasing $1,999,000 of the stock). The consequence was that the common stock received no dividend, the St Paul Company permitting just so much traffic to pass over the Western Union line as would pay the bonds. This was an important circumstance in considering a later stage of this question, when the liquidators came to realise the bank's interest under the Mitchell agreement.

It was now necessary to deal with the question of the reserve fund. There was accumulated during the period complained of a reserve of £260,000. That did not amount to anything like the interest, which was £316,000, but still it was necessary to show that that £260,000 had nothing to do with the interest upon the American account at all. It was never reserved for the purpose of being a safeguard against that American account, and, in truth, it was required, and more than required, for those accruing deficits which were incident to the conduct of this business. Mr Muir was asked—"Do you find in the books of the bank any bad debts standing under that title simultaneously with the reserve?" A question of admissibility arose with reference to that question which had been reserved by Lord Shand at the proof.

The respondent had at the time objected to the question and line of examination, and in support of his objection now argued—The question which Lord Shand reserved upon the proof was this, Whether the liquidators were entitled under this note to prove, or to attempt to prove, that in 1870, when Mr Mackinnon left the bank, there existed certain bad debts which were treated as good assets in the books of the bank. These bad debts divided themselves into two classes, to which separate objections were taken. The first class of alleged bad debts consisted of certain sums carried in the year between the balance of 1868 and the balance of 1869 from past-due bills and credit accounts to an account titled "Bad Debt Account," or "Bad and Doubtful Debt Account," and which in the balance-sheet of 1869 and subsequent years appeared under various names as an asset of the bank. There were a large number of these alleged bad debts, the amount of many of them being comparatively small, but the number being some 20 or 30. The second class consisted of debts, or portions of debts, which Mr Muir found to have been written off as bad at various dates between 1872 and 1878, long after Mr Mackinnon left the bank, but which Mr Muir professed, by going back into the account, to be able to show to have been bad in 1870, and to have been dormant from at least 1866, no payments, or substantial payments, having been made in the liquidation of the accounts by the debtors. Now, what the liquidators proposed to do was this—The respondent replied to their demand by pointing to the reserve fund, and saying—"Even if what you say about the American railways is well founded, still we did not pay it away in dividend; we passed it into the reserve fund, which remained good to meet any possible loss on the American securities." The liquidators, however, without any notice, wished in the course of the proof to challenge the reserve itself by proving that a number of debts ought to have been written off as bad debts long before Mr Mackinnon retired. Mr Mackinnon objected to this being done, and his objection went deeper than mere want of notice. He contended that the liquidators were really raising a new case. Suppose that they had based their original case on these alleged bad debts, and on Mr Mackinnon answering, "The debts may be as bad as you please, but I have the American securities as a set off," and the liquidators had then, in the course of the proof as to the badness of the debts, proposed to impugn the American securities, and to import the whole of the enormous evidence in this case to prove their afterthought of an answer, could it have been maintained that they were entitled to do so? Yet how did that case differ from what actually took place?

Authority—*Inglis* v. *Douglas*, January 21, 1860, 22 D. 505.

The liquidators were not called on.

At advising—

Lord President — The general allegation against the respondent in the note for the liquidators is, that during his tenure of office as a director there had been carried into the balance of profit and loss interest supposed to have accrued upon certain American securities, whereas in point of fact no such interest had accrued, and therefore the balance of profit and loss which was divided among the shareholders was to that extent not truly interest accruing upon these securities, but capital belonging to the bank—in short, it was a payment of dividend out of capital. The answer, among other things, which is made by the respondent in his papers is this—that "When the respondent retired from the board in 1870 there existed a reserve fund of £260,000, accumulated from undivided profits during the period of the respondent's directorate, and that there was in addition in the bank's coffers an undivided profit for the year 1870 amounting to about £92,000. These sums together amounted to £352,000. There was thus a margin of undivided profit more than sufficient to meet or cover the sums alleged by the liquidators to have been improperly paid away as dividend." Now that, on the face of it, is a very formidable answer to the complaint of the liquidators. But it depends entirely, of course, upon the truth of the averment that there did exist a reserve fund of £260,000 as in 1870, and the liquidators proposed in the course of the proof to show that there was in reality no such reserve fund, because the so-called reserve fund was composed to a great extent of accounts which were accounts of bad or bad and doubtful debts. Now, it was objected at the proof when the liquidators proposed to lead evidence to this reply that there was no notice of that given to the respondent, and I think the respondent probably had very good ground for stating that objection. But I am also of opinion that Lord Shand, presiding at the proof, disposed of that in quite a right way. He said—"In the first place, there is no notice here, and if you desire to have time to meet this part of the liquidators' case you shall have it." That was not taken advantage of by the respondent, and the evidence was admitted, subject to the judgment of the Court, which we are now to give. Now, it appears to me that a reference to such a case as *Inglis* v. *Douglas*, or a reference to any proceedings as to the relevancy of a record,

with a view to a trial by jury, has no application here at all. This is a very special proceeding, under a particular clause of the Companies Act, section 165, which directs an inquiry to be made in a summary manner into the conduct of any director who is alleged to have misapplied funds, or committed various other delinquencies in connection with the management of the affairs of a company. It does not appear to me that it is at all necessary for us in an incidental proceeding of that kind in a liquidation to resort to the Court of Session Act of 1868, or to any of the other Judicature Acts, for the purpose of complying precisely with the forms of process in ordinary actions in this Court. On the contrary, we are quite entitled under that section of the statute to direct the inquiry to be made in any way we think expedient, and to appoint parties to either make statements according as the exigencies of the particular proceeding may require. We are not therefore, I think, bound by any of the ordinary rules of pleading, and all that we ought to do, I think, is to make sure that no injustice is done to the respondent here by reason of the want of notice of which he complains. Now, if he is in a position to say that if he had had this notice he could have made a defence which he is not in a position to do now, or was not in a position to do at the time this proof was taken, then I should be for giving him an opportunity of amending his evidence by leading that additional evidence, whatever it might be—in short, to give him an opportunity, either by adjournment or otherwise, of making his case as strong in every respect as he could have done if he had had notice of this proposed evidence before the proof was ordered. But if he does not wish to avail himself of that indulgence, then I am for admitting the evidence, because I think it is quite impossible to reject any evidence here that is pertinent to the inquiry which we are to make under the 165th section of the statute.

Lord Deas—I am entirely of the opinion expressed by your Lordship. I think there is a palpable difference between the procedure in an ordinary action of damages and the procedure in an inquiry of this kind under a liquidation. I agree with your Lordship that the respondent Mr Mackinnon is entitled to every sort of indulgence, and that he is not to be subjected in the evidence or otherwise to any hardship whatever. But I think there is nothing of that kind done by the deliverance which Lord Shand pronounced. I think it is quite open for us to give him, and I for one shall be quite ready to give him, an opportunity still of putting things right or making anything clear here which is doubtful. That being open to him, I do not think that any rules of process could either require any more or give him any more for his fair and reasonable defence.

Lord Mure—I agree with your Lordship that in a summary application of this sort, arising under the statute in the course of a liquidation, the Court are not to hold the parties tied down to the strict rules of pleading applied in such a case as that of *Inglis* which has been referred to. But, keeping in view at the same time that this inquiry relates to a matter of a very serious and *quasi* criminal investigation in one sense, I think that the respondent was plainly entitled to distinct notice of some sort or other from the liquidators before they went into a proof of this description. So far as I recollect, during the long discussion on relevancy this allegation of the respondent about there being a reserve fund was not challenged by the liquidators at the time. I have no recollection of it being challenged. But now, in the course of the proof before Lord Shand, his Lordship, when the point was raised, very naturally allowed the parties, if they liked, to have the proof adjourned in order to enable him to meet that kind of investigation. But they do not seem to take that view of it, and that has never been done. Therefore I think the course which Lord Shand proposed in the circumstances was one that was calculated to obviate the objection that might be raised to the course of procedure, and I think that matters should be so adjusted between the parties as to give the respondent an opportunity of bringing forward any evidence he can lead better than that which he has adduced, in respect of no notice having been given to him.

Lord Shand—Although in the course of the proof I reserved for this Court the question of the admission of the evidence, I may say that I had a strong opinion that the evidence was quite competent, and indeed I stated so to the parties at the time, coupling it, as your Lordships observe, with an offer to the respondent to adjourn the proof if he desired it for whatever time would enable him fully to meet the evidence which was tendered for the liquidators; and I entirely agree therefore in the view which your Lordships have expressed as to the competency of the evidence. I do not think it was incumbent on the liquidators in the first instance in their note to take any notice of a reserve fund. Their case was as they have stated it—that although there was no interest whatever accruing upon this American account over this long period of time, interest was carried to profit and loss, which was divided annually. The respondent, on the other hand, was quite right, if he was able to make a point of the reserve fund, to do so, and in his answers undoubtedly the reserve fund assumes a very prominent place, for besides the passage read by your Lordship there are others in the answers which bring out this with great prominence. I see that after stating that the reserve fund is of an amount greatly in excess, or at least in excess, of the interest which was said to have been paid away upon this American account, the note goes on to say that the respondent contends that the whole amount accrued in each year to the reserve fund ought to be applied in reduction of the sum claimed in each year, and the whole reserve fund as at June 1870, with the profit earned in the year ending 1870, ought to be so applied. And again, in a subsequent passage of the answers towards the close, there is this passage—That the whole sums credited to the general interest account cannot, either in whole or in part, be separated from the whole amount which was carried to the credit of the profit and loss account and to the reserve fund, and such particular interest—that is, the American interest in this case—cannot be treated as having been applied to the payment of such dividends, at least in so far as such particular interest did not exhaust the

sum so carried to the reserve fund. In short, the respondent in his answers claims credit for every farthing of that reserve fund, year by year, and if he gets that credit there can be no charge against him. That answer therefore raised a very important matter of fact. It appears to me that after that answer was given, and at the time at least when the Court allowed a proof in this case, the liquidators, if it had occurred to them then, should have intimated that they meant to challenge this reserve fund. They should in some way, by means of a minute lodged in process or otherwise, have given Mr Mackinnon full notice, not only generally that they meant to dispute his averments about the reserve fund, but specifying the particular accounts and names of the parties, with the sums which they referred to, and particularly the debts for which Mr Mackinnon could not take credit in this question of the reserve fund. They, however, not having done that, the question arose at the proof how the matter was to be dealt with. I have no hesitation in saying that in a proof of this kind, differing as it does from a jury trial, the proper course was to admit the evidence, but I think justice will be fully served by allowing to Mr Mackinnon, as I should still propose to do, if he desires it, an opportunity of leading further evidence, for I think that, as I reserved the question of admissibility, his counsel were very fairly entitled to take the opinion of the Court before finally deciding whether or not they should ask for an adjournment. I have only to add that I do not think it would have made any difference in the course I took if I had been dealing with a case on a closed record. Even on a closed record I should have admitted this evidence, because I think substantially the objection would have been want of notice. Probably in that case it would have been necessary to have, and I should have allowed, an amendment of the record under the provision of the statute which requires the Judge to allow an amendment on a record at any time to cure an obvious defect in it, which this certainly was. But I agree with your Lordship in thinking that in a case of this class, where the inquiry is in a liquidation, where we have no closed record, and where the pleadings are simply upon note and answers, it is unnecessary to have any amendment of the papers, and that the parties are entitled to retain this evidence as part of the proof, subject to the right of Mr Mackinnon to lead further evidence if he desires it.

The respondent made no motion for further allowance of proof.

Counsel for the liquidators then proceeded to comment on the evidence relating to the alleged bad debts, with the result of showing, as they contended, that in 1870 the bad debts, largely past-due bills, amounted to £373,034 and the reserve fund to £272,438—a deficiency of £100,596.

The next point was—What was Mr Mackinnon's knowledge of the practice of debiting interest to the railway account? and how did he justify that practice? This was his evidence:—"I believe there was interest debited to this account. I assumed it was debited on the general principle adopted in debiting every subsisting account in the bank with interest. (Q) If you were not getting payment from time to time of your coupons, how could there be any interest to debit on the account?—(A) I take it that the rule of all banks is to debit to every account that stands in their books as good and subsisting a regular amount of interest at each balance—I mean where in their opinion it is a good account. That applies to a case where the bank believes they have a solvent debtor—where they believe that the account will be ultimately realised in full, including the interest. I knew that the coupons in the present case had been dishonoured—I suppose because the embarrassed railway company had not funds to pay them. (Q) If the coupon was dishonoured, on what principle could you treat it as received?—(A) The coupon was certainly received; it was there as the representative of debt. I treated it as I would treat any other account. I suppose the manager debited a good account with interest although the debtor owed the bank £5000 and did not pay the interest exactly on the day it was due. (Q) If your coupon was not paid, on what ground could you treat the amount of the interest as received?—(A) Because I expected it would be paid in future. I must have learned that from 1858 to 1870 the coupons continued not to be paid—not the whole of them, because there was a large amount paid, as is admitted, by the Northern Illinois Company on its coupons. (Q) But you knew that year by year the coupons held by the bank on bonds other than those of the Northern Illinois were always dishonoured?—(A) As we went on I knew they were not paid in cash, but I knew at the same time that we had in prospect to get the bonds of the railway in exchange for those coupons. They became a fresh debt to the bank, and I consider that the bank was justified in assuming that they would ultimately be paid. I believed they would be paid ultimately either in meal or in malt. . . . I always thought that the securities which we had in hand, and which we were getting from time to time, were amply sufficient to cover the whole amount of principal advances and interest thereon, and that ultimately these would be realised in full to cover everything. I did not think during the earlier years that twelve years would pass without the coupons being paid. When we found, as time went on, that they were not paid, we did not change the system, because from time to time we had offers from outside parties for the securities which justified us, in my opinion, in permitting interest to be charged to the account. . . . I know it is a very common thing in banking business for bankers to make loans to parties, and to charge interest year after year, though it is perhaps not paid for three or four years, and ultimately at the end of the period they get payment of the whole. I was very much engaged from time to time in the negotiations for realising this debt. In considering the propriety of accepting or rejecting the offers, I never inquired how much interest the sum at the debit of the account included. I always knew it included interest, but how much, or at what rate, I never inquired. (Q) Were you in frequent communication with Mr Stronach and your co-directors about this account?—(A) If you mean once a fortnight, and sometimes oftener, and sometimes not so often, then I was in frequent communication with them. Occasionally we did discuss the state of the account and the prospects of recovering it. I have no recollection of its being mentioned during those communications how

much of the debt consisted of interest. (Q) When you found that the coupons continued to be dishonoured longer than you expected, did anything occur as to whether the rate of interest charged should continue to be the same, or should be increased or diminished or stopped?—(A) I cannot from memory give a reply to that question. I do not remember anything of the kind occurring down to the time of the letter which I wrote to Mr Stronach in 1867. I did, however, know that interest was being charged. I assumed that he was debiting the current rate charged upon ordinary overdrawn accounts for the time being." These passages show quite plainly what was the attitude of Mr Mackinnon towards this account. He admitted that he knew of the account. He admitted that he knew interest was being charged upon it. He did not state that he knew the exact rate, but he admitted that he assumed it was being charged with the full amount of interest debited upon ordinary overdrawn accounts, and he knew that the coupons were being dishonoured. Now, he seemed to present only two justifications for that proceeding. He said it was the custom of bankers to debit an account with interest and carry it to profit and loss, though the debtor does not come to the bank and square up every half year—qualifying that, no doubt, by saying, "I mean where in their opinion it is a good account," —and applying that principle to this account he justified so treating it. Then, in the second place, he said—"They always expected they would get bonds in lieu of their coupons, and that these would ultimately be paid;" and he founded upon the offers made from time to time as justifying that belief. Both these heads of justification failed, because whilst a banker might with propriety debit an account with interest and treat it as good, and divided the interest as profit, although the debtor had not happened to pay it up, that was where he in good faith believed that his debtor was solvent and able to pay the amount. What was the position of this account? It was not an account upon which there was a debtor at all. It was not an account to which interest could be debited year by year, trusting to the whole balance being wiped off ultimately, the debtor being solvent throughout. It was an account which, from the very nature of it, there must be a half-yearly settlement in payment of coupons, and every half-year when the coupons became payable and were presented to the railway for payment and were dishonoured, the account forthwith fell into the position of an ordinary trader's account who had been called upon to pay up his interest and said he could not do it. And therefore the justification set up here was wholly inapplicable, unless it can be shown that when a bank suspected its customer and said—"The accruing interest upon your overdrawn account for the past half-year is £500; we must have a settlement with you; we insist upon you paying it,"—and he told them, "I cannot; I have not the means of doing it;" unless after such an intimation the banker was entitled to look upon it as a good debt available for division amongst the shareholders.

When the liquidators came to realise the stock which the bank held under the Mitchell agreement, they applied to Mitchell as the person most likely to be a purchaser. He did purchase the line, giving bonds of his own company for those of the Western Union Company, and these were ultimately disposed of through a syndicate. The common stock of Western Union Company the liquidators sold to Mitchell for £5000; the total realised a sum of £615,000 as against advances to the amount of £905,166. The total loss on realisation the liquidators estimated at £401,000. That was reached in this way. The interest on £905,166 (the amount of the advances in 1870) from June 1871 to August 1878, at 5 per cent., was £369,609, but from that there was to be deducted £258,297, the interest actually received, leaving £111,311, which added to the capital advanced made £1,016,000. The common stock was practically worthless, owing to the control which Mitchell had over the line as already explained.

Argued for the respondent—The history of the line without special reference to Mr Mackinnon would be first considered; then his personal relation to the facts so disclosed would be ascertained. When the history of the present case commenced the bank stood in advance £117,000 to persons who had given in security bonds by the Racine and Mississippi Railway. That was the situation immediately after the suspension of the bank in 1857. But the committee of investigation appointed on that occasion did not say a word against this particular advance. Then who were the bank's advisers in America? There was first Mr Richard Irvin, a man of the highest character and great caution, and he in 1866, after all that had happened, expressed his deliberate conviction that the bank held ample security for its advances. The result of the correspondence during the earlier period to 1860, both with him and with Mr Thomson, a man undoubtedly of more sanguine temperament, came to this, that the line being unfinished would not fetch very much in the market if sold at once, but possessed undoubted capabilities, which in the hands of one able and willing to "nurse" it were amply sufficient to cover the advances the bank had made. The only other point during these earlier years related to the arrangement with the Farmers Trust, which the liquidators had condemned. In the first place, that was the only way which seemed practicable of getting the line out of the hands of its original management, which was objectionable, a foreclosure suit being, as the bank were advised, unlikely to prove successful. And secondly, although the accruing interest was, under the arrangement, postponed, yet it was truly a fresh advance towards the construction of the new portion of the line—an investment of capital in what the bank believed to be the most judicious way.

Coming to the next period, the extension of the line to Freeport did not prove so great a success as had been anticipated. The reason of that mainly was that another company, the Illinois Central, which had promised a connection at Freeport, had withdrawn its support. The question, therefore, before the bank was, whether they should let the railway remain at Freeport dependent on its neighbours for all but a local traffic, or advance money to complete the line to the terminus originally intended, at Savanna on the Mississippi. They resolved to do the latter, but by means of a new company, the Northern Illinois. The reason why a new company was created was in order to get rid of the power of

redemption which under the Farmers Trust arrangement the Racine and Mississippi Company possessed, the exercise of which would have enabled the old directors to resume the management. That line under its charter might, had it been deemed advisable, have been extended to Savanna. The bank also at this time, in accordance with Thomson's advice, increased their hold over the line by buying up its bonds. They did so at the rate of 40 per cent. for Eastern and 25 per cent. for Western Division bonds. These purchases were very expedient, and proved in the result very profitable, but they were laid hold of by the liquidators to show the depreciated value of the bank's security. That was unfair argument, as the market value of such bonds was no test of the real value of the line if properly developed

The resolution on the part of the bank directors to extend the line by the formation of the Northern Illinois Company was come to only after very anxious consideration. In particular, an exhaustive report by Mr Irvin was before the board, in which he considered with great detail the merits of the proposal, and concluded—"From the foregoing statements you will gather the reasons on which I have formed decidedly the following opinions:—1st, The construction of a railroad from Freeport to Savanna, to be operated in connection with the R. and M. R.R., would of itself be a profitable enterprise. 2d, That the connection of such a road with the R. and M. R.R. would increase at least 50 per cent. the receipts of that road, and provide at an early day the payment of all the bank's advances, and make full provision for its bonds." The directors resolved in consequence of that and other evidence to appropriate by way of loan the proceeds accruing to them by the Racine Railway, and they also resolved to subscribe to the stock of the new company. Why they took stock, not bonds, was this—that until a certain amount of stock had been taken up the company could not borrow.

But the directors had other evidence than mere opinion as to the value of their American property. Mr Thomson wrote on 4th June 1861—"Matters here go on satisfactorily, but all hands are kept fully employed. Our secretary, Mr Redburn, had to give up work two months ago, and is not likely to recover—a change which involves additional work; and on the 10th May we balanced our books, took stock of everything, and are now preparing our annual statements. The business on the road is also very large in freight, keeping fully our power running. I am particular in stating these facts, as I am anxious you should understand that there are good reasons for my not writing more frequently." And there was positive evidence of this in the surplus earnings of the line. In 1860 there was a surplus of 34,000 dollars; in 1861 the surplus had risen to 66,000 dollars, and that without any increase of mileage.

The extension to Savanna undoubtedly proved a success, so much so that others thought of buying, and the bank of selling, the bank's interest in the undertaking. The bank actually received and declined an offer from the Chicago and North Western which, on a 5 dollar exchange, would have given them £314,000, their debt being £330,000. They declined, because they thought they could get a better offer.

In connection with the disposal of the line, the question of exchange was highly important, as according to the view taken the value of the railway as a security was materially affected. The liquidators contended that the directors proposed to take the money home, at an enormous loss on the exchange. Mr Mackinnon said that the bank, not requiring the money, did not need to take it over to this country. All that was necessary was a reinvestment in a safer form of security in America till the exchange righted itself. Thus Mr Irvin wrote in November 1863—"The negotiation with the Chicago and N. W. Coy. having been abandoned, they have no immediate practical application, but during next year we shall probably have other propositions, on the consideration of which by your board they may be useful, especially in reference to the question of exchange, which is now the chief obstacle to a satisfactory arrangement. That question has to us presented itself in this aspect—that your property, being already on this side, subject to our depreciated currency, if we could, while getting rid of present responsibilities, obtain for you other securities of same amount of stronger and more available character, the bank would be in a better position for realising their property when exchange became more favourable, and in the meantime be getting interest on the whole. American gold today is 148⅜ and exch. 163 %". And similarly Mr Thomson says—The question of exchange would present the separate consideration to the bank, whether the unfortunate crisis in which this country is involved made it advisable to withdraw their money at once at a loss, or whether it was best to allow it to remain in American securities, with confidence that the course of events will restore the amount so held at a par exchange in a few years. My confidence in the future is strong; and I cannot contemplate the vast resources of the country, the energy and intelligence of the people, without feeling assured that a strong Government will be established, which will succeed the present Government of the Northern States, and take upon itself the responsibilities arising from the acts, or created, by the present administration. In that view I would not think it well to make a sacrifice upon exchange. The exchange of the bank's holding, as it now stands in the railroads, for other securities in this country, at a fair adjustment of relative values, would unquestionably be a most advantageous transaction for the bank in many respects. The matter was therefore undoubtedly under the consideration of the board, although they rejected the particular offer with reference to which Mr Irvin wrote, on the ground mainly that they doubted the solvency of the Chicago Company, wrongly as the subsequent history of that company showed. One phase of that offer was commented on by Mr Muir, accountant in Glasgow, who was examined for the liquidators. He, applying his exchange rule, valued the offer at £212,000; taking a par exchange it was £370,000 — an enormous difference to throw away. The bank's advances at that date were £360,000.

The period of redemption of the old Racine and Mississippi Company expired in 1864, and after considerable obstruction a foreclosure was completed. Thereafter arrangements for consolidating the lines, which had by this time been

extended to Port Byron, the furthest extension, were begun and completed in February 1867, the new company being called the Western Union. For its entire advances—principal and accumulated interest—the bank received stock on bonds of the new company. It was said that this result was obtained by a process of "watering" the new stock and bonds as compared with those of the old companies. That was not so—[The argument then entered into a long and minute examination of the details of the consolidation arrangements. Apart from figures, the position was briefly this—that the new, consolidated, and completed line was able to bear a larger quantity of stock and bonds than the old, separate, and local undertakings].

It was to be borne in mind in considering this whole matter that the American war was raging during a great part of the period in question. That circumstance must have had its influence on Mr Hall, whose views were unquestionably gloomy as to the prospects of the line, more so than his fellow investigator Mr Dunlop. In his evidence Mr Hall said—"When I went out I put myself in communication with Mr Irvin. I had met him before. There was no man in New York who occupied a higher position in the commercial world, or who does so still. He is a man in whose judgment I would be disposed to confide, and I had the most perfect confidence in his integrity. I also put myself in communication with Mr Thomson. He and I did not get on very well together. I was not disposed to accept the whole of his estimates of the future traffic of the railway. He held very tenaciously to his opinions, and he had very great confidence in the future of the railroad. I think Mr Dunlop, my colleague, had a better opinion of the interest than I had. He was disposed, I think, to put a greater degree of faith in Mr Thomson's views than I was. I believe Mr Mackinnon was also disposed to place more reliance on Thomson's views than I was."

There were numerous other offers besides that of the Chicago and North-Western, but the most important was that which was actually accepted with a financier named Mitchell—thereafter termed the "Mitchell Agreement." Its principal features have been already detailed. It was said that the Mitchell agreement proved that the stock had been "watered," so many of the bonds having been cancelled under the agreement. The true nature of the agreement was thus explained by Mr Mackinnon in his evidence:—"I must have known that at the date of the Mitchell agreement the coupons for the Western Union stock between 1866 and 1868 had not been paid. I believe I knew that preference stock had been issued to represent those coupons. That stock was not annihilated by the Mitchell agreement; it was cancelled, and a certain amount of common stock was given in exchange. That is my view. When we got the common stock in lieu of the unpaid interest I regarded the common stock as to a certain extent cover for the interest. (Q) Did you regard the common stock given in 1869 as giving you the means of repaying the interest of 1867 and 1868?—(A) I considered that the common stock in 1869, under the Mitchell agreement, was much more valuable than the preferred stock which had previously been held. It was part of the Mitchell agreement that $1,000,000 first mortgage bonds should be cancelled. I consider that the cancelment of that $1,000,000 of bonds greatly enhanced the value of the common stock—indeed to a larger extent than the cancelment of the bonds. In 1869, at the date of the Mitchell agreement, the bonds which had been added on in 1866 were not written back; the transaction had no reference whatever to that. I am not aware that the number of mortgage bonds had been largely increased in 1866. I should like to see the documents before assenting to that. I assisted to adjust the agreement under which the $1,000,000 first mortgage bonds were written off in 1869. That was done because it was one of the conditions under which Mitchell would go into the arrangement, and in lieu of the $1,000,000 stock was created. It was not my view that there were too many first mortgage bonds. (Q) Then why did you annihilate $1,000,000?—(A) Because we wanted to make a settlement, and realise at the most favourable opportunity. (Q) And that involved the writing off of $1,000,000 first mortgage bonds, getting common stock in lieu thereof?—(A) Yes; and the common stock, I consider, was increased so much in value by the cancelment that more than one million was secured to the bank as the result. The importance which I attached to the Mitchell agreement was this, that we were getting a man into the management who had enormous facilities for controlling railway traffic. He took two million of stock, and the moment he went in he gave life and vitality to the whole thing, and increased the value of the four million of stock much more than the cancelment of the one million of bonds. It was part of the agreement that the common stock should be taken by Mitchell at $650,000, with the option to the bank to take back the half of it. I always had it in my mind to take it back. (Q) You were giving Mitchell $2,000,000 of common stock for $325,000 by the same agreement in which you wrote off $1,000,000 of first mortgage bonds for nothing?—(A) Yes."

The importance in the present question of the Mitchell agreement lay in the evidence it afforded of the value of the bank's property when Mr Mackinnon left the board in 1870. Of course he was responsible at that date for the agreement along with the rest of the board; and there were some who thought a better arrangement might have been made. Thus Mr Irvin writes—"The price with the heavy abatement on the bonds is altogether inadequate in my opinion, and about half a million dollars less than was offered from another quarter." But in so far as Mr Irvin was right by so much was the bank's property the more valuable before 1869, the date of the agreement. At all events, the stipulated interest on the bonds was faithfully paid down to the date of the liquidation, the average dividend being £5, 11s. per cent. Now, what the liquidators said was—You must judge of the value of the property by what it brought in the liquidation, and as it was sold for £615,000, and the total advances were £905,000, with interest (see *supra*, p. 298)—the loss was £401,000. That was an unsound method of arguing.

The broad facts about the realisation were these. The liquidators made an exchange of bonds with the Chicago, Milwaukee, and St Paul line. The bonds of the Western Union which they held were 7 per cent. bonds, and these they

exchanged for 6 per cent. bonds of the Chicago, Milwaukee, and St Paul road. The stock they disposed of for a cash payment of $25,000 to the same parties—the Chicago, Milwaukee, and St Paul Co., acting through Mitchell. The St Paul 6 per cent. bonds were sold by the liquidators to what was called a syndicate, at 98 per cent., and the syndicate realised the bonds at a little over par, the liquidators sharing in a small portion of the profits made by the syndicate. That was to say, Kennedy, who acted for the syndicate, charged a fee of 10,000 guineas, and gave back the remainder of the profits—a somewhat larger sum—to the liquidators

The way in which the liquidators set about the disposal of this property was a little curious. In the first place, in the investigator's report, published a few days after the failure of the bank, the bonds were valued at only £436,000, and the stock at £11,000. And it was Mitchell who supplied this ridiculously low estimate. Mr Irvin had gone to him to obtain for the liquidators an estimate of the value of these assets of the bank. Thereafter the liquidators introduce Mr Thomson to Mr Mitchell for the purpose of getting his advice—to get advice from the enemy. What took place is thus described in a letter from Thomson—"I wrote you on the 9th per Cunard steamer 'Abyssinia,' and I have since received yours of 26th ulto. I have with Mr Kennedy had various meetings and consultations in relation to the question of selling the Western Union and other securities. At first with Mr Mitchell we hoped to get a proposition from him which we could recommend the liquidators to entertain. Mr Mitchell expressed great desire to help the liquidation in view of the great calamity of the failure, and gave us emphatic assurance that he would not under any circumstances seek personal profit in connection with the business, but that he would endeavour to get a party of capitalists to make a fair offer for a cash purchase, and do all in his power to facilitate the conclusion of a satisfactory sale. We were urged to name terms which we thought would be acceptable, and after full consideration we intimated that we were prepared to recommend the liquidators to accept ninety per cent. (90) for the bonds, with the stock thrown in, for a cash sale. Our proposition was received with a smile, which conveyed to us that the terms were far from what would be entertained. Mr Mitchell then talked of the bonds having sold at 70 and 75, and of other low price bonds in the market, adding that the security of the road was thin, that he had had to advance the interest at times, and that there was no money on hand to pay the February coupon. We found it difficult to get any indication of the terms Mr Mitchell had in his mind, such as could be attained; but at a late interview he said that he gathered from a good judge of the value of such securities that sixty-five (65) per cent. would be a fair price, *ex* the February coupon, which would make the price up to 68½; and he added that the stock is worth nothing at all. We think the proposition out of all reason, and on the other hand the terms we named as low should be thought of." In the end they got 98 per cent. and £5000 for the stock. The way Mitchell brought them to terms was by defaulting the coupons, which, as having the control of the line, he could at any time do. That discredited the coupons in the market, and although there was a counter move open to the liquidators—to foreclose, that required time, which the liquidators as such were probably not entitled to take.

Now, Mr Mackinnon impugned this realisation of the stock for £5000. He had nothing to say against the realisation as liquidation realisation, which almost necessarily involves loss, but he did say that he ought not to be made responsible for that loss. He ought to have had an opportunity to offer for the stock. It ought not to have been sold behind his back if it was intended to raise this question. It was said that the stock practically was worthless; that Mr Mitchell having the majority interest in it could do with it what he pleased. That was, on the American evidence, doubtful law, and at any rate, time and patience, which Mr Mackinnon could use though the liquidators could not, would certainly have produced a very much more favourable result. The earnings of the line were equal to a 2½ dividend on the stock, though in point of fact that sum never came to the stockholders.

The same remarks applied to the sale of the 6 per cent. St Paul bonds which the liquidators took in exchange for the 7 per cent. Western Union bonds. That sale was effected behind Mr Mackinnon's back, by one of the liquidators themselves transacting through the cumbrous machinery of a syndicate.

The second branch of this argument will now be briefly considered, viz., Mr Mackinnon's personal relation to the foregoing facts. His position as regards the interest and dividends was this—That he took for granted that the account was being charged with interest in the books of the bank. He did not make it his duty to ascertain—it was not his duty unless specially moved thereto—what precise figure of interest it was being debited with; and down to 1867 his evidence showed clearly that he took for granted that the rates of interest which were being charged against this account were the ordinary rates chargeable against an overdrawn account, that being the position most analogous to that which the railway held in reference to the bank. In 1867 his attention was directed by himself to the question of what amount of interest was being charged, and there were letters of material importance upon this subject, written in 1867, in which he made inquiry about the amount of interest being charged. Although not personally present in Glasgow, but writing from abroad, making it his duty to ascertain whether the dividend of that year was justified, he asked—"What are you charging against the American account?" and his advice was—First, that from that time they should not charge interest at all upon the account until realisation; and second, that they should not pay so high a dividend as was then in contemplation. In these matters he was overruled. But he did not, so far as these years are concerned, in the least degree divest himself of interest and even responsibility in this matter. Mr Mackinnon's explanation and justification of the practice of debiting the railway account with interest have already been given (*supra*, p. 297, in the argument for the liquidators). Findlater, the cheque clerk, gave evidence as to the actual mode in which the debiting was carried out, which came to this, that in 1857 and 1858 the

ordinary rate upon cash-credit accounts was charged, and thereafter the security rate. According to the ledger those accounts were taken over by the bank. [LORD PRESIDENT—It could hardly have been the security rate after that. LORD SHAND—They first had 5, and then they went back to 7. They had two years at 5, and apparently the manager for a time went back to these two years, and added 2 per cent. But when you come to 1859 there is a curious rate—8 per cent.] They were 8 per cent. bonds. [LORD PRESIDENT—Do you mean that the coupons were for 8 per cent.?] Yes. [LORD PRESIDENT—I thought they had been for 7 per cent.] The latter ones—the Northern Illinois—were 8 per cent.; they all were 8 per cent. up to 1866, and then 7, and so they remained down to the end.

Now, what was contended against Mr Mackinnon was that he actually paid away capital of the company as dividend—not that by his negligence he allowed others the opportunity of doing so. But, in the first place, it was not the directors—it was the shareholders who declared the dividend on the advice of the directors, no doubt, but still the shareholders, who on the view submitted in the preliminary discussion, were alone interested in this matter. Then, on the evidence, it appeared (1) that the act of debiting the account was the act of the manager, not of Mr Mackinnon; (2) that Mr Mackinnon down to 1867 did not know what rate of interest was being debited to the account; and (3) that he dissuaded the manager from debiting any interest after that date, but was overruled. Mr Mackinnon further contended (1) that the liquidators had failed to prove that when Mr Mackinnon retired the American property was not sufficient to cover interest and principal; (2) that the bank had homologated the transactions complained of; and (3) that by realising as they had done they had barred themselves from insisting in their present claim.

It was necessary to consider some of the authorities on these questions. First, on the relations of the directors and the manager— *Cullen* v. *Thomson's Trustees*, July 14, 1862, 4 Macq. 424, showed that the manager was not the mere servant of the directors—See also *National Exchange Company* v. *Drew and Dick*, July 27, 1860, 23 D. 1; *Leslie* v. *Lumsden*, June 19, 1856, 18 D. 1046. Then, on the main question of this case, the rule was thus stated by Mr Justice Lindley, Partnership, p. 794—"But neither directors nor shareholders are liable to refund dividends declared and paid on a *bona fide* valuation of assets, although such assets may ultimately prove valueless"—*Stringer's* case, April 26, 1869, L.R. 4 Chanc. 475; *Rance's* case, December 15, 1870, L.R. 6 Chanc. 104 The facts of this case were such as to free Mr Mackinnon from liability on the principle of that rule. On the matter of the bad debts which it was sought to place against the reserve fund there was nothing to suggest on the bank books that these debts were bad, and Mr Mackinnon as director was under no duty to inquire—*Western Bank* v. *Baird*, 24 D. 859. On the general nature of the misfeasance necessary to bring a director within the scope of the 165th section of the Companies Act 1862 there were two recent English cases—*Forest of Dean Coal Mining Company*, 1878, L.R. 10 Chanc. Div. 450; *Coventry* v. *Dixon*, 1880, L.R. Chanc. Div. 660. Then the bank by drawing the dividends from these bonds from 1870 onwards had homologated the previous actings in regard to this property—*Western Bank* v. *Baird's Trustees*, November 22, 1872, 11 Macph. 96. Further, the liquidators had been guilty of undue delay in bringing this action. They knew of the grounds upon which they now proceed on 23d November 1878, as appears from their minute of that date:—"Statement submitted, showing the interest, &c., received in respect of American securities by the bank from 1858 to 1870, and the amounts actually carried by the directors in these years to profit and loss, and so divided among the shareholders. Resolved to communicate this statement to the procurator-fiscal." Yet they took no action, and gave Mr Mackinnon no notice till they served the summons in the relative action on June 30, 1880. In the meantime they changed the properties without notice to Mr Mackinnon, and by this he had suffered loss, as he would have made a better bargain. But it was not necessary to instruct loss. Mr Mackinnon was virtually a cautioner, and a cautioner did not require to establish a case of loss in order to assert his right that no change should be made on the security given by the debtor—*Forsyth* v. *Wishart*, February 8, 1859, 21 D. 449; *Hume* v. *Youngson*, January 12, 1830, 8 S. 295; Ersk. iii. 3, 6—iii. 5, 11; 1. Bell's Comm., 359 (377, 7th ed.); *Macdonald's Trustees* v. *Mitchell*, May 31, 1821, 1 S. 42; *Rees* v. *Berrington*, 2 White and Tudor, 1007.

Replied for the liquidators—On the law the first point related to the alleged homologation. Here the essential element of an act of homologation was absent—that the company knowingly adopted what they might have rejected had they pleased. Had the question been as to the homologation of the Mitchell agreement, that would have been different, but the company knew nothing about misapplication of the capital. Then lapse of time was suggested as another answer to the liquidators' demand. But mere lapse of time was no answer, though it might be important in conjunction with something else, *e.g.*, as evidence of acquiescence. Lastly, as to the change in the securities which the liquidators had made. The respondent said, in the first place, that he was entitled to be free on the mere ground of this change, whether he showed that he had suffered prejudice or not; and he likened his position to that of a cautioner. That was an unsound analogy. Both a cautioner and a director were entitled to stand on their contract; but a cautioner's contract gave him, while a director's contract did not give him, the right for which the respondent contended. The respondent, however, maintained that he had suffered prejudice by the change of security. Had he in fact? He did not in his evidence say so; and it was plain that the bonds by themselves were not equal, and could not be made equal, to the advances. While as to the stock, that was practically worthless, owing to the hold Mitchell had got over it under the agreement the respondent and the other directors had made, against the advice of Irvin, whom they said they had such confidence in. It also seemed to be contended that though the respondent from 1867 knew of the practice of debiting interest to the railway account, he remonstrated, and that freed him. But the reverse was rather the true inference—*Joint Stock Discount Company* v. *Brown*, L.R. 8 Eq. 381.

The respondent having replied, the Lords made a vizandum.

At advising—

Lord President—The serious and important questions which we are now to determine have arisen in the course of the liquidation of the City of Glasgow Bank.

On the 13th November 1880 the liquidators presented to the Court a note, under the authority of the 165th section of the Companies Act 1862, in which they claim from Mr William Mackinnon, a director of the bank from 1858 till 1870, a sum of £311,666, 16s. 9d., paid away to the shareholders as dividends between 1858 and 1870 on the recommendation of the directors, including the respondent Mackinnon, on the ground that this sum did not represent profits earned, but was in effect paid out of the capital of the bank.

If this charge be proved, it certainly amounts to a breach of the bank's contract by those who were appointed to administer its affairs, and independently of special contract it would be at common law a gross breach of trust.

It is not a charge of negligence or failure in duty; the fact alleged is an overt act of misapplication of a large portion of the bank's capital, done knowingly and wilfully.

But an allegation that dividends have been paid out of capital may be either a very simple act of misfeasance, easily proved as matter of fact, or it may be only an inference in fact from complicated and continuous transactions stretching over a long course of years, and capable of being construed and judged of only by the application of commercial and actuarial knowledge and skill. That the present case belongs to the latter and not to the former of these categories may be presumed from the almost unprecedented bulk and variety of the evidence laid before the Court.

The task of analysing and digesting this evidence has necessarily occupied a long time. But the results of our deliberations may, I think, be stated within a comparatively short space.

In 1856 Mr William Gemmel had acquired from an American railroad company, called the Racine and Mississippi Railway Company, a number of bonds for $1000 each, which were a first charge on the line, bearing 8 per cent. interest, having a currency of about thirty years, with a provision of a sinking fund of 1½ per cent. to be set aside annually to reduce the principal.

The bank agreed to make, and did make, advances on the security of these bonds, and certain other stocks belonging to Mr Gemmel, or other parties for whom he acted, in 1856 and 1857.

On the 11th November 1857 the bank stopped payment, and did not resume business till the 31st December thereafter. At this date the advances made by the bank on the securities above mentioned amounted to £117,608. The railway bonds held in security for this advance were of the nominal value of £134,000.

Up to this time the respondent, though a shareholder of the bank, had never been a director, or been concerned in any way in the management of its affairs. But an investigation committee having been appointed, composed partly of shareholders, and partly of merchants and accountants unconnected with the bank, Mr Mackinnon was about the same time named a member of a shareholders' committee who were to co-operate with the directors. The investigation committee made a full inquiry into the affairs of the bank and its financial condition at the time of its stoppage, and at a meeting of shareholders on the 8th of December 1857 their report was considered, the result being a resolution to resume business.

The respondent thus became acquainted with the way in which the advance of £117,000 had been made, and with the nature of the securities held for the same. But neither in the report of the committee of investigation nor at the meeting of shareholders was doubt expressed as to the propriety of the advance or the sufficiency of the securities.

The bonds already mentioned extended over the part of the railroad which was finished from Racine to Beloit. But in February 1858, after resuming business, the bank made further advances on the security of bonds of $1000 each over a further portion of the line which had then been constructed.

Both sets of bonds were a first charge on the railway, and as such the bonds with their coupons furnished security (such as it was) for the interest as well as for the principal advanced.

As to the estimated value of these securities, it is enough to say at present that the railway company was in great embarrassment, in consequence of the depression caused by the war between the Northern and Southern States, and was not in a position to pay the interest as it accrued due. But if the line afforded a good ultimate security for the principal and interest of the whole bonds issued by the railway company, which were a first charge, the non-payment of interest was, in practical effect, nothing else than an additional advance by the bank on security.

The bank had agents in New York named Irvin & Company, who seem to have been persons of high character, and who in their correspondence with the manager, while admitting the impossibility of realising during the war, gave a confident opinion as to the ultimate sufficiency of the securities for both principal and interest.

It was in these circumstances that the respondent became a director of the bank in July 1858; and the first overt act of misfeasance charged against him is, that he as a director signed the balance-sheet of 1859, to be submitted to the shareholders at the annual meeting of that year.

The financial year of the bank ended in June 1859, and the interest due on the American railway securities, amounting to £7552 for the year, was added to the amount of the debt in the bank books at that date, and was carried to the credit of the profit and loss account. The result, of course, of the operation was to increase to that extent the balance of profit for the year appearing in the balance-sheet.

The contention of the liquidators is, that the interest for the year, £7552, not having been received, was not profit, and the dividend of the year was to that extent paid out of the capital.

But if no dividend could ever be paid except out of cash in hand or in bank, representing profits or interest actually received, it is obvious that the business of such a company could not be practically carried on, and the existing shareholders of the company would have good reason to com-

plain that they were deprived of their just share of the profits of the concern actually earned and well secured, because these profits could not be converted into cash before the balance-sheet of the year was struck.

When profits have been earned and not paid, but invested on undoubted security, and these profits have been carried to the credit of the profit and loss account, and a dividend declared and paid out of the balance of profits thus obtained, it is no doubt true in a literal sense, that the dividend is to the extent of these unpaid profits paid out of capital, because the company not having cash to represent these earned and secured profits, must find the money to pay the dividends elsewhere, and they can find it nowhere except by applying to the purpose cash which forms part of the floating balance of capital. But if the unpaid profits are fully secured they become part of the capital of the company, as a *surrogatum* for the cash of equal amount taken from the floating capital and paid as dividend, and thus the capital is not diminished, but a certain part of the floating balance of capital becomes invested in the securities which the company hold for the earned but unpaid profits in question.

From this it seems to me to follow, that in order to convict the directors of this company of paying a dividend out of capital in 1859 it is necessary to prove not merely (1) that they knew that the interest on the American railway investment though due was not paid, and (2) that it was brought to the credit of profit and loss, and so divided as clear profit, but also (3) that they had not reasonable ground for believing that the interest was well secured and would ultimately be recovered.

If they had reasonable ground for so believing, they acted in good faith, and so cannot be said to have committed a breach of trust; for while it is the duty of directors to act very cautiously in estimating the securities which they hold, they are necessarily left, by the very nature of their office, to exercise their own judgment and discretion in making such estimate. They owe to the company an obligation to leave a safe margin in striking the balance of profit and loss, so as not to endanger its financial position. But they are equally bound to have a due regard to the interests of the individuals who for the time are the holders of the stock of the company, and to whom they are under an honourable, if not also a legal, obligation to pay such a dividend as in their opinion may fairly be paid out of the profits consistently with the financial wellbeing of the company.

If, indeed, it could be shewn that when the respondent and the other directors recommended the dividend of 1859 they were in the knowledge that the securities which they held for the outstanding and unpaid interest were truly and substantially unsound, and such as would not have been relied on by prudent and mercantile men in the management of their own affairs, I should not think it by any means a sufficient defence of what they did that the securities were nominally of sufficient value. I should regret extremely if the opinion I express could be construed to justify directors in treating such a matter lightly or negligently. But on a full consideration of the evidence I am satisfied that in the present case the directors acted not only in good faith, but with fair and reasonable grounds for the judgment which they formed.

I have hitherto confined my attention to the conduct of the directors in 1859 (the first year of the respondent's official responsibility), because it conduces to simplicity and clearness to state the principles on which I think this case must be decided as applicable to one period and one act of alleged misfeasance. But it is of course necessary to have regard to the whole conduct of the directors from that year down to 1870 (when the respondent resigned) to determine whether the considerations which seem to me to justify the recommendation of the dividend of 1859 are equally applicable to the varied condition of the American securities during the subsequent years.

If, however, I should attempt to give a detailed and connected history of the American railroad, and the relations of the bank to its concerns and prospects during the whole years of the respondent's official connection with the bank, I should necessarily exceed, to an enormous and unjustifiable extent, the reasonable and usual limits of a judicial opinion. I can only therefore undertake to state the results of a careful study of the whole evidence.

I give no opinion as to the wisdom or prudence of the original advances made by the bank on the security of the railway bonds, for two reasons —(1) because the respondent was not a director when they were made, but took them up on his joining the direction as an investment to which no objection had been made by the committee of investigation, or by the shareholders when their attention was called to the matter during the temporary suspension of the bank's business in 1857; and (2) because the wisdom or prudence of such investments generally must be judged of by persons of mercantile rather than of legal knowledge and experience, and I cannot find that there is any such concurrence of opinion in the evidence as could lead me to hold that the original investment must be condemned as exceptionally unwise and imprudent.

One salient point in the case is, that in progress of time the bank's interest in the railway, and the amount of money that they embarked on the faith of its ultimate prosperity and success, increased from £117,000 to £905,000 (including, however, the unpaid and accumulated interest) during the respondent's connection with the direction; and this on a superficial consideration of the history of the case has undoubtedly a good deal of the appearance of what is colloquially called throwing good money after bad. But I am satisfied that would be a rash and unjust conclusion, if it be true, as the respondent contends, that the sum of the company's capital which he left invested in the American railway's securities when he resigned as a director in 1870 was well secured. At that date the figures stood thus:— The total amount of principal and interest due to the bank was £905,166. The nominal amount of the securities held for this debt was £974,866, leaving a margin of £69,700 in favour of the bank. Of course everything depended on the real value of the securities.

It has not been suggested on the part of the liquidators that it would have been prudent to write off the debt secured on the American railways as a bad debt, either in respect of principal

or interest, when the respondent entered on his duties as a director; and I do not understand that such a proceeding would, in the view of the liquidators, have been justifiable at any time between 1858 and 1870. If such a course had been adopted, the directors would, as a necessary consequence, have ceased to take any steps for improving their position as creditors in the railway bonds, or even to expend any money in watching over their interests as such creditors. But if this course was not to be followed, then it must be at once apparent that, from the nature of the investment and the financial condition of the United States at the time, this portion of the bank's assets required the most vigilant attention, and, if necessary, the expenditure of more money, in the hope of tiding over difficult and embarrassing times.

It very soon became clear that unless the directors were prepared to encounter the loss of their advances of £117,000, with accruing interest, they must make up their minds to "nurse the line," *i.e.*, they must advance more money to enable the railroad to be completed to such an extent as to connect Lake Michigan with the Mississippi, without which it could not ultimately prove a paying concern. They had also to prevent or discourage damaging competition, and to get the management of the line out of incompetent and untrustworthy hands.

In the course of all these complicated proceedings they had the constant advice of Messrs Irvin, of New York, whose correspondence proves them to have been persons of large experience and capacity in dealing with such affairs, and they had a special agent, Mr Thomson, who was on the spot, and who, if somewhat sanguine, was also a very energetic and able man.

The whole money advanced under this advice was secured on substantially the same kind of securities as the bank held from the beginning, and the securities obtained were always large enough, at least nominally, to cover all the overdue interest for the time.

The directors had been constantly assured by their agents, during the twelve years in question, that their investments were sound, and in the end would certainly prove good both for principal and interest.

Notwithstanding these assurances, the directors were very anxious to realise their investments, because they naturally felt that there was too much of the bank's funds locked up in one class of securities, which was for the time unproductive; and their desire to realise was uniformly pressed on their agents and advisers in America. But here they encountered a great difficulty, in consequence of the rate of exchange between the United States and this country. If they had disposed of their interests in the railways, they could not have obtained payment of the price except in United States currency, which could not be converted into gold in London without a great loss. There is no doubt that, but for this embarrassment, they could have obtained a price, on more than one occasion, which would have repaid the whole advances, both principal and interest, and even left a margin of gain.

The liquidators in argument make a great deal of this topic, and say that the offers which were made are, as indications of the value of the investments, of little account; for the real value, they contend, must be measured by the amount of gold they could have got, as the produce of the transaction, when the money was brought home to this country. But I think this argument is based on a fallacy. No doubt it was impossible, except at a great loss, to bring home the money to this country, and it would of course, have been much more convenient to bring it home, if the doing so had not been attended by such loss. But nobody supposed that the very exceptional financial condition of the United States, arising out of the war, was to be permanent, or even of any very long continuance, and still less that the Government would become bankrupt. Now, though it was impossible without great loss to bring home the money, it was quite possible to invest it in unexceptionable securities in America without any loss. The Government securities, and particularly what were called the 5.20 United States bonds, might then be purchased at par, and these bonds on maturity were payable in gold. It was a further and most important recommendation of such securities that the directors were by the contract of copartnery of the bank specially authorised to invest in the "securities and stocks of the Government of Great Britain and Ireland, or of the United States of America, or of foreign States."

The directors did not accept any of the offers for the purchase of their entire interest in the railways. The precise character and denomination of the securities varied from time to time, according to the exigencies of the railways, and the judgment the directors formed as to the best way of handling for the time the investments which they held. But in the end, *i.e.*, in 1870, they held, as already mentioned, securities of the nominal value of £974,000 for a debt, principal and interest, amounting to £905,000.

The evidence as to the real value of these securities in 1870 is voluminous and multifarious, and an examination of it has left on my mind a decided impression that after many years of anxious and careful treatment of the investments of this portion of the bank's funds the directors had got into comparatively smooth water, and were possessed of a property or investment of a sound description.

Certainly this impression is very strongly confirmed by the undoubted fact that in 1870 the investment began to pay interest, and continued to do so down to the stoppage of the bank in 1878. The rate of interest indeed varied from time to time, but the average of the eight years was 4 per cent.

Now, it must be remembered that the investment of £905,000 which was thus yielding interest at 4 per cent. was composed not only of the money advanced by the bank, but of all the unpaid interest at a high rate which had accrued due since 1856; and thus this £905,000, which formed in 1870 an important part of the capital of the bank well secured included, as one of its component parts that £311,000 of the bank's capital which the respondent is charged with having misapplied by paying it away in dividends. For while a portion of the floating capital in the form of cash or money at call, or the like, was used to enable the bank to pay dividends corresponding to the amount of the interest due but unpaid on the American railway securities from 1858 to 1870, there was growing up, in precisely

the same proportion, an addition to the capital of the bank in the form of securities for the said interest accumulated with the principal sum of the advances made, the result being that in 1870 the amount of the bank's capital stood undiminished by the operations complained of.

In judging of the conduct of the directors during the twelve years before 1870, it is also a very material circumstance that the reserve fund provided for by the company's contract had risen in amount during that period from £15,000 to £260,000. Such a fact is inconsistent with the idea that the directors were rashly and indiscreetly endeavouring to make their dividends as large as possible without due consideration for the financial wellbeing of the bank. It is alleged, no doubt, that this large reserve was required and would be absorbed in providing for bad debts of the bank unconnected with the American securities. To this, however, it is enough to answer, that if there was such an amount of bad debts at that time, there is no reason to suppose that Mr Mackinnon was made acquainted with that fact or was aware of it.

Hitherto I have not made any distinction between the position and conduct of the respondent Mr Mackinnon and those of the other directors. But it is only fair to him to notice some circumstances which are peculiar to his case.

It does not appear that he ever made use of his knowledge or influence as a director to procure any pecuniary or other advantage to himself. It was tacitly admitted in the course of the arguments that the greater part of his extensive banking business was done with another establishment; that any discounts which he obtained from the City Bank were in the ordinary course of business; and that the bank would have been much benefited if he had been induced to give them more of his custom.

During his tenure of office it appears that the respondent gave more of his time and attention to the management of the bank's affairs than could well be expected from a man engaged in extensive mercantile transactions on his own account. In the prosecution of his own business he was necessarily often, and for long periods, absent. But even then he maintained a frequent correspondence with the manager, in which he gave the bank the benefit of his judgment and experience, to aid them in determining how they should deal with this branch, among others, of their business and investments.

In 1867, having seen some reason—in consequence of the commercial crisis of 1866—to be more cautious than ever in handling securities of this description, he dissuaded his brother directors from continuing longer to place the unpaid interest to the credit of the profit and loss account, and so to include it in the balance of profit for dividend. He was overruled in this, and considering it to be a matter of opinion and judgment, he acquiesced for the time, but continued to urge his objection periodically till his resignation in 1870.

It is stated in Mr Mackinnon's answers that the system of making large unsecured advances to directors and their friends and partners, which proved the ultimate ruin of the bank, had not begun while he was a director. This has not, so far as I can see, been disputed either in the evidence or in the course of the arguments.

For what took place after 1870 the respondent is of course not answerable. New directors and a new manager came into office between that date and the stoppage of the bank, and in this liquidation we have only too good reason to know that their management of the affairs of the bank was of the worst possible description.

After the liquidation commenced we are informed that the American railway securities were disposed of by the liquidators at a heavy loss—a loss, if I understand rightly, of more than 25 per cent. To this the respondent answers that he cannot be made responsible for the results. He says, truly, that the realising of assets for division among creditors is always a very unfair test of the value of the assets, because it must to some extent be gone about hastily, and in a necessarily unfavourable state of the market.

But the respondent goes further, and contends that the conduct of the liquidators in realising these securities has been such as to liberate him from all responsibility, even if he had been otherwise liable.

In considering this part of the case it is necessary to keep always in view that when the note was presented Mr Mackinnon had been for ten years entirely unconnected with the management of the bank; that for six years he had not even been a shareholder, having sold out in 1874; that he was in no way a party to the liquidation; and that the first notice he had of the serious charges and the heavy pecuniary claim made against him was the service upon him of this note in November 1880, or of the relative summons in June of the same year.

In the interval of more than ten years many important events had taken place. In 1870 the then existing board of directors and the manager took over the railway securities from the retiring directors as a good investment, which they thenceforward managed according to their own discretion. As time went on the management of the bank became in the highest degree imprudent and even criminal, and ended in ruin and disaster in October 1878. Meantime the gentleman who was manager of the bank while Mr Mackinnon was a director had died; some of his co-directors had gone out of office like himself; and when the crash came, and the liquidation commenced, the respondent was apparently no more concerned than any other outside member of the public.

When the note is served upon him, he learns for the first time, not only that he is to meet a charge of breach of trust going back for a period of more than twenty years, but also that the securities, in dealing with which the breach of trust is said to have been committed, have been realised by the liquidators at a great sacrifice.

The respondent says that if he had had notice he would have been prepared to relieve the liquidators of the securities, by paying them a price largely in excess of what they obtained; and he complains that he was not afforded an opportunity of doing so.

He has no occasion to say that the liquidators in realising at a sacrifice did not act for the best in the interest of the creditors and shareholders—for in a liquidation it is sometimes advisable to make a sacrifice in order to effect a speedy realisation. But he has occasion to say that that sacrifice ought not to have been made behind his back, especially as the whole responsibility for

what was done with these securities prior to 1870 is proposed to be laid on him alone, to the exclusion of those of his co-directors who are solvent, and, it may be, as much answerable for what was done as he can be.

In these very peculiar circumstances I am of opinion that the present claim, even if it were on its merits well founded (which I think it is not), is barred by what has occurred between July 1870 and November 1880.

There is only one other question on which I think it right to offer an opinion before concluding—I mean the question, whether the liquidators have a title to maintain this claim against the respondent.

The liquidation has now advanced so far as to show that the creditors of the company will be paid in full, and that a surplus will be left for division among the partners. The liquidators therefore are suing, not in the interest of creditors but of shareholders. But the only shareholders who have any right to the surplus assets of the company are those who have paid up their whole calls and remain solvent.

The number of these persons is 208, and the stock which they held at the stoppage of the bank and still hold is £88,722. Of the total number of these shareholders sixty-nine acquired their shares prior to Mr Mackinnon's retirement in 1870, and the amount of stock held by them is £38,324. Those who acquired their shares after 1870 are 139 in number, and hold stock amounting to £50,395.

But a much larger number of shareholders, being unable to pay their calls in full, settled with the liquidators by composition, and as part of the arrangement surrendered and assigned to the liquidators their whole interest in the company, representing £757,342 of stock. This stock was held at the stoppage of the bank by shareholders who acquired it before 1870 to the amount of £337,227; and to the amount of £420,515 it had been acquired (by those who held it at the stoppage) after 1870. A considerable amount of the stock was held at the date of the stoppage by or for behoof of the bank itself.

The inquiry at once presents itself, What are the liquidators to do with the £311,000 demanded from the respondent, when they get it into their hands? Are they simply to distribute it among the remaining solvent shareholders, according to the amount of their shares? The result would be that those shareholders who got their full share of the capital of the company improperly paid away in dividends, would receive payment of these dividends a second time in whole or in part. But all could not expect to receive an equal amount, for some have profited by the unlawful dividends to the full extent of twelve years' dividends, while others may have only received such dividends for one or two years. In any view, therefore, some of the solvent shareholders would be entitled to no part of the £311,000, having received their full share of it already, others might be entitled to a full share of it corresponding to the amount of their stock, and others might be entitled to a proportionate share varying in amount according to the precise date of their acquiring their stock between 1859 and 1870.

These considerations suggest three serious objections to the title of the liquidators to recover the sum which they demand from the respondent:—(1) It is clear that they are asking a great deal more than they can justly dispose of; (2) They have not shown, and probably cannot show, how much they could justly dispose of; and (3) Such a demand is plainly not within the meaning of the 165th section of the Act of Parliament.

But there is a still more serious, and I think a fatal, objection to the title of the liquidators to insist in this demand. Every shareholder of the company for the time received his share of each of the dividends said to have been unlawfully paid, and so each share of the company's stock received just as much of these dividends as every other share. Now, a purchaser of shares in such a company takes precisely the place of the seller, and cannot ask for himself a participation in any advantage of which his author has already received the proportion corresponding to the shares sold. This proposition, which seems to me sound in general principle, receives very strong support from the 33d article of the bank's contract of copartnery, which provides that every person acquiring shares, whether by inheritance or purchase, "shall take and assume the place and liability of his author, ancestor, or other cedent, and become subject to all the obligations incumbent on him." If the shareholder who received payment of a dividend out of capital is to have the improperly divided capital replaced, in order that in the liquidation he and his copartners may have the replaced capital divided among them rateably, then he must repay the dividend improperly paid and received; and his assignee or successor, who has "become subject to all the obligations incumbent on him," must fulfil the obligation to repay the dividend. His claim, therefore, is barred on the principle *frustra petis quod mox restituturus es.*

Such being the position of those who are now practically the only constituents of the liquidators, for whose benefit alone they will now administer the estate in liquidation, my opinion is that the liquidators have no title or legitimate interest to insist in their claim against the respondent Mr Mackinnon.

I am for refusing the prayer of the note for these three reasons:—

1. That the liquidators have, at this stage of the liquidation, no title or legitimate interest to maintain the claim they make.

2. That the claim is barred by lapse of time, combined with the action of the managers and directors of the bank between 1870 and 1878, and the conduct of the liquidators in disposing of the railway securities without any communication with the respondent or notice to him.

3. That there is an entire failure to establish that the respondent was a party to any proceeding which can properly or fairly be described as paying dividends out of capital.

Lord Deas—The contract of the City of Glasgow Bank was entered into early in the year 1840. The original capital of £750,000 was increased in 1843, under powers conferred by the contract, to £1,000,000, divided into £10 shares, which were converted in 1860 into consolidated stock. The bank suspended payment on 11th November 1857, but was resuscitated at a general meeting of the shareholders on 31st December of the same year. The bank then carried on business till October

1878, when it finally stopped payment, and its affairs were agreed to be wound up by voluntary liquidation under the supervision of the Court. The supervision of that liquidation entailed upon your Lordships of this Division much laborious duty of a painful nature, not only as regarded the ruin of many innocent shareholders, but also as involving the punishment and degradation of those directors whose malversations in office contributed directly and largely to the lamentable result.

The present case arises out of an earlier period of the bank's history, and the liabilities sought to be vindicated in it are solely of a civil or pecuniary description. They are, however, very large, and the case is on that account, as well as for other reasons, one of great anxiety and importance. The proof adduced, documentary and parole, as to the nature of the transactions sanctioned by the directors, and for which the defender, as the only solvent director, is sought to be made responsible, is extremely and unusually voluminous. The able pleadings on both sides of the bar, before and after the leading of that proof, have been proportionally extensive, occupying weeks of judicial time, and it would be altogether impracticable for each of us, I may say for any one of us, to travel over the whole in detail. I shall not attempt to do so, but rather to state the conclusions at which I have arrived, and where my chief difficulty has lain, and still lies, in regard to one or more of the conclusions which have been reached.

The proceedings have assumed a shape which can hardly be reconciled with strict judicial rule, and which I find to be considerably embarrassing in endeavouring at this stage to form and express an opinion upon them.

The note now before us was presented by the liquidators in November 1880. In that note a general narrative is given of the bank's transactions with certain American railway companies, but the substantive matter of complaint in the note is, that in the accounts kept by the bank with these railway companies, as entered in the bank's books, the directors of the bank had for the year ending in June 1858, and for each of the subsequent years down to and inclusive of the year ending in June 1870, debited the railway companies with large sums of interest, amounting in whole to £315,897, 7s. 8d., and had paid these sums half-yearly to the shareholders of the bank as dividends, while, except to the amount of £4230, 10s. 11d., no part of said interest had been actually received by the bank, and the railway accounts referred to had all along remained unproductive.

This the liquidators have alleged was equivalent to payment of dividends out of capital, and on this footing the note concludes by craving "decree against Mr Mackinnon for £311,666, 16s. 9d., or such other sum as shall be ascertained to be the amount of the interest debited to the accounts in the books of the said City of Glasgow Bank, titled 'Railway Debenture Account' and 'Railway Stock Account,' and paid away as dividend in accordance with the reports of the directors of the bank."

Shortly before presenting this note the liquidators in June 1880 had raised an ordinary action against Mr Mackinnon, which is now in dependence in the Outer House. In that action, besides making, in *verbatim* the same terms as in the subsequent note, the claim for interest said to have been improperly paid away as dividends, the liquidators have libelled a different and additional ground of liability against Mr Mackinnon, viz., that while he was a director of the bank there had been expended certain large sums of money, beginning with the purchase of mortgage bonds over the Racine Railway, and when these were found to be inadequately secured, then much larger sums in constructing from time to time extensions of that railway until it ultimately became, what had been contemplated by the original projectors, viz., a continuous line between the two great termini of Racine on the east, and Port Byron or Savanna on the Mississippi on the west. This expenditure the liquidators alleged in their summons and condescendence was a breach of duty by the directors of the bank while Mr Mackinnon held office; and as the whole securities and property thus acquired by the bank had, when realised by the liquidators under the present liquidation, produced less than the amount expended for them by £122,565, 2s. 8d., the summons concluded against Mr Mackinnon for that sum, with interest at 5 per cent. per annum from 22d October 1878 till paid.

What is called an unclosed record was prepared in that action by condescendence and answers, in which the parties, besides embodying what I have mentioned as to the matter of interest and dividends, have set forth more fully than in the note and answers all their averments as to the bank's investments in and connected with the said Racine Railway and its extensions. The voluminous proof which has been adduced, documentary and parole, has been directed to the whole averments thus made by the parties respectively in the ordinary action as well as in the note. The discussions at the bar, as the printed notes show, have also been applicable to both claims against Mr Mackinnon, viz., the claim for £122,565, 2s. 8d. of damages in respect of loss upon the investments and purchases, and the £311,666, 16s. 9d. of interest applied in payment of dividends when that interest had not been actually received by the bank.

It seems to me therefore incumbent on us at this stage of the liquidation, and with a view to facilitate its further progress, that we should now express our views, tentatively at least, upon each of these grounds of liability, deciding them only in so far as we may be agreed that they are ripe for decision.

The natural order in which to deal with these two claims seems to be to take first the more general question—although not involving the largest amount of pecuniary liability—I mean the question how far the investments by the bank in and connected with the line, or rather lines of railway, from Racine to Port Byron or Savanna on the Mississippi were or were not breaches of trust on the part of Mr Mackinnon and his co-directors inferring liability on his part for the difference between the amount expended by the bank on these investments and the price realised for them when sold by the liquidators.

This question must be judged of altogether under the circumstances in which Mr Mackinnon found himself placed when the expenditure said to have constituted a breach of trust on his part was commenced, and afterwards continued and increased. The opinion which may be formed on

that question in these circumstances can be no precedent or authority for forming a similar opinion where the circumstances may be different. It will be kept in view that large advances had been made by the bank to the Racine Company both before the bank suspended payment temporarily in November 1857 and after it had been resuscitated by the shareholders in December of that year. These advances had begun as early as 1856-57 and the beginning of 1858, and they left a sum of upwards of £117,000 due to the bank in February 1858, for which the bank had virtually nothing to look to but the credit of the Racine Company, which the liquidators say in their note was then in embarrassed circumstances, and unable to pay the interest on its bonds.

In like manner, in the unclosed record in the ordinary action the liquidators make the following statement:—"In February 1868 the Racine Company was in embarrassed circumstances, and unable to pay the interest of its bonds. The second part of the line was formed to the extent of only one-fourth. The company had meantime made an issue of 700,000 dollars of bonds over that part, and had contracted with Mr George A. Thomson, stockbroker, London, afterwards of New York, to place the said bonds, which he had failed to do. The bank, on the security of 163 of these bonds of 1000 dollars each, and a promissory note for £20,700 by the president of the company (Mr Durand), had discounted drafts of Thomson upon Watson & Company, of Glasgow, to the extent of £20,000. Thomson and Watson & Company were quite unable to pay, and the Racine Company had no prospect of meeting their president's promissory note at the time it fell due on the 29th April 1858. The promissory note was accordingly dishonoured, and a month later an arrangement was made, under which it was handed back to the company in exchange for 194 more bonds of 1000 dollars each over the second part of the line."

All this, it will be observed, was before Mr Mackinnon became a director of the bank, which he did not do till 5th July 1858. The question which in these circumstances necessarily presented itself to the mind of Mr Mackinnon when he accepted the office of director was—What was he to do?

To lose the debt of £117,000 due by the Racine Company would obviously infer the ruin of the bank. The Racine Company, and consequently the bank as creditors of that company, were in a state of embarrassment apparently inextricable by any ordinary means which could have been adopted; and for this state of matters, whoever had been to blame, it was not Mr Mackinnon. The ship was overweighted and ready to sink. A large unsecured debt, like an ill-omened albatross, hung over her, and unless some one of unusual energy and whose motives were at the same time above suspicion could be called in to right her the vessel must be abandoned.

The choice, so far as appears, was limited to one of two courses. Either to restore the credit of the Racine Railway Company and to endeavour to make the line a paying concern, or, with or without the sanction of the Court, to convene another meeting of the shareholders, to recal the former resolution, and resolve to wind up the affairs of the bank. I am not surprised that this latter course did not commend itself to the mind of Mr Mackinnon and his co-directors as one which they should bring under the consideration of the shareholders of the bank; or that they did not think it likely to meet with their approval when he was appointed one of these directors in July 1858. It was only seven months since the question of going on or winding-up had been before the shareholders, and had been determined in favour of going on. Additional advances had been made by the bank on the credit of the Racine Railway Company between the date of that resolution and the date of Mr Mackinnon's appointment as a director, and I see no reason to think that the shareholders of the bank would have been desirous or willing to stop short and pocket a heavier loss in July 1858 than they were willing to do seven months previously in December 1857. I think, on the contrary, their resolution of the latter date to continue the business of the bank could not in the circumstances be regarded otherwise than as an indication to the directors of July 1858 that they were expected to continue and carry out the system of advances by the bank to the Racine Railway Company till the object of these advances should be effected, viz., that of restoring the credit of that company and rendering all previous advances safe and available to the bank. This was obviously the object which Mr Mackinnon and his co-directors of 1858 had in view in the course which they adopted.

They did not, however, enter upon that course by making further advances, either rashly or rapidly. Their first advance seems to have been limited to £884 to purchase a large quantity of tools and rails of which the railway would otherwise have been despoiled by a sale under a Sheriff's warrant at the instance of creditors holding a judgment for 4000 dollars against the company. Their next step was to acquire a considerable additional amount of mortgage bonds, in order to have the means of preventing hostile creditors from adopting separate measures and effecting foreclosures, &c. Up to 1859, however, the bank were the holders of mortgage bonds or other securities only, and no stock of the railway. But the directors were now brought face to face with the question, Whether they were to promote an extension of the line, or lose all the advances they and their predecessors had hitherto made?

It had at no time been supposed that the line would prove a paying concern as a short or local line. The charter was for the construction of a railway between the two great physical features and trade centres of that part of America—Racine on Lake Michigan on the east, to Savanna on the Mississippi on the west. The line was first made from Racine to Davis, a distance of about 90 miles, and the company were engaged in constructing it further to Freeport, at an expense which would be in all $586,000 between Racine and Freeport, when the bank directors were recommended by Messrs Irvin and Thomson, and other reliable correspondents in America, to aid and promote the extension of the line to Freeport, in the hope that this would improve the value of their securities over that part of the line already made. The advice was adopted, and Freeport, which is 104 miles from Racine, was reached in September 1859. The effect upon the traffic of the extension to Freeport was somewhat disappointing, but this only increased the

urgency of further steps in the same direction. I shall not, however, pursue this detail any further, because the vindication of the policy pursued by Mr Mackinnon and his co-directors is to be found, I think, in the state of matters as he found them when he became a director in July 1858, and for which, as I have said, he was in no degree to blame. Was it a breach of trust on his part to sanction the expenditure which he did on coming into office in the hope of recouping losses previously sustained? If that question be answered in the negative, as I think it must be, none of the advances made with the same object, while he was a director, can be stamped as breaches of trust, and for which he is to be held personally liable.

They were all the natural sequence of each other. Nor were any of them bestowed upon a hopeless undertaking. I have already noticed the advantageous position of the termini of the railway. The splendid country through which it was to pass—fertile to begin with, and as likely to be studded with towns and villages as the prosperous Illinois Railway, which crosses it at Freeport. In short, in place of there being a loss, the prospect of large profit to the bank was likely to be realised, and in all probability would have been so, had a number of adverse circumstances—which nobody could have foreseen—not combined in the end to frustrate that prospect. One of these had been the fact that from causes with which Mr Mackinnon had nothing to do the bank was compelled to go into the present liquidation before its transactions with these American railways were, or could have been, wound up, and the liquidators have felt it not consistent with their official duty to delay the realisation of the bank's investments connected with these railways till prices and credit had revived, which they have done remarkably and speedily, and by which loss to all parties might have been ultimately avoided.

Moreover, I must say that although the liquidators may not have been legally bound to give notice to Mr Mackinnon of their intention to dispose as they did of the bank's securities and investments connected with these railways, it is unfortunate that it did not occur to them to do so, as he would thereby have had an opportunity of paying in full the claims of the liquidators (which he had ample means of doing if inclined) and of taking over the whole American assets, and retaining them till they could be realised to advantage, which subsequent events had shown they might have been within no long period after the liquidators (conscientiously, I have no doubt) considered it to be their duty to dispose of them.

As to the encouraging prospects which were all along held out to Mr Mackinnon and his co-directors to persevere in their efforts for the extension and completion of the railway, and the apparently trustworthy nature of the recommendations they received to do so, I have not dwelt on these points, because they have been fully gone into by your Lordship in the chair. But it is particularly noteworthy to remark that some of the later extensions were those which proportionally added most to the traffic and to the surplus income afforded at different periods by the railway.

Upon the whole, as regards this part of the case—I mean the claim of the liquidators for £122,565, 2s. 8d. as the sum by which the price obtained by the liquidators fell short of the expenditure by the directors of the bank, in investments connected with the railway or railways in question as at 22d October 1878—the opinion I have formed is altogether adverse to the success of that branch of the liquidators' claim.

There remains only the shorter, but as regards amount the much larger, question, viz., the claim of the liquidators against Mr Mackinnon in respect of money paid away as dividends from June 1858 to June 1870, both inclusive, as set forth in the note as well as in the condescendence in the ordinary action. The money thus applied in payment of dividends is represented by Mr Mackinnon and his co-directors to have consisted of interest duly earned upon two of the American railway accounts, and periodically debited thereto accordingly. So far this is not disputed by the liquidators. But they remark that while the interest so debited during the twelve years mentioned and treated as profit, amounted in whole to £315,897, 7s. 8d., the payments actually received to account of that interest amounted only to £4330, 10s. 11d., leaving £311,664, 16s. 9d. of a deficiency for which the liquidators hold Mr Mackinnon personally liable.

It appears to me that the defence against this branch of the claim is, or might have been in some aspects of it, attended with much more difficulty than the other.

Payment of dividends out of capital (which this is said in substance to have been) may be so palpably contrary to the duty of directors that they shall not be heard to allege *bona fides* as a defence against it. Here the adventurous appropriation of unpaid interest to the payment of dividends went on half-yearly for no less than twelve years. I do not doubt that Mr Mackinnon and his co-directors believed that the interest for all the years in question would be recovered in the end; nor do I doubt that they had reasonable grounds for believing so, but I have great difficulty in seeing why the directors, however much they expected and believed that all the interest would be so recovered in the end, should have done that which they might have left undone—namely, paying the dividends for so many terms in place of waiting till they had first received the interest out of which they were to pay them. I should be sorry to see the course adopted drawn into a precedent—and I hope it may prevent it from being so—that although it may not lead to personal liability in this case, it must be seen to have been sufficiently perilous to make it rather a danger to be avoided than an example to be imitated.

One answer, which undoubtedly deserves serious attention, was made to it by Mr Robertson in his very able address for Mr Mackinnon (as indeed all the addresses were extremely able)—viz., that in 1870, when Mr Mackinnon ceased to be a director, there was in the hands of the bank (securities included) property equal in value to the whole principal and interest advanced; and I do not doubt that this may have been so had that property been realised in prosperous times and in a favourable market. But all answers of this kind leave the difficult question behind, Who shall bear the burden if times are not prosperous or the markets are unfavourable?

There is one answer, however, to this branch of the claim of the liquidators which I confess has all along appeared to me to be insuperable. That answer has, amongst others, been stated by your Lordship, and it arises thus:—The shareholders were, of course, the parties who received the dividends in question. The debts of the bank have all been paid; and the liquidators represent shareholders only; but in that capacity they have no title to sue for these dividends any more than the shareholders themselves, who have already received them.

In conclusion, I must observe that whatever opinions may be formed as to the legal questions involved in this case, it is a great comfort to find that there is no trace throughout of any interested or selfish motive on the part of Mr Mackinnon in what he did or concurred in doing. He never made the bank in any way a convenience to himself or his friends, as we know to have been done by other directors at a later period of the bank's history.

I am sensible of the imperfection of the brief observations I have now made on both branches of this voluminous and important case. But any one who reads the printed notes of the discussion—interspersed, as they are, with observations from the bench—will not fail to see that we all followed that discussion, and appreciated its object and value, however briefly we may have found it necessary or practicable to resume the details of it here.

Lord Mure—In dealing with the merits of this very serious claim it is important, I think, to keep in view that under the note as laid no question is raised as to the power of the directors of this bank to advance money upon securities in America. The claim is not one for repetition of capital alleged to have been illegally invested in such securities. That question is, as I understand, made the subject-matter of a separate action, to which reference has been made during the discussion, but which we are not at present called upon to decide. The note as laid, on the other hand, proceeds upon the assumption that the investments in America, on which it is alleged no interest was paid at the time it was taken credit for, were within the power of the directors of the bank to make; and the complaint is that those investments, being thus unproductive, and no interest having been remitted to this country or received from them in America beyond a comparatively small amount, the directors, from 1858 to 1870, and among them the respondent, allowed the amount of this interest to be carried to the profit and loss account in framing the balance-sheet for the year, and allowed a dividend to be declared on the footing that the interest had been received. And it is maintained that by so doing the respondent was "guilty of a breach of trust in relation to the company," for which he is liable in repetition, under the 165th section of the statute of 1862, to the extent of about £300,000, being the amount of capital or other funds of the bank alleged to have been so misapplied in payment of dividend from 1858 to 1870.

In answer to this demand the respondent, while he admits that the interest on the American advances had not been remitted to this country at the time the yearly balance-sheets were framed, denies that these interests had not accrued. He, on the contrary, alleges that those interests, in each of the years during which he was a director of the bank, had been earned and were due at the time the yearly balance-sheets were prepared; and that although they had not been actually paid, and become available as cash in hand at the time, they were all along admitted by the debtors to be due; and that securities in the shape of bonds over the railways, or of railway stocks, were from time to time received more than sufficient to cover the amount of money advanced and the interest due upon those advances. The respondent also alleges that where interest is due, but is not actually available as cash in hand, it is in accordance with the custom of trade and with mercantile usage to carry such interest to the profit and loss account for the year in which it is due, and to calculate the profits on that footing; and he maintains that this is not paying dividend out of capital in the sense of being a breach of trust in relation to the company, provided that interest is believed to be properly secured. And the respondent further alleges that when he left the board of directors in 1870 he believed the American railway securities belonging to the bank formed a sufficient cover for the advances made in America up to that date, and also for the whole interests due on those advances, and that he had good grounds for that belief.

Such being the general nature and substance of the question at issue, the broad leading facts on which its solution mainly depends appear to me, notwithstanding the great bulk of the evidence adduced, to lie within a comparatively narrow compass, and are substantially as follows:—

Before the respondent became a director of the bank in 1858 the bank had made advances to parties in America to the amount of about £117,000, as against which they held the security of mortgage bonds of the Racine and Mississippi Railway Company of the nominal value at par of about £141,000. The debtors in those advances were quite unable to pay them, and the bonds could not at the time be realised, as the line was still in the course of formation merely, and not likely to make any return for some time to come.

In these circumstances it became a matter for anxious consideration by the board of directors what course should be adopted to secure these advances. No one proposed that this large sum should be written off as a bad debt. The committee of investigation which had been appointed to report upon the position of the bank at the time it had suspended business in 1857 did not recommend that course; and the directors were advised by parties of reputation and great commercial knowledge and experience in America, that in the circumstances in which the railway was then placed, the best, if not the only, way to prevent that large sum of money from being lost was to contribute along with the other bondholders in making further advances towards the completion of the line of railway to Freeport, and so on to the Mississippi. This, after full deliberation, the directors resolved to do, and for these advances with the accrued interest thereon they received mortgage bonds.

On the completion of the line to Freeport some difficulties seem to have arisen with other railway companies as to its continuation; and

after further anxious consideration of the advices received from America on the subject, the directors of the bank, of whom the respondent was one, came to the conclusion that it would be necessary to make further advances towards the completion of the line to the Mississippi. It was represented to them by their advisers in America, that although the value of the line had been much increased by its extension to Freeport, its continuation to the river was absolutely necessary in order to develope the line, and so to render the railway securities available for disposal in the market within a reasonable time. On this advice the directors acted, and arrangements were made under which a company, called the Northern Illinois Company, undertook the completion of the railway to the river. Towards this object the directors made further advances on the security of the Northern Illinois Company's mortgage bonds and stocks, which they were advised were amply sufficient to cover those advances. And they also came to the resolution, in the absence apparently of the respondent, in the year 1864, to allow the interests which had accrued, and were to accrue, on the Northern Illinois bonds, to be lent to that company on mortgage bonds, or on stocks of the railway, with a view to an extension of the line to Port Byron. That was accordingly done, and the line was in this way completed about the year 1865.

For all the money so advanced, and for the interest which had accrued, the directors received bonds or stock of the Northern Illinois Company, which were exchanged for the Western Union Company bonds or stock on the consolidation of the Racine and Mississippi and Northern Illinois Companies into the Western Union Railway Company, in 1866.

After this consolidation arrangement matters seem to have remained in substantially the same state till the Mitchell agreement was made in 1869, although, in the intermediate time some abortive offers appear to have been made for the acquisition of the bank's interest in the line. Under that agreement there was a reduction and rearrangement of the respective quantities of mortgage bonds and stock in the line, which has been the subject of a good deal of adverse observation. But, upon the whole, it appears to me to have been in the circumstances a fairly satisfactory arrangement, and under it matters remained till the respondent ceased to be a director of the bank in 1870, and until the bank stopped payment in 1878.

Under that agreement interest began to run upon the bonds at 3 per cent. for three years from 1st January 1870, and from 1873 at 7 per cent.; and from 1873 to 1878 there was remitted to the bank interest amounting, on the average, to £40,000 a-year—the remittance in 1878 being £41,585, and in 1879 £42,000—being at the rate of 4½ or nearly 5 per cent. on the £900,000 which had been advanced on American securities; and had it not been for the failure of the bank, and the consequent necessity of almost immediate realisation, there is no reason to suppose that that remittance of interest would not have been continued.

At the time when the respondent ceased to be a director the securities, of one kind and another, held by the bank amounted at par, according to the vidimus prepared by the liquidators, to £980,866, while the amount of the advances was £905,166, leaving a surplus of £75,700. According to the state, also prepared by the liquidators, these securities amounted to £974,866, leaving a surplus balance of £69,700, after deducting advances; while according to the state given in by the respondent the securities amounted to a considerably larger sum—viz., £1,053,935, leaving a surplus balance, after the same deduction, of £148,769. This difference arose from the respondent having taken into calculation, under the heading of Racine Warehouse and Dock Company stock, certain sums which are not included in the liquidators' state, and which I am disposed to think he was entitled to do.

It further appears from each of these states that during each year from 1866 to 1870 the securities held by the bank, taken at par, were much more than sufficient to cover the principal and interest on the whole advances. And that such was believed to be the position of matters by Messrs Irvin & Company, who acted for the bank in America in taking these securities, is plain from the evidence of the two partners of that firm, who were examined on commission in America, and has a very important bearing upon the question. Mr Wetmore, who was a partner of Mr Irvin's house at the time, and is now treasurer of the International and Great Northern Railway, is asked to state "what were the relations from 1859 to 1866 of the bank and this railway account in regard to the earning and realisation of interest upon the outlay of the bank?" and he says—"The bank owned the securities, and as interest matured on these securities it was put into other securities," which, "as far as the bank was concerned, were new investments." He is then asked to state "what kind of securities the interest was invested in which was collected in behalf of the bank from 1859 to 1866?" and the answer is, "From 1859 on Racine and Mississippi bonds. As interest matured and the plan of reorganising or issuing Western Union securities for part of the coupons of Racine and Mississippi was adopted, they received Western Union bonds, part Western Union stock and part Western Union preferred stock, and in some cases they received Northern Illinois bonds, which afterwards went into Western Union bonds; eventually they received Western Union securities for all of that interest;" and he adds in answer to another question, that "the whole of the interest which fell due upon the securities from 1859 to 1866 was paid to the bank;" and a similar answer is given with reference to the interest falling due and collected from 1866 to 1869.

Mr Irvin is examined on the same matter, and he states, in answer to a question put to him in cross-examination—"The securities taken for interest were new and fresh securities. When the Western Branch of the Racine and Mississippi Railroad and Northern Illinois Railroad were being constructed, the amounts received for interest were invested in the new securities on these roads, and were expended on their construction. When the Western Railroad Company was organised it included all the former organisations, and all the securities then held were exchanged in bulk for the securities of that organisation in bulk. After the organisation of the Western Union Company

in 1866, until the bank's agent came out in 1869, the proceeds of the interest were invested in preferred stock of the Western Union Company, according to my best memory."

So standing the facts, the question to be disposed of is this—Does the mode in which the bank dealt with the interest on these securities during the period embraced in the note, viz., by carrying it to profit and loss account in this country, while investing it as capital in railway securities in America, amount to a payment of dividend out of capital; or is it, on the other hand, to be looked upon as being substantially an investment on American securities of the interest which had accrued there, but which could not then be made available as cash for transmission to this country?

I am of opinion that it is not, in any just sense, a payment of dividend out of capital, but an investment of the interest in America as part of the capital of the bank.

By so dealing with the matter, the interest which had accrued, but which the railways could not pay in cash at the time it fell due, was, in my opinion, paid in money's worth in the shape of these mortgage bonds and stocks which were taken in lieu of the payment of it as it accrued: and the interest was in this way secured as part of the bank's capital in America. So that the amount of money carried to profit and loss in this country as interest in each year did not operate as a diminution, either permanent or temporary, of the capital of the bank, which it is essential that it should have done in order to subject a director acting in complete *bona fides* to the serious, even in certain circumstances criminal, charge of paying dividend out of capital; and it did not so operate for this plain reason, because a sum corresponding in amount to that carried to profit and loss as interest was invested in America in substitution, and as a *surrogatum* for the money taken from the bank in this country when the dividend was paid. This was substantially, therefore, an investment of capital in America, and if done in the *bona fide* belief that the security was sufficient, constitutes a good defence to the present demand.

Now upon this question of *bona fide* belief the evidence is all one way. The respondent's own evidence on this is clear and distinct, both in his examination-in-chief and when pressed in cross-examination; and I may observe that I never read evidence given apparently in a more fair and full and frank manner, carrying truthfulness on the face of it. [*His Lordship after quoting the respondent's evidence proceeded*]—And he had, as it appears to me, sufficient grounds for this belief, as explained by himself, and particularly the advice and opinion of the gentlemen in America who were consulted by the directors on the subject. [*His Lordship then referred in detail to the evidence of Messrs Wetmore and Irvin.*]

As against this evidence, which is confirmed by other witnesses, and among them by Mr Thomson and Mr Hall, there is no equivalent evidence adduced by the liquidators. But they point to their own realisation of the securities in 1879 which fell short of the gross sum against which the securities were held by £300,000, and rely upon it as shewing that the securities were then insufficient, and that a loss has to that extent been sustained. But that is not, as I humbly apprehend, any answer under this note to the defence maintained, and which is, I think, substantiated on the part of the respondent. If I am right in holding that the transaction under which these interests were invested in America was in each year a *surrogatum* for the sum applied in payment of dividend in this country, and that this was all done in perfect *bona fide*, and in the well-grounded belief at the time that the securities were a good investment, the case is then taken out of the category of cases of payment of dividend out of capital; and if that be so, it appears to me to be altogether beside the question to say that the securities ten years afterwards turned out to be, in some respects, an insufficient investment. That may or may not be made the foundation of a claim against the respondent and the other directors for an illegal or insufficient and improper investment of the funds, as beyond their powers under the contract of copartnery, such as I alluded to at the outset of this opinion; but it is not, as I conceive, a relevant answer to the defence which has, I think, been here established on the part of the respondent, that at the time he ceased to be a director of the bank in 1870 he never had been guilty of any breach of trust against the company by paying dividend out of capital, with which he alone is charged under this note.

This observation would, I think, in such circumstances, be well founded with reference to any ordinary case, where a loss might arise on ultimate realisation through an unfortunate investment. But this is, in many respects, no ordinary case, and the loss on realisation arose from no fault on the part of the respondent. It has arisen under a liquidation rendered necessary by the culpable and reckless, and in some respects criminal, mismanagement of the affairs of the bank, begun after the respondent had ceased to be a director; and a careful examination of the evidence bearing on this part of the case has left a strong impression on my mind that if the realisation had not been forced on by one of the greatest monetary catastrophes that ever occurred no loss would have been sustained. And I think there are also pretty strong grounds for holding, that if the realisation had to be made now, there would not only be no loss, but a considerable profit in the result. I am not disposed to attach the slightest blame to the liquidators for the way in which the realisation was conducted, and I believe they did the best they could in the difficult position in which they were placed. But they were in the position of parties who required to realise as speedily as possible a very large amount of bankrupt estate. Now, such estate proverbially sells cheap, and there is generally a loss on realisation, owing to the purchasing world being aware that it is the duty of the liquidator, or trustee, as the case may be, to endeavour to realise with despatch. The evidence of Mr Harding, a gentleman of great experience in such matters, is very decided upon this point. He says, that, according to his experience, there is in liquidation "always a large percentage of loss in realising, unless the securities are everyday of marketable value. If they are exceptional securities, in my experience an unusual loss is realised—liquidation being adverse to favourable realisation." And in such a case as the present, where the securities were in some respects exceptional,

he rates the loss at 25 per cent., which appears to be just about the loss that was here sustained. One item of loss which may be referred to as confirmatory of Mr Harding's view is the loss that was sustained in the sale of the Western Union stock of the bank. For that stock, which had not begun to pay any regular dividend in 1870, the bank refused an offer of £130,000 at that time. In 1879, by which time the line was paying a small dividend on their stock, the liquidators were obliged to dispose of it for £5000, although for the other half of that Western Union stock Mr Mitchell, a short time after he acquired it in 1870, managed to realise about £240,000.

A good deal of argument was addressed to us on the subject of certain offers which were made to the bank for the purchase of their interest in the railway, more particularly after the consolidation of it into the Western Union Railroad, and on the conduct of the bank in declining to accept any of these offers, which it was said would have probably very nearly cleared the bank. It is very easy to throw doubts on the policy of the bank in this respect, with the light which has now been cast upon it; but after giving the matter the best consideration in my power, it appears to me that the main ground on which the bank, as I understand it, declined to close with them—viz., that the state of the money market and the rates of exchange were at that time such as to render it impossible to realise and remit the money to this country except at a very considerable loss, was sufficient. One inference, however, which is to be deduced from the number and the amount of the offers made from 1866 to 1868 is, that the securities in question were not so worthless in the opinion of moneyed men in America, and of railway companies there, as they have been represented in these proceedings; and another inference is, that the loss sustained in realisation in 1879 was due to exceptional causes, and chiefly to realisation under liquidation, and did not arise from the inferior quality of the securities. The loss, therefore, on realisation is, in my opinion, no evidence in this case that the investments were not sufficient in ordinary circumstances to cover the advances.

Upon the whole, therefore, on this branch of the case, I am very clearly of opinion that the liquidators have failed to instruct that the dividends in question were paid out of capital, or that any misfeasance or breach of trust in relation to the company has in any way been committed in the sense of the 165th section of the statute.

On the preliminary questions I entirely concur with the views of your Lordship in the chair.

I think the plea that the demand comes too late well founded. The respondent left the directorship of the bank in 1870, and from that time to the stoppage of the bank no hint or surmise was ever made against his conduct in the directorship. Till the stoppage of the bank in 1878, the bank were for six years in the receipt of large sums of money—£40,000 a-year—the proceeds of some of these securities, which were annually divided among the shareholders of the bank, and seemed thus to have deliberately accepted those securities as part of their property, yielding a return of about 4½ per cent. on the advances. Had the bank remained solvent, and been advised to make such a claim as that now made, they would, I think, have been held to be barred from insisting on it, and I do not think the liquidators in this respect stand in any more favourable position. And of this I am very clear, that it was in such circumstances a duty they owed to the respondent to give him the earliest notice possible of their intention to make this demand, and in every event to do so before they set about realising the securities. Your Lordship has alluded to what the respondent says in his pleading and in his evidence as to the course he would have followed had any such notice been given him, and had he received the offer, and made arrangements for taking over the securities at a valuation, with a view to their realisation by degrees on his own account, I have a very strong impression that with his capacity, as disclosed in his correspondence and evidence in this case, his great experience in business, and with ample means at his command, he would have effected a very different result from that which has been the result of the present forced realisation. But he received no such notice, and I quite concur with your Lordship in thinking that the liquidators are on that account, as well as on account of delay which has occurred, barred from their present demand.

On the other question of title or interest to sue I also concur, and on it I have nothing to add.

Lord Shand—It must be satisfactory to the parties, as it certainly is to the members of the Court, that this case is now to be disposed of after a full investigation of the facts, and not on any merely preliminary formal or technical grounds. In stating the reasons which have led me to the conclusion that the judgment must be in favour of the respondent, I shall, following the course which your Lordships have adopted, deal in the first instance with the merits of the controversy between the parties.

The question presented for determination is, Whether the respondent was guilty of a breach of trust in his capacity of a director of the bank, in having misapplied its funds to the extent, as it is now stated, of nearly £300,000, by payments made in name of dividends to the shareholders out of the capital of the bank during the period from 1859 to 1870, both inclusive? The Solicitor-General in presenting the case of the liquidators in the last discussion submitted a series of propositions which he maintained were established by the evidence, and as I think these propositions brought out fairly and clearly the points which it is incumbent on the bank to make out in order to succeed in this application, I begin with a statement of them. The first two were to the effect that during Mr Mackinnon's directorate interest to the amount alleged by the liquidators was debited to the American railway account, and that the interest so debited was divided amongst the shareholders. The former of these statements is conceded, the latter is disputed, by the respondent, who maintains—with reference to the allocation of profits yearly, by which sums amounting in all to about £300,000 were, during the period in question carried from the profit and loss account to the reserve and buildings fund—that the liquidators have failed to show that the total interest on the American account was paid away in dividends. But the more important questions between the parties are raised by the three

following propositions said to be established, viz. :—

"*Thirdly*, That except to the extent of about £20,000 no part of that interest" (that is, the interest on the American account) "was received by the bank during Mr Mackinnon's directorate, either in cash or as an equivalent for it."

"*Fourthly*, That except to the extent of that sum of about £20,000 no part of the interest was ever recovered, but was an ultimate loss to the bank; and

"*Fifthly*, That the respondent knew that that interest was being debited and divided; that he knew it was not being received by the bank; and that he knew there was no reasonable prospect of its ever being recovered."

There can be no doubt that, if these propositions have been established by the evidence, apart from the pleas of no title, and of bar to the present application to be afterwards considered, the liquidators would be entitled to an order or decree against Mr Mackinnon for payment of so much of the sum sued for as the Court might be satisfied was paid away as dividend from the alleged or pretended interest on the American advances, for the case, as thus presented, is obviously one of wilful, deliberate, and intentional breach of trust by repayment to the shareholders of capital in name of dividend. The defence accordingly traverses the facts alleged. While it is conceded that by much the greater part of the interest was not received in cash, it is alleged by the respondent that the whole was invested, and was regularly covered by securities held by the bank, and given from time to time in respect of interest. It is further and separately pleaded that while Mr Mackinnon was not aware of the particular rates of interest debited year by year to the railway account, he honestly believed that the bank was at all times possessed of securities sufficient to cover and provide not only for the principal sum due, but also for such interest as he understood was debited to the account from time to time. And in regard to the ultimate loss on the American account, while it is not disputed that the amount was considerable, the respondent maintains that this loss was the result of a forced sale of the bank's securities in the liquidation, and that if a gradual realisation had taken place, by which a reasonable time had been allowed for the development of the railways, and the rise which actually occurred in the market value of the securities, the bank would ultimately have received a sum considerably in excess of the whole capital and interest standing at the debit of the account.

The conflict between the parties as to the facts involves an inquiry into transactions, many of them of a detailed and complicated character, ranging over a period of twelve years, and beginning no less than twenty-four years ago. It is satisfactory, however, to be able to say that there is no lack of the means of ascertaining the truth. It is not necessary to resort mainly, or indeed to any but a comparatively limited extent, to the parole evidence of witnesses speaking now to their recollection of events and impressions of many years ago. There is a body of contemporaneous written evidence, contained in correspondence and minutes written at the time when the bank's advances were in the course of being made, which records in the clearest terms the views of the bank officials and directors in this country, of their advisers in America, and those in the management of the railways in which the bank was so deeply interested, both as to the value from time to time of the bank's securities and the prospects of realisation. This correspondence being of the most confidential and unreserved character, records faithfully the opinions and anticipations of the parties at the time. I have not known a case in which the evidence of this kind was more complete and satisfactory. The only difficulty in dealing with it has arisen from its great extent. It has been necessary carefully to consider the effect of the various and important changes which occurred in the extension and development of the railway enterprise in which the bank by its increasing advances became so deeply interested; the result of these changes as affecting the value of the bank's securities from time to time; the reports and views of the bank's representatives in America communicated to the bank here; and the opinions which were formed by Mr Mackinnon and the other directors and officials of the bank as to the value, present and prospective, of the securities held for the bank's advances and accruing interest. The course of the inquiry, the evidence of accountants, and the arguments for the parties, have made it necessary to form a judgment as to the position of the bank's account with reference to the value of the securities as a cover for the bank's advances and interest, and the views of the officials of the bank and the respondent on that subject, on the occasion of each of the several extensions of the Racine and Mississippi railroad. Only ninety miles in length of this line existed when Mr Mackinnon joined the direction in 1858; and in 1870, when he retired, it had been extended to 180 miles, mainly by the expenditure which the bank was induced to make, adding to the line stage after stage during these twelve years, either because favourable anticipations had not been realised, or because unlooked for opposition from active competitors for traffic had been met with. It is not my intention to enter into the details in figures which the parties have respectfully presented with reference to the dates when the several extensions to Freeport, Savanna, Port Byron, and Rock Island were resolved on and carried out, or to state in detail the results of an examination, either of the Consolidation Act of 1866, by which the Racine and Mississippi railroad became united with the Northern Illinois under the name of the Western Union Railway Company, and the securities for the bank's advances were all made to affect the entire line, or of the Mitchell agreement in 1869 for a sale of the Western Union line, which was entered into and completed shortly before Mr Mackinnon left the direction. To enter with detail into these matters, or into the grounds of the conflicting views presented by the parties, as to the value of the different offers made from time to time for the bank's property, would be an almost endless task. It has been necessary to look carefully into the evidence as to these various transactions in order to form an opinion on the question, whether, as the liquidators maintain, at the dates when they occurred, and with reference to the nature and particulars of the transactions themselves, the position and value of the bank's securities were such as to make it improper to debit

the account with interest; and as to the question whether this became known to the respondent; but a general statement only can be given with reference to each of the important points of time in the history of the railway account, and of the grounds which have led to the conclusion that the liquidators have failed to establish the propositions on the proof of which their success in this application depended.

It does not appear to me that there is any dispute between the parties as to the law applicable to this part of the case, as I think appears clearly enough from the propositions in fact which the counsel for the liquidators seemed to concede must be proved to entitle them to decree. It is clear that it is not necessary that there must be cash realised and in the coffers of the bank, received expressly on account of interest or profits, in order to justify the payment of a dividend. To enforce such a rule would be to run counter to ordinary and reasonable usage in the case of mercantile companies. In order to ascertain the profits earned and divisible at any given time, the balance-sheet must contain a fair statement of the liabilities of the company, including its paid-up capital, and, on the other hand, a fair or more properly *bona fide* valuation of assets—the balance, if in favour of the company, being profits. These profits may, and must often to a great extent, be represented by obligations of debtors, often secured, and by direct securities over property. They are not the less profits fairly realised and divisible because they exist in that form and have not been received in cash. If profits have been earned, and are, in the judgment of those in the management of the company, secured, the shareholders of a joint-stock company are, in the ordinary case, entitled to have such profits, which may properly be called realised profits, declared and divided, except in so far as they may be otherwise appropriated, either by the express terms of the contract or by the exercise of powers conferred on those charged with the management of the company; and the directors may properly use funds otherwise available to them, and forming part of the floating balances on capital account, in payment of the dividend. All this, however, infers a valuation of assets, and it is in this operation that it is represented the respondent was guilty of a breach of duty, in having knowingly and wilfully overvalued the American securities when he treated them from time to time as sufficient to cover interest and principal on the bank's advances.

One thing is abundantly clear with reference to such a charge, and to the duty of valuation of assets, that it involves a matter of judgment or opinion, and eminently so with reference to such a subject as the railroad properties on which the bank's advances in the present case had been laid out. The amounts to be carried into the balance-sheet and profit and loss accounts respectively for the year depend on the estimate which has been formed of the value of the company's property and securities. It seems to me that where such accounts have been regularly prepared in the ordinary course of administration of a business, and have been given effect to in the fixing and payment of dividends, and more especially where the acts are challenged after the lapse of a number of years, the Court ought strongly to presume the correctness of the proceeding, and to require clear evidence of want of *bona fides* where, as here, a case is rested on that ground; for although the charge has not been in these words, I cannot avoid the conclusion that it is made to that effect when it is maintained, as the result of the proof, "That the respondent knew that the interest was being debited and divided; that he knew it was not being received by the bank; and that he knew there was no reasonable prospect of its ever being recovered." And if it appears that the person against whom the charge is insisted in has taken pains to make himself acquainted with the various considerations which might affect the value of the subject of valuation, in order to form a correct judgment, all the stronger must be the presumptions in his favour, and against the view that would attach to him the want of good faith. Were the law otherwise, I fear it would only deter men of character and means and standing from taking part in the management of joint-stock companies.

I must confess that in the present case, however, I have felt there are considerations which go very far to weaken—I should perhaps rather say to overcome—the strength of the presumptions I have now mentioned. I refer to the fact, which does not admit of dispute, that although interest was regularly debited to the American account, and the amount carried to profit and loss account, no part of that interest over the whole twelve years ever reached the bank in this country, while in the meantime the bank's advances had grown from £117,000 to about £600,000 of capital, and the money so advanced had not been lent in the ordinary course of banking business, but had been advanced to be expended in extensions of an American railroad. It cannot for a moment be disputed that this is a most unusual, probably unprecedented, state of matters in the history of a banking company in this country. The fact being proved or admitted that interest was charged, and to a great extent paid away in dividends over so long a period, and in such circumstances, with the *prima facie* unfavourable impression which a proceeding so unusual was calculated to produce, seems to me to overcome much of the strength of the presumptions I have referred to, and to lay a certain *onus* on the respondent—I mean the *onus* of accounting, by a satisfactory explanation and evidence, for the payment of so long a series of dividends in the circumstances. I have accordingly examined the evidence offered in explanation with scrutinising care, and recognising the *onus* that thus lay on the respondent in circumstances so peculiar. The result, however, has been to satisfy me (1) that the increasing advances were made from time to time under a complete conviction that they were necessary in order to obtain an ultimate recovery of the large sum at stake when Mr Mackinnon became a director; (2) that while interest was being debited to the railway account, Mr Mackinnon honestly believed that the bank's securities were sufficient to cover the whole amount of principal and interest due to the bank; and (3) that he had reasonable grounds for firmly holding that opinion.

Before noticing the general grounds on which I rest this conclusion, I must, in the first instance, refer to a point which has always appeared to me to be of primary importance as affecting the de-

cision of the case — I mean the effect of the high rate of exchange between America and this country which prevailed throughout a great part of the twelve years in question, and particularly during the years from 1862 to 1870, both inclusive. From the table contained in the joint statement for the parties it appears that the American currency was so depreciated, that in place of five dollars being equivalent to the £, the rates during the years just specially mentioned varied from five to seven and eight dollars, and even at one time, in December 1864, the rate of exchange was 10½ dollars to the £. Now, the liquidators, by the evidence of their accountants and the pleadings of counsel have maintained that in valuing the bank's securities, the various classes of bonds held from the railway companies, and also in estimating the value of the various offers made from time to time for the purchase of the railways and securities, the directors were bound to take the current rate of exchange with this country at the time, and having first made their estimate in dollars, to convert the amount into money sterling, not at the normal rate of five dollars to the £, but at the much lower rate prevailing at the time. If the liquidators be wrong in this contention, I have never seen, and do not now see, how they could possibly succeed in this application, and I rather think this was virtually conceded before the close of the argument. It cannot be disputed, that if in place of the conversion of the estimated value of the bank's securities in dollars, at the rate of 8½, or 6 or 6½, dollars to the £, being the rates taken by the accountants for the liquidators in three valuations made by them in 1864, 1866, and 1869 respectively, the normal rate of five dollars to the £ be applied, a very much larger amount is the result—and so important is the difference, that, in several instances of points of time at which valuations have been made by both parties, either with reference to the securities then held by the bank, or to offers of purchase made to the bank, in the one view there is a large deficit on the amount necessary to meet the balance at the debit of the railway account, while in the other view there is either a clear surplus after paying off principal and interest, or the deficiency is so small—a matter of £20,000 or thereby on a total sum of £900,000 of principal and interest—as to make the figures substantially square each other. It seems to me clear, therefore, that in any view that can be taken of the case the liquidators could only succeed in this application by showing that the officials of the bank were bound to adopt the principle of valuing their securities in money sterling, according to the rate of exchange of the day. This, I am clearly of opinion, the officials and directors were not bound to do.

In the opening argument on the evidence it was maintained that not only had the bank invariably looked at each offer made for their securities in the single light of what it would produce in sterling money if at once remitted home, at the rate of exchange of the day, but that it was very much of an after-thought on the part of the respondent to maintain the view that he regarded the state of matters in America as temporary; that he looked for a speedy termination of the war; that with returning peace a strong Government would give security to traders, and lead to the commercial prosperity of the country; and that with all this in a short time a return to the normal rate of exchange might be looked for. The respondent's counsel was able in reply to show by a number of passages in the correspondence between the bank and their agents and representatives in America, and in letters to and from Mr Mackinnon, that, as he himself explains in his evidence, he entertained the opinion that the exchange would ere long right itself and come to par, and that there was every reason for believing that the bank would act on that view, and even if they sold their securities, invest the proceeds in 5/20 Government bonds, or other securities recommended to them, and have these realised and the proceeds remitted, when the loss on exchange could be avoided. In the concluding argument for the bank it was no longer, I think, maintained that there was not evidence to show that in the event of a realisation of the bank's securities in American currency it was not in the view of the parties to retain the money invested in America till the loss on the exchange could be avoided. The argument finally, or at least mainly pressed, was that a purchase of other securities would have been a speculation into which the bank was not entitled to enter, any more than if they had realised securities at home and sent out the proceeds to get the benefit of a favourable exchange for remittance, and in the expectation of gaining by exchange afterwards coming to par.

It seems to me that the contention of the bank on this question—a contention which is vital to their case—is unsound. To begin with, the effect of the rate of exchange, entering as it does into the principle of valuation, involves a matter of opinion or judgment, and it would be necessary to show want of *bona fides* on the part of those who in making their valuations at the time, or in resolving on the best course to be followed in the event of a sale, acted, or were prepared to act, on the view that they were not called on to give effect to an abnormal rate of exchange which they regarded as temporary. There is no evidence to support a charge of this kind. Again, there is abundant evidence corroborative of what Mr Mackinnon said as a witness, that the subject was presented for consideration, and that if the bank had acted in accordance with his views they would have realised money, which were formed after considerable experience in his mercantile dealings in his own private business. In March 1862 Mr Irvin, the bank's confidential adviser in New York, wrote to the secretary in Glasgow: —"The prospects of the country in connection with our domestic war is much changed. The superior power and resources, as well as determination of the North, is so manifest that the war must soon be closed, or at least be confined during the remainder of its continuance to a small portion of the cotton States, where the revolt may be expected to die out speedily." In November of the following year Messrs Irvin & Company in another letter to the bank put their view very plainly. They say, with reference to the prospect of offers for the bank's securities— "The question of exchange has to us presented itself in this aspect—that your property being already on this side, subject to our depreciated currency, if we could, while getting rid of present responsibilities, obtain for you other securities of same amount, of stronger and more available

character, the bank would be in a better position for realising their property when exchange became more favourable, and in the meantime be getting interest on the whole." Mr Thomson, the manager of the railways, about the same time wrote to a similar effect. [*This letter is quoted in the argument.*] It is only necessary to quote further the bank's reply through their secretary on the 5th of December 1863, following on a meeting of the bank directors held two days before, at which Mr Mackinnon was present, when the letters of Irvin & Company and Mr Thomson just noticed were read. The secretary's letter to Irvin & Company is in these terms:—"I wrote you on the 27th ulto., and have since been favoured with yours of the 16th ditto, enclosing Mr Thomson's letter of the 10th, and to both the directors have given their most careful consideration. The suggestion of making an exchange of our interests in the railways for some other securities of a stronger and more available character, free from further outlay, meets with our approval, and would dispose us to hold on and be content with a moderate interest until the exchange got rectified. The subject will again be taken up after we have a reply from you to our letter of the 20th ulto." The advice of Irvin & Company is what was no doubt given and acted on at that time in the case of many private investors in this country having securities in America. There are other important letters to a similar effect of subsequent dates, and in particular a letter from the bank inviting suggestions on the subject, and a reply by Irvin & Company suggesting amongst suitable securities for investment U. S. 5/20 bonds, which could be had about par, and one or more letters by Mr Mackinnon, in which he expresses the opinion that exchange will soon be at par. It remains only to be stated that, as appears from the evidence of Mr Guild, the bank, on account of the unfavourable exchange, actually returned to America a sum of £2300 which had been sent home to them in cash, in order that it might be invested in America, and remitted only after the exchange had reached or nearly reached par, and further directed Irvin & Company to retain the interest paid on the Northern Illinois bonds for the same reason.

Again, it seems to me to be quite unsound to represent the proceeding of leaving money in America to be so invested as a speculation of the same kind as the sending out of money for investment. As Mr Irvin observed, property on that side was already subject to the depreciated currency, and it was only an act of fair and reasonable administration, on the part of those who thought the depreciation temporary, to avoid the loss which would result from their withdrawing it by remittance to this country. And even if there be an element of speculation in taking that course, which is probably quite true, this cannot affect the question here under consideration, which after all relates to the *bona fides* of the valuation or estimate of the bank's assets. I have perhaps dwelt longer on this subject of the rates of exchange than was necessary, but, as I have said, it seems to me to be so important as to be at the root of the case of the liquidators, and it is because of this that I have given my reasons fully for holding that the views maintained on their behalf cannot receive effect.

I have said that I think it is proved that the respondent honestly believed throughout the currency of the railway account that the bank's securities were sufficient to cover principal and interest, and that he had reasonable grounds for this belief, and I shall now state what has led me to that conclusion. Mr Mackinnon has himself given clear testimony to that effect. He is evidently an intelligent and able man of business, and his evidence was generally given with candour, and so as certainly to impress me favourably. I have no doubt of its absolute truthfulness. The case he presented for himself was not that of a director ignorant of the business which has been the subject of inquiry, who trusted entirely to the paid officials of the bank, and who did not accept responsibility himself for what was done. On the contrary, he explains that in the autumn of 1858, the year in which he joined the direction, he made himself acquainted with the state of the account, and went over the recent correspondence in regard to it, and it is clear that from that time onwards he took an interest—it may be fairly said an active interest—in regard to the account, and the securities which the bank held and acquired to cover their advances, and that when called on he gave such assistance as he could in advising as to the best policy to be pursued in order to secure and ultimately realise the bank's debt and the accruing interest. This statement must be so far qualified as to say, that having business interests of magnitude of his own requiring his constant attention, Mr Mackinnon was frequently absent from Glasgow and from this country for considerable intervals, and that although when in Glasgow he was available when wanted for consultation on the bank's business, particularly in relation to this account, and even when not at a great distance he was ready to give his advice by letter when consulted in this way, yet he did not profess to do more than aid the manager for the time and the board with such assistance as he could give consistently with giving due attention to his own business matters. When he entered the direction he found the bank involved in the undertaking of the Racine and Mississippi Railway Company to the extent of about £117,000. He became aware of all the important advances made thereafter, by which the debt was so largely increased, and, indeed, was a party to the granting or sanctioning of a number of them. In regard to the interest debited annually to the account, he explains that it was left to the manager and other officials of the bank, as a matter of detail, to debit the various accounts with the proper rates of interest, and that down to 1857 at least he had no information or communication with the manager on this subject in regard to the American railway account. He assumed, however, that this account was debited with interest from time to time at the usual rates applicable to ordinary overdrawn accounts, and was of opinion that it was right to do so, as he considered principal and interest to be fully covered by the property and the bank's securities. It appears from the evidence of Mr Findlater, who was head cheque clerk in the bank, that in point of fact in 1857 and 1858 the ordinary rate upon cash-credit accounts was charged, and that thereafter, by direction of Mr Stronach, the manager, the higher rates of seven and eight per cent., mentioned in the bonds held by the bank, were debited to the account—the

difference being an increase of two or three per cent. on the ordinary cash-credit account rates.

It has not been suggested that there is any reason—beyond the grounds which are presented by the accountants for the liquidators as to the value of the securities at different times—for refusing to give effect to the evidence of Mr Mackinnon. He had certainly no personal interests to be served by either increasing the bank's advances in America, or treating the account as one fully covered by securities, if he had thought it was not secured. His interest in the bank was comparatively small. He was a holder of £2000 of stock, which he retained for some years after he left the direction—selling out ultimately only because he was disposing of all his investments of that kind to lay out his money to better advantage. He gave the bank but a limited amount of his firm's business in discounts, and, so far as it appears, he never for himself or friends applied for or obtained any special advantage from the bank. It is, in my opinion, a circumstance very favourable to him in the present question that in his letters written from Homburg in June 1867, the ninth year of his directorate, he proposed a policy of caution—suggesting that in that year interest on the Western Union bonds should not be carried into the profit and loss account, and also that a proposal to increase the bank's dividend from 7 to 8 per cent. should not be agreed to—in both of which points he seems to have stood alone and been overruled. He explains in his evidence the reasons which induced him to make these suggestions—the severe commercial crisis of 1866, and the fact that an offer for the bank's American securities, then under consideration, seemed likely to fall through; and it seems to be only a fair inference from his conduct in 1867 that if at an earlier date he had thought the suggestion not to debit the American account with interest, or to carry the amount to the profit and loss account, should have been made, he would have made the suggestion then.

Mr Mackinnon's evidence is strongly corroborated in all its material points by the great mass of written evidence to which I have already referred. He was not himself in America to make his own observations or inquiries on the spot. His impressions and belief were therefore formed entirely on the information furnished to the bank and directors from time to time—a circumstance which leads me to say that after all the inquiry on this part of the case is, not so much what was the intrinsic value of the property on which the bank had advanced so much money, as what were the respondent's views of the value of that property, formed on the reports and communications laid before him. Your Lordships have referred to the communications which were regularly and frequently received from Mr Irvin and Mr Thomson, and I concur in all that has been said as to the effect of their letters, reports, and memoranda. It is impossible to read the correspondence of Mr Irvin without being satisfied that the witnesses who speak to his standing—his great knowledge and experience and sagacity in business—have not spoken too highly. It appears that on two occasions, at the special request of the bank, he went specially over the property of the railway companies in order to form an independent judgment—on one of these occasions having spent between two and three weeks in doing so—and that once in the course of Mr Mackinnon's directorate he was in this country and had an interview with the board. There can be no doubt that Mr Thomson also was an able and energetic man of business. It is said that he was sanguine, and that may be, and probably is true; but I am bound to say that the proof as a whole has left the impression on my mind that Mr Thomson's views of the future prosperity of the country which the railway lines traversed, and the ultimate success of the lines themselves, have been borne out by the results, and that it would probably have been better for the bank in the end if they had yielded to his advice about certain of the offers of purchase of the whole undertaking which they rejected, with the final result of concluding the agreement with Mr Mitchell. But the question of importance here is, What did Mr Irvin and Mr Thomson think of the undertaking on which the bank's advances were made; and how did their views impress the bank officials and the respondent? To this inquiry only one answer can be made. They invariably represented that, though patience must be exercised, the property was a most valuable and improving one, and the bank's advances were duly covered, and would be repaid with interest. Mr Thomson, who was repeatedly in this country, fully discussed the subject with the board, and strongly impressed them with his views. Mr Hall, who was sent out to report on the subject, was not so favourably impressed, at least with the prospects of a speedy realisation; but Mr Mackinnon explains that throughout he took a more favourable view of the bank's investment than Mr Hall did; and Mr Dunlop, his colleague, and subsequently Mr Leresche, who was at a later time sent to America on the bank's business, were both strongly impressed with the conviction that the bank would be able to make a realisation which would entirely recoup them in principal and interest. There was no doubt anxiety, particularly at times of temporary depression. This was inevitable about so large an advance on a recently constructed railway in a foreign country, and Mr Hall was particularly impressed with that feeling, having in view that the creditor was a bank in this country. But allowing for all this, it is, I think, clear from the contemporaneous correspondence and documents that there never was a time when the parties either in America or in this country were led seriously to doubt that the bank was fully secured. That circumstance is decisive of the present question. That Mr Mackinnon had reasonable ground for his opinion and belief is proved by the fact that he had the assurances of so many others on whose opinions he relied, who knew the district and the railways thoroughly, that the property was most valuable and improving. He had reports shewing the actual cost of construction and value of the lines, and of the stock and plant with which they were fully equipped; and these shewed the property to be fully capable of bearing the burdens on it, and were strongly confirmatory of the opinions and advice on which he relied; and from time to time, and particularly after the line had been carried to Savanna, there were a number of offers made to purchase it, the terms of several of them being such as would recoup the bank in principal and interest, unless, indeed, they had been

compelled at once to turn their new securities into money and remit to this country with a most unfavourable exchange, for which, as I have already said, I think there was no necessity.

There has been a considerable controversy on the question whether there was ever any transaction by which the bank received a large amount of securities in name of interest. I think it has been made out that from the time the Northern Illinois Railway was in operation considerable sums were received in cash on account of interest; and although the interest generally falling due on the bonds of the Racine and Mississippi Railway Company, and the certificates for the moneys advanced to the Farmers Loan and Trust Company, was not paid when due, but was expended with the bank's consent in the construction of the extended lines and equipment of the railways, yet the railways were by this expenditure increased in value, and when the amalgamation of the whole lines into one, under the name of "The Western Union Railway Company," was carried out, I think it is clear that securities by the new company in bonds and stock were given to the bank on account of the past-due interest owing to them. I agree, however, in an observation made by the counsel for the respondent, that it is really not very material to the decision of this case whether bonds or other securities were given at any particular time to represent or cover interest expressly *eo nomine*. It was justly observed by the counsel for the liquidators that shortly after Mr Mackinnon joined the board this railway account became no longer an account in which Gemmell, Watson, and others were the debtors, and the parties interested in the railway bonds held by the bank merely as a security. The best arrangement the bank could make was to discharge the debtors and take over the bonds as their own property. This it was that led the bank in the gradual expenditure of money in extensions of the line; and the result undoubtedly was that the accounts, in place of representing loans to a customer, really represented a speculative enterprise. That being so, the question, What was the bank's position at any particular moment? was really one of valuation of the bank's securities—bonds and stocks—after stock had been acquired—and the amount of any valuation was rather a question of original outlay and profits than of capital and interest, as in the case of a loan to a customer. Accordingly when interest was being year after year debited to the account, the true question which those in the management of the bank had to solve was whether on a fair valuation there was such a profit on what had become really a speculation by the bank as would warrant the carrying of 7 or 8 per cent. to the debit of the account, and so to the profit and loss account. If it be supposed that the bank under the sale to Mitchell had got a much larger price, it is obvious this would not have represented interest in any way, but simply so much profit. It thus appears to me that the true question in the case is not, did the bank receive regularly the interest on its bonds, although I think that substantially they did so, but rather at the time of balancing of each year was there on a sound valuation a profit to carry to profit and loss account?

In this point of view it is not unimportant to note that there were several circumstances in the history of the transactions by which the bank profited largely, the more important of which I may here notice. The first of these was that about the time of the amalgamation in 1866, when the Western Union Railway Company was created, the whole of the original stock of the Racine and Mississippi Railway Company was extinguished by means of the foreclosure suit at the instance of the bank as bondholders. The bank thereby became proprietors of the line in virtue of their mortgages, freed from stock, and in the amalgamation it became possible, accordingly, to create all the more new stock. Again, at a time when the East and West Division bonds of the Racine and Mississippi line were depressed, Mr Thomson having faith in the capabilities of the line, advised the purchase of bonds at 25 % and 40 % respectively, and the bank, for the purpose at once of having a decided control over the management, and also with the view of reducing the average of the bonds they had, authorised a considerable purchase to be made. For the bonds so purchased they got in exchange bonds of 1000 dollars each at par over the Western Union Railroad at the amalgamation. Again, at the formation of the Northern Illinois Railway Company, on the suggestion of Mr Irvin and Mr Thomson, the bank purchased about 2500 shares of 100 dollars each of the stock of the company, on which only 25 per cent. was paid. At the amalgamation this stock was treated as fully paid up, and new stock of the amalgamated company given for it accordingly, obviously to the great advantage of the bank. Again, there was a large profit on the combination account referred to in the evidence. Mr Guild says of it, that the cost to the bank was £54,896, while the bonds alone realised £80,007; half the stock sold to Mitchell, £21,177; and there was, besides, a share of the other half of the stock, which was sold by the liquidators. And besides these, there were profits arising to the bank on the two iron rail credits, also explained in the evidence, which are estimated by Mr Guild at £20,245 and £13,000 respectively. In the question of treating the railway account as bearing interest or profit, it was obviously quite legitimate to take the results of these various transactions into view.

I have only to add, on this part of the case, that I cannot doubt that by the act of amalgamating the lines and consolidating the undertaking into one the property of the bank was greatly enhanced in value, and accordingly the result was immediately seen in the offers which from that time onward were made by different parties for the Western Union Railway. Finally that railway was sold to Mr Mitchell, before Mr Mackinnon left the board, for a certain payment in cash and bonds and stock, which I think were fairly regarded as sufficient securities for the bank's debt, principal and interest. It is clear that all the parties at the time placed great value on the stock, and had reasonable grounds for doing so. The investment was thus put in a shape in which the bank were freed from any further call for advances, and they obtained securities on which interest was regularly paid from 1870 till the bank stopped payment. On the merits of the case, therefore, and as the result of a review of the material points in the evidence, I am satisfied that judgment ought to be for the respondent; and having given the details of the evidence my best consideration, I must add, that,

so far as I am concerned, I do not think the question one of doubt or difficulty.

The respondent maintains three pleas of a preliminary nature, with which I shall now deal shortly. The first of these is, that all parties are not called; that the application cannot be insisted in against Mr Mackinnon alone and without having the other directors of his time made respondents, as being liable in joint responsibility; secondly, that the liquidators have no title to maintain such an application; and third, that the application is barred by the lapse of time and proceedings of the company from 1870 to 1878, when the liquidation commenced; and alternatively by this and the realisation by the liquidators of the bank's securities without notice to the respondent of this claim, or giving the respondent an opportunity of himself taking over the securities.

On the first of these points my opinion is against the respondent. It is enough to say that the case presented is one of breach of trust, and it is quite settled that the responsibility in such cases is joint and several, so that the complainer in such a case is entitled to maintain an action against any of the alleged wrongdoers.

On the question of title, I concur with your Lordships in holding that the liquidators have no title to enforce such a demand as is here made, at the point to which the liquidation has advanced. It must be taken that for all practical purposes the liquidation is now in its second stage, viz., the adjustment of the rights of the contributories; for the claims of creditors have been fully provided for by the remaining assets in the hands of the liquidators. Can the application, then, be maintained in name of the company or its liquidators, on behalf of the whole body of solvent shareholders? I am of opinion it cannot. It appears to me that a claim for repayment of dividends wrongly paid out of capital, when the claims of creditors have been provided for, can only be insisted in by individual shareholders, each for himself; and that, assuming that such a claim will lie, its success will depend on considerations personal to the individual, and depending on his peculiar position. When the bank stopped payment, out of 1282 holdings of the bank's stock, 588, representing stock to the amount of £375,551, had been in whole or in part acquired prior to 1870. These holdings, being about four-ninths of the whole, were held at the stoppage by the persons who had drawn the dividends said to have been improperly paid out of capital, or part of them. Shareholders owning sixty-nine only of these holdings remain solvent, the owners of the remaining 519 holdings having surrendered and assigned their interest to the liquidators—that is, to the remaining solvent shareholders. The shareholders who thus take as assignees in the liquidation can of course take no higher right than their cedents had when the liquidation began; so that if the shareholders themselves could not claim a second payment of dividend, neither can their assignees do so in their right. Now, I take it to be quite clear that shareholders who have already drawn dividends, however improperly the payments may have been made, cannot ask payment of the same sums again. They may have a claim of damages for mismanagement of the company, in which the fact that a great part of the capital had been paid back might have an important bearing; but there is no legal medium on which it can be maintained that the shareholder shall have his money paid to him twice over. This seems obvious on the mere statement of it, and it was expressly laid down by the Lord Chancellor (Hatherley) in the case of *Turquand*, L.R. 4 Chanc. App. 383. This being so, it follows that the liquidators cannot maintain their claim. If they succeeded, they must make a *pro rata* division of any sum received by them amongst the solvent shareholders, just in the same way as they would divide surplus assets after payment of the company's debts. In this way shareholders to the extent of 4-9ths—that is not much short of a half of the holdings in 1870—would get payment a second time of the money they have already got as dividends. Even as to the remaining shareholders, it is a question of great difficulty to answer—whether, seeing the holders prior to 1870 of the shares they now possess got the dividends applicable to these shares, it can now be maintained that new holders of the shares can demand a second payment? If there be room for such a claim, I think it must rest on some representation made in reports by the directors, or in some other way, in regard to the capital extant, on the faith of which the shares were purchased; and if that be so, it is plain that the validity of such a claim must depend on special circumstances peculiar to the individual. The result in any view is that the claim is not a company claim. It cannot be maintained on behalf of all the shareholders as a body, for the shareholders are in many different positions; and even if the claim were made by the shareholders themselves, it is certain that a large class of them could not possibly succeed. The case is of the same class as that of *Mann* v. *Sinclair*, 6 Ret. 1078, in which it was held that the trustee on a sequestrated estate had no title to sue an action for the general body of creditors in reference to a state of matters in which the creditors were in different positions—some, it might be, with a claim against the defender, while others certainly had no such claim.

Finally, I am of opinion that judgment ought also to be for the respondent on the pleas in bar of the application. He had no notice of any claim against him in connection with the railway account till the service of the summons in the ordinary action in June 1880. After he left the direction, fully eight years elapsed before the liquidation began. During these years the business of the company was carried on regularly by a manager and other officials, and a board of directors. The company continued in possession of the securities on the American account as the respondent left them, drawing the interest regularly on the Western Union bonds. Now, if this be, as the liquidators represent it, a company claim, for how long a time may the company, carrying on its business, delay the assertion of it? It appears to me that it must be brought forward within a reasonable time; and I am disposed to hold that after so long a period as eight years it cannot be entertained. The opposite view would infer that the shareholders might allow any number of years within the prescriptive period to elapse—and it was so maintained in the argument—take the benefit of the securities in the meantime, and wait the result of rising and falling markets, and finally, after a loss for the first time, assert their claim many years after a director had retired. I cannot assent to this, or hold that because the company carries on the business by a manager and

directors, that this gives the partners privileges in a question of this kind which a private company would not have. It appears to me that within a year, in ordinary circumstances, or at all events in the course of a second year, the demand must be made, so that the respondent may preserve any rights of relief, or rights to demand repayment of the dividends from any persons liable, and may also have the option of taking over the securities if he think fit, admitting his liability. It is not necessary, however, to decide this question taken by itself—for besides the lapse of time already mentioned before the liquidation, nearly two years elapsed after the liquidation began before the ordinary action was raised, and in the meantime the liquidators had parted with all the bank's securities in exchange for others, which others they had realised at a considerable loss on the whole account. I may say here that I do not think that this realisation can be taken as giving the means of ascertaining the true value of the bank's securities acquired under the Mitchell agreement. But apart from this, taking the realisation into view with the delay that occurred in making the present claim, it seems to me that the company is barred from maintaining this application. I do not doubt that the liquidators acted rightly in realising as and when they did, seeing that it was necessary for them to convert the assets of the bank into cash without delay to enable them to pay the demands of creditors. But I am equally satisfied that with time—it might be a year or more—for negotiation, and if necessary legal proceedings in America, a result considerably more favourable would in all probability have been obtained; and I refer especially to the stock of the Western Union Railway Company, for which, although large offers for it had been previously rejected by the bank, a trifling sum only was realised, as has been explained by my brother Lord Mure. The respondent was, I think, entitled to an opportunity of taking over the whole securities, which he might have done on much more favourable terms than the bank realised, and even on such terms as might possibly have induced him, in order to avoid litigation, to have made some settlement of the liquidators' claims. I do not think it is any sufficient answer to Mr Mackinnon's plea on that point to say that the liquidators had not when they realised the securities resolved to insist in a claim against him. The hardship to him of sustaining the claim, after all the securities have been realised at a considerable loss, which might have been possibly avoided, would be all the same. I am of opinion that the delay and proceedings of the company up to 1878, combined with the proceedings of the liquidators before they made a claim against Mr Mackinnon, form a complete bar to the present application.

The Lords refused the prayer of the note, with expenses.

Counsel for Liquidators — Dean of Faculty (Kinnear, Q.C.)—Solicitor-General (Balfour, Q.C.)—Asher—Lorimer. Agents—Davidson & Syme, W.S.

Counsel for Respondent — Dean of Faculty (Fraser. Q.C.)—Mackintosh—Robertson—W. C. Smith. Agents—Murray, Beith, & Murray, W.S.

Tuesday, December 20.

FIRST DIVISION.

[Sheriff of the Lothians.

ANDERSON *v.* LATTIMER.

Process—Appeal—Competency—Where Proof not duly Boxed—Act of Sederunt March 10, 1870, *sec.* 3, *sub-sec.* 1.

Where an appellant duly boxed the note of appeal, record, and interlocutors in terms of the Act of Sederunt March 10, 1870, sec. 3, sub-sec. 1, but, through the mistake of his agent, omitted timeously to box the proof, the Court *repelled* an objection to the competency of the appeal, but found the appellant liable in modified expenses.

This was an appeal from the Sheriff of the Lothians. When the case appeared in the Single Bills the respondent objected to the competency of the appeal, on the ground that the appellant had not complied with section 3, sub-section 1, of the Act of Sederunt 10th March 1870, which provided that "the appellant shall, during session, within fourteen days after the process has been received by the Clerk of Court, print and box the note of appeal, record, interlocutors, and proof, if any," unless the Court should have dispensed with printing, and if the appellant should fail within the said period of fourteen days to print and box the papers required as aforesaid it was further provided that he was to be held to have abandoned his appeal, and not entitled to insist therein except upon being reponed, as provided by the 3d sub-section of the same section. The process in the present case was received by the Clerk of the First Division on December 2, and the note of appeal, record, and interlocutors were duly boxed thereafter in terms of the above provision of the Act of Sederunt. But there was a proof, which the appellant omitted to box within the prescribed period, owing, as he averred, to the mistake of one of his agent's clerks, and he endeavoured to comply with the Act of Sederunt by printing and boxing the proof as soon as the omission was noticed.

The appellant cited *Young* v. *Brown*, February 19, 1875, 2 R. 456; *Walker* v. *Reid*, May 12, 1877, 4 R. 714; *Muir* v. *Mackenzie*, October 15, 1881, 19 Scot. Law Rep. 3.

The respondent cited *Robertson* v. *Barclay*, November 27, 1877, 5 R. 257.

At advising—

Lord President—I think that this case falls within the principle of *Young* v. *Brown* rather than that of *Robertson* v. *Barclay*. In the case of *Robertson* v. *Barclay* there was an entire failure to print. The appellant had taken no step—he had not even attempted to take any step—to print and box the appeal, and it was there held that he had no excuse at all, except an obviously trivial attempt to palliate his default on the ground of some verbal and half-hearted communings between the parties with a view to a settlement. In the case of *Young* v. *Brown*, on the other hand, there was a failure to print a part merely of what is required by the Act of Sederunt, no doubt a part of less importance in the discussion of the case than what has been omitted here;