1966
*May 20, 24
June 28

FRANK CONRAD OLAFSON and OLIVE DOROTHY LEECH (*Plaintiffs*) ..... APPELLANTS;

AND

TWILIGHT CARIBOO LODGE LTD. (*Defendant*) ..... RESPONDENT.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Companies—Agreement to purchase all outstanding shareholders' loans and shares in capital of company—Mortgage of company to secure unpaid purchase price—Whether mortgage given without consideration and in contravention of s. 152(1) of the Companies Act, R.S.B.C. 1960, c. 67.

At the time the respondent company was incorporated by the appellants in connection with the purchase of a certain hotel property, only 20 shares of common stock were issued, 10 of which were allotted to each of the appellants for the price of $1 each and the real capital of the company with which the property was purchased was supplied by the appellants in the form of a shareholders' loan of $195,000. The appellants later entered into a formal agreement for the sale of the company to two individuals.

The agreement of sale provided that the purchasers would purchase all of the outstanding shareholders' loans ($142,369.55) and shares in the capital of the company for $225,500, $65,000 of which was to be paid in cash out of which the appellants agreed to forthwith retire an existing mortgage debt of the company of $59,461.42. The appellants also undertook to pay off a bank loan to the company of $12,500 and to deliver all the issued shares (*i.e.* 20 shares) to the purchasers at the time of closing on the condition, which did not appear to have been fulfilled, that they were to be held in escrow as part of the security for the unpaid balance owing under the agreement which was to bear interest at the rate of 7 per cent and was to be paid by monthly instalments of $1,429.30. It was further agreed that the $160,000 remaining unpaid should be secured by a mortgage on the whole assets and undertaking of the company.

The mortgage became in arrears and foreclosure proceedings were commenced resulting in an order *nisi* being granted. On appeal, the Court of Appeal set aside the decision of the trial judge and allowed the respondent's counterclaim for a declaration that the mortgage was void and unenforceable on the ground that it was given without consideration and in contravention of s. 152 of the *Companies Act*, R.S.B.C. 1960, c. 67.

Held: The appeal should be allowed and the judgment at trial restored.

The Court found that the agreement of sale must be interpreted as meaning that the shareholders' loans were not to be assigned until the company's indebtedness to the appellants had been properly protected by the giving of the mortgage for which the above recited obligations were more than adequate consideration. It was true that the company

*PRESENT: Fauteux, Judson, Ritchie, Hall and Spence JJ.

was not a party to the agreement, but once the purchasers had become the sole shareholders and directors, it was quite competent for them to consolidate the company's obligations into one item of indebtedness payable in monthly sums and secured by a mortgage in accordance with the agreement arrived at between the vendors and the purchasers.

The Court of Appeal had treated the circumstances of this case as being governed by the *Thibault* case (1962), 33 D.L.R. (2d) 317, affirmed [1963] S.C.R. 312, and accordingly held that the transaction was in contravention of s. 152(1) of the *Companies Act, supra,* which reads: "A company shall not give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase made or to be made by any person of any shares in the company;..." This Court was of the opinion that the *Thibault* case was distinguishable from the circumstances here disclosed and held that the present case was not governed by that authority.

APPEAL from a judgment of the Court of Appeal for British Columbia[1], allowing an appeal from a judgment of Branca J. Appeal allowed and judgment at trial restored.

Humphry Waldock, for the plaintiffs, appellants.

J. Giles and *P. Jensen,* for the defendant, respondent.

The judgment of the Court was delivered by

RITCHIE J.:—This is an appeal from a judgment of the Court of Appeal for British Columbia[1] allowing an appeal from the judgment rendered at trial by Branca J. and thereby dismissing the claim of the present appellants for foreclosure of a mortgage given by the respondent for the stated consideration of $160,000 covering a hotel property situate at Lac La Hache on the Cariboo Highway. By this judgment the Court of Appeal also allowed the respondent's counterclaim for a declaration that the mortgage was void and unenforceable on the ground that it was given without consideration and in contravention of s. 152 of the *Companies Act,* R.S.B.C. 1960, c. 67.

The transaction which is here in question can only be properly understood in light of the following circumstances which gave rise to it.

When the respondent company was incorporated by the appellants in February 1961 in connection with the purchase of the hotel property in question, only 20 shares of common stock were issued, 10 of which were alloted to each

[1] (1966), 55 W.W.R. 385.

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of the appellants for the price of $1 each and the real capital of the company with which the property was purchased was supplied by the appellants in the form of a shareholders' loan of $195,000.

In the autumn of 1963, Louis C. Buendia and Cyrias W. Prevost of Kamloops, (hereinafter called the purchasers) became interested in acquiring the company and on the 31st of December of that year the appellants entered into a formal agreement with them for its sale. It is the construction to be placed on the terms of this agreement which has given rise to the difference of opinion in the Courts below.

The financial statement of the company as at December 15, 1963, disclosed its liabilities and capital to be as follows:

LIABILITIES AND CAPITAL

CURRENT LIABILITIES		
Accounts payable	$ 6,042.33	
Bank overdraft	94.01	
		$ 6,136.34
MORTGAGE		
Principal	58,388.76	
Accrued interest	1,072.66	
		59,461.42
LOAN		
Shareholders	142,369.55	
Bank	12,500.00	
		154,869.55
CAPITAL		
Authorized—10,000 shares par value $1.00 each	10,000.00	
Issued—20 shares par value $1.00 each		20.00
		$220,487.31

The agreement of sale provided that the purchasers would purchase all of the outstanding shareholders' loans and shares in the capital of the company for $225,000, $65,000 of which was to be paid in cash out of which the appellants agreed to forthwith retire the existing mortgage debt of $59,461.42. The appellants also undertook to pay off the bank loan and to deliver all the issued shares in the company (*i.e.* 20 shares) to the purchasers at the time of closing on the condition, which does not appear to have been fulfilled, that they were to be held in escrow as part of the security for the unpaid balance owing under the agree-

ment which was to bear interest at the rate of 7 per cent and was to be paid by monthly instalments of $1,429.30. It was further agreed that the $160,000 remaining unpaid should be secured by a mortgage on the whole assets and undertaking of the company and as it is this provision in the agreement which has given rise to much of the difficulty, I think it desirable to set it out in full as follows:

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(c) The said balance of One Hundred Sixty Thousand ($160,000.00) Dollars shall be secured by the Purchasers upon the whole assets and undertaking of the Company by way of mortgage of the said assets and undertaking in favour of the Vendors together with an escrow of all outstanding shares of the Company. Such mortgage and escrow agreement to be in the usual form and approved by the Vendors. *The time and the manner of the assignment of shareholders loans to the Purchasers shall be as agreed upon by negotiation with a view to mutual protection of all parties.* And said mortgage shall include an acceleration clause upon a default not remedied within ninety (90) days of notice of default.

The italics are my own.

It appears to me to be important to observe that the shareholders' loans were not assigned automatically as a result of the agreement and in fact were not required to be assigned until they had been properly protected by the taking of the mortgage which was given by the company as security for its indebtedness to the appellants.

As has been pointed out by the learned trial judge, the company was enriched to the total amount of $71,961.42 by the appellants assuming the outstanding mortgage and the bank loan and in the absence of clear and unambiguous language compelling me to do so, I am unable to interpret the agreement as meaning that the parties intended that the appellants were to assume these obligations and also to assign their shareholders' loans in the amount of $142,-369.55 without first being properly protected by some form of security. I am therefore, with the greatest respect for the view adopted by the members of the Court of Appeal, of the opinion that the agreement must be interpreted as meaning that the shareholders' loans were not to be assigned until the company's indebtedness to the appellants had been properly protected by the giving of the mortgage for which the above recited obligations were more than adequate consideration.

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It is true that the company was not a party to the agreement of December 31, but once the purchasers had become the sole shareholders and directors, it was quite competent for them to consolidate the company's obligations into one item of indebtedness payable in monthly sums and secured by a mortgage in accordance with the agreement arrived at between the vendors and the purchasers.

The Court of Appeal has suggested that this interpretation of the agreement results in the company having assumed an obligation of $160,000 to the vendors while remaining liable to the purchasers as assignees of the shareholders' loans in the amount of $142,369.55. I do not so interpret the situation. It appears to me that the substance and effect of the agreement of December 31 was that only as the purchasers paid off the mortgage of $160,000 they would become, to the extent of the payment, subrogated to the position of the vendors.

The Court of Appeal, however, treated the circumstances as being governed by the case of *Trustee of Estate of Thibault Auto Ltd. v. Thibault*[1], (hereinafter referred to as the "*Thibault* case") which was affirmed in this Court[2], and accordingly held that the transaction was in contravention of s. 152 (1) of the *Companies Act* which reads as follows:

> A company shall not give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase made or to be made by any person of any shares in the company;...

The *Thibault* case was not one in which the vendors as mortgagees were seeking to foreclose a mortgage given by way of additional security in the manner disclosed in the present case. In the *Thibault* case the action was brought by the trustee in bankruptcy of the Thibault Company which had itself been incorporated for the express purpose of facilitating the sale of Mr. Thibault's personal assets to one Clavette. The circumstances were that Thibault, who

[1] (1962), 33 D.L.R. (2d) 317.

[2] *Sub nom. Thibault v. Central Trust Co. of Canada,* [1963] S.C.R. 312.

operated an automobile business in Edmunston, decided to cell it to Clavette for $60,000, but finding that the purchaser did not have the funds available, he consulted his accountant and his lawyer and finally arranged to transfer the assets to a company which he incorporated for the purpose and then to sell the shares in that company to Clavette for $90,000 on the understanding that Clavette would arrange to have the purchase price secured by giving him a mortgage of the company's assets for the full amount of $90,000 which was to be paid in instalments over a period of 15 years. It appears that Thibault was encouraged in making these arrangements by the advice that in conveying his business assets to the company an advantage would accrue to him through avoiding a charge back to income of any recapture of capital cost allowance previously claimed as a deduction for income tax purposes. In any event, the transaction from beginning to end was predicated upon the understanding that the company would issue a mortgage for the full amount of the purchase price for the sole and express purpose of providing security for the purchase of the shares by Clavette. What the *Thibault* case decided was that such a transaction could be set aside at the suit of the company's creditors on the ground that it was a flagrant breach of s. 37(1) of the *Companies Act*, R.S.N.B. 1952, c. 33, which in all relevant essentials was the same as s. 152(1) of the British Columbia *Companies Act*.

In the *Thibault* case there was no question of a down payment having been made or any other consideration having been given for the shares except the undertaking to pay the amount secured by the mortgage, nor was there any assignment of shareholders' loans or assumption of company obligations by the vendors. For these reasons and for those given by Mr. Justice Branca, I am satisfied that the *Thibault* case is distinguishable from the circumstances here disclosed and with the greatest respect for the views expressed by the Court of Appeal of British Columbia, I do not think that this case is governed by that authority.

For these reasons, as well as for those set out in the reasons for judgment of Branca J., I would allow the appeal

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and restore the judgment at trial. The appellants will have their costs in this Court and in the Court of Appeal.

Appeal allowed and judgment at trial restored.

Solicitors for the plaintiffs, appellants: Oliver, Miller & Co., Vancouver.

Solicitors for the defendant, respondent: Farris, Farris, Vaughan, Taggart, Wills & Murphy, Vancouver.