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* Mar. 3, 4, 5, 6, 7, 10, 11, 12.
* Oct. 7.

NESBITT, THOMSON & COMPANY LIMITED (DEFENDANT)... APPELLANT;

AND

JOSEPH M. PIGOTT AND PIGOTT CONSTRUCTION COMPANY LIMITED (PLAINTIFFS) ..... RESPONDENTS.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Contract—Rescission—Alleged fraudulent misrepresentations in a selling circular inducing purchase of shares in company—Construction of representations—Right to rescission of contract of purchase—Principles applicable—Status to sue—Shares bought and held by purchaser

* PRESENT:—Duff C.J. and Rinfret, Crocket, Kerwin and Taschereau JJ.

(1) (1928) 62 O.L.R. 83. (2) (1923) 54 O.L.R. 24.

for benefit of a company which later surrendered its charter after assigning its assets to a successor company—Limitation of actions—Time from which statute of limitation begins to run.

This Court dismissed the defendant's appeal from the judgment of the Court of Appeal for Ontario, [1939] O.R. 66, dismissing its appeal from the judgment of Greene J., [1937] O.R. 888, rescinding a contract for purchase from the defendant of shares of stock in a company on the ground that the purchase was induced by false and fraudulent representations in a prospectus or selling circular issued by the defendant.

Per Rinfret, Crocket and Taschereau JJ.: The mere fact that statements in a prospectus issued by a defendant are false does not necessarily render him liable in damages; the false representation has to be made knowingly, or without belief in its truth, or with reckless disregard of whether it is true or false. If the defendant was indifferent as to whether the statements were false or true, this frame of mind is sufficient, when the facts are proven to be false, to create civil liability (*Derry* v. *Peek*, 14 App. Cas. 337).

The shares in question had been purchased by P. who purchased and held them as trustee for P.-H. Co., the beneficial owner. That company later surrendered its charter, after having assigned its assets to its successor, P. Co., which therefore became the beneficial owner of the shares, P. holding them as trustee for it. The plaintiffs in the action were P. and P. Co. *Held:* The action was maintainable. *Per* Rinfret, Crocket and Taschereau JJ. (agreeing with Masten and Fisher JJ.A. in the Court of Appeal): (1) P. had by himself a status to maintain the action; P. Co., though not a necessary party, was yet a proper party plaintiff. (2) The rule that a right incidental and subsidiary to the ownership of property is assignable and does not savour of champerty or maintenance, applies to the facts of this case. *Per* Kerwin J.: The contract was made between defendant and P., and the right of action for rescission vested in P. as trustee and there it remains.

A contention that the action was barred by *The Limitations Act*, Ont., over six years having elapsed between the purchase of the shares and the commencement of the action, was rejected. The judgment of Masten and Fisher JJ.A. in the Court of Appeal, refusing to interfere with the trial judge's findings that plaintiffs had not been guilty of laches and did not suspect any fraud until a time much less than six years before commencement of the action, and holding that the statute began to run only at that time, was (*per* Rinfret, Crocket and Taschereau JJ.) approved.

APPEAL by the defendant from the judgment of the Court of Appeal for Ontario (1) dismissing (Henderson J.A. dissenting) the defendant's appeal from the judgment of the trial judge, Greene J. (2), holding that the plaintiffs were entitled to rescission of a certain contract for purchase of shares of stock in the Montreal Island Power

(1) [1939] O.R. 66; [1938] 4 D.L.R. 593.
(2) [1937] O.R. 888; [1937] 4 D.L.R. 598.

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Company and to repayment of the purchase price with interest, upon the plaintiffs returning to the defendant the shares. With respect to said shares, the formal judgment at trial declared that the plaintiff Joseph M. Pigott was induced to purchase them by means of false and fraudulent representations in a prospectus or selling circular issued by the defendant, and that the contract for the purchase was not binding upon the plaintiffs; and rescinded and set aside the said contract; and provided for delivery by the plaintiffs of the share certificates, recovery against the defendant of the price paid for the shares and interest, and delivery to the defendant of the share certificates upon payment of the sum recovered against the defendant and costs.

Besides the disputes with regard to the alleged misrepresentations, certain other questions were raised.

The shares had been purchased by the plaintiff Joseph M. Pigott, and were purchased and held by him as trustee for the beneficial owner, Pigott-Healy Construction Co. Ltd. (the name of which was later changed). That company later surrendered its charter, after having assigned all its assets to its successor, Pigott Construction Co. Ltd., which therefore became the beneficial owner of the shares, Mr. Pigott holding them as trustee for it. The latter company was made a co-plaintiff in the action. The defendant contended that the plaintiffs had no right to maintain the action.

Dealing with this question in the Court of Appeal, Masten and Fisher JJ.A., with whose reasons on this question Rinfret, Crocket and Taschereau JJ. in this Court agreed, said

> Here, the contract for purchase of these shares was between the appellants and Pigott as an individual, and the misrepresentations complained of were made to him. The shares were transferred to him and he became and has remained at all times a shareholder of the Power Company. As the contract was his, and the representations were made to him, he has the right to claim personally its rescission for such a right is incidental to his personal contract with appellants, and the fact that third parties are entitled to look to Pigott as a trustee for them cannot affect, much less annul, his right to claim rescission. Indeed, as a trustee, that was his duty. As between the successive cestui que trustent the transfer of interest from one to the other cannot operate to annul and defeat Pigott's right of action. The appellant contracted with Pigott personally and cannot set up in his defence the outstanding rights of third parties for whom Pigott is trustee.

and, after referring to certain cases and authorities, they concluded:

(1) That Pigott had by himself a status to maintain this action, and that the Pigott Construction Company, Limited, though not a necessary party, is yet a proper party plaintiff.

(2) That the rule that a right incidental and subsidiary to the ownership of property is assignable and does not savour of champerty or maintenance applies to the facts of this case.

The defendant claimed that the plaintiffs' alleged cause of action was barred by *The Limitations Act* (R.S.O., 1927, c. 106, s. 48). The purchase of the shares in question was made in 1927 and the action was commenced in 1935. On this question the trial judge said:

* * * The plaintiffs made no enquiries until 1932 and according to the evidence of Mr. Pigott did not suspect any fraud until Mr. Acres, an engineer employed by the plaintiffs, made his report late in 1934. In my opinion, the statute began to run then. It was argued for the defendant that there must be concealment by the defendant to prevent the statute running, but *Bulli Coal Mining Company* v. *Osborne* (1) is authority for the statement that so long as there has been no laches by the party defrauded, it is immaterial whether or not there have been on the part of the wrongdoer active measures to prevent detection. See also Kerr on Fraud and Mistake, 6th ed. at p. 447, and at pp. 16 and 17.

The plaintiffs were not guilty of laches. Dividends were not expected on the preference shares for a few years, so that the plaintiff in commencing his definite enquiries in 1932 acted with reasonable promptness.

In the Court of Appeal, Masten and Fisher JJ.A., with whose reasons on this question Rinfret, Crocket and Taschereau JJ. in this Court agreed, said:

We have carefully read and considered all the cases that are referred to by counsel on either side, and it seems to us that they are completely and accurately summarized in the 9th edition of Salmond on Torts, at page 180, in the following words:—

"When the defendant has been guilty of fraud or other wilful wrongdoing, the period of limitation does not begin to run until the existence of a cause of action has become known to the plaintiff. This is commonly spoken of as the rule of concealed fraud, but the term *fraud* is here used in its widest sense as meaning any act of wilful and conscious wrongdoing—for example, a wilful underground trespass and abstraction of minerals. The term *concealed*, moreover, does not imply any active suppression of the facts by the defendant, but means merely that the wrong is unknown to the person injured at the time of its commission."

Whether the circumstances imposed a duty on the plaintiffs of making an earlier investigation, and whether they were thus guilty of laches is a question of fact upon which the trial Judge gives effect to the evidence of Mr. Pigott that he did not suspect any fraud until late in 1934. The fact that no dividends were to be expected on this stock for some years after its purchase, lends support to this finding of fact by the trial Judge;

(1) [1899] A.C. 351.

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and for the reasons which have appeared earlier in this judgment we think that this Court ought not to interfere with the finding of fact of the trial Judge.

W. N. Tilley K.C. and *B. V. McCrimmon* for the appellant.

Glyn Osler K.C. and *H. A. F. Boyde K.C.* for the respondent.

THE CHIEF JUSTICE—I agree that this appeal should be dismissed with costs.

The judgment of Rinfret, Crocket and Taschereau JJ. was delivered by

TASCHEREAU J.—The claim of the respondents is based on alleged misrepresentations made to them by the appellant and which induced them to purchase a number of 6% preference shares of an issue of $1,000,000 of the Montreal Island Power Company (dividends to be cumulative from January 1st, 1928).

The circular which was issued by the appellant on the 15th of June, 1927, contained, *inter alia,* the following statements which are the target for the attacks of the respondents, and which are qualified as being misleading, untrue and false representations:—

BUSINESS AND PROPERTY: The Montreal Island Power Company, incorporated under the laws of the Province of Quebec, has been formed for the purpose of developing a water power located on the Rivière des Prairies (Back River) about seven miles from the heart of the city of Montreal, Que. It is estimated that this site, under a head of 26 feet, is capable of developing 65,000 h.p. twenty-four hour power. Construction will start immediately and will be so carried out that 40,000 h.p. should be available for delivery by the end of 1929, provision being made for increasing the capacity to 65,000 h.p. at minimum cost, as required.

POWER MARKET: The Company has entered into a contract with the Montreal Light, Heat & Power Consolidated, whereby that Company will purchase all the power from this development for a period of thirty years, with provision for extension of the contract for a further like period. The power will be taken in specified annual instalments, until the entire capacity is absorbed.

Montreal Light, Heat & Power Consolidated operates one of the largest public utility systems in Canada. Directly, through subsidiaries or associated Companies, it does all the gas business and practically all the electric power and lighting distribution for domestic, industrial, municipal and tramway purposes in Greater Montreal, serving a rapidly growing community with a present population in excess of 1,000,000. The growth and strength of the contracting company are indicated by its net revenue, which has been as follows:—

1922—$6,483,473. 1924—$7,670,190. 1926—$8,693,688.

The average annual increase in demand for power for the past five years amounted to 16,000 h.p. At the same rate of increase the entire capacity of Montreal Island Power Company would be utilized and sold within four years.

EARNINGS: Under the above mentioned contract at ultimate capacity, it is estimated that net earnings of the Company will amount to approximately $900,000 per annum, or over seven and one-half times dividend requirements after payment of bond interest.

ENGINEERING AND CONSTRUCTION: Under arrangements agreed upon the technical work and supervision of construction of this development will be carried out by the Engineers of Power Corporation of Canada Limited.

This development has been favourably reported upon by the Engineers of Power Corporation of Canada Limited, and by Messrs. J. M. Robertson, R. S. and W. S. Lea and T. Pringle & Son Limited.

The plaintiffs allege that on the strength of these representations they purchased, on the 22nd day of June, 1927, 100 preferred shares of this issue and 40 shares of common stock at the aggregate price of $9,800, and on the 27th of April, 1929, 50 additional common shares at the price of $2,000. They claim rescission of these contracts and the return to the plaintiffs of the sum of $11,800 with interest.

Their contention is that the alleged misrepresentations were false and untrue and related to (1) the estimated output of power; (2) the contract under which the power was sold; (3) the estimated future increase in power demand; (4) the estimated net earnings, and (5) the reports made by the engineers. The trial Judge maintained partially the action, ordered the defendant to pay $9,800, but dismissed the claim for rescission of the contract for the purchase of 50 shares made on the 27th of April, 1929. The Court of Appeal (Mr. Justice Henderson dissenting) affirmed this judgment.

There is no doubt, as it has been pointed out by the learned counsel for the appellant, that whether or not there were fraudulent misrepresentations on the part of the appellant, must be determined not by the examination of subsequent evidence, but by an examination of circumstances at the time the circular was issued. It is also settled law that the appellant may be found liable only if the statements of which the respondents complain were false and were made knowing them to be false, or with reckless disregard as to whether they were true or false.

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It is what the appellant thought the result of the enterprise would be that must be considered, and not what it turned out to be.

After a careful study of the various reports prepared by very reputable firms of engineers, I have come to the conclusion that they do not justify the appellant to say in its circular letter that "it is estimated that this site, under a head of 26 feet, *is capable* of developing 65,000 h.p. 24 hour power."

In 1922, Pringle & Son Limited estimated an output of 45,000 h.p. In 1923, J. M. Robertson, of Montreal, reached identical conclusions, and in 1924, R. S. and W. S. Lea said in their report:—

> We believe 20,000 c.f.s. or more a fair estimate for the average year, but not likely to be maintained every year, assuming of course that past records are correct.

They also expressed the view that in a few years, the flow would be over 20,000 c.f.s. and eventually nearer 30,000 than 20,000 c.f.s., but this possibility, however, was on the basis of further storage developments. The highest headrace figured by R. S. and W. S. Lea is 56 feet, giving a maximum head of 26 feet, with therefore an output of approximately 50,000 h.p., but this is assuming that the head would always be 26 feet, which under the conditions prevailing at Des Prairies River is an impossibility. R. S. and W. S. Lea also warned that they were not sufficiently familiar with ice conditions to offer an opinion on the head which would be available during the winter months.

In September, 1926, a further report was obtained from the Power Corporation of Canada, Limited, and the engineers of that Company came to the conclusion that at the date on which the report was written, 20,000 c.f.s. may be accepted as a dependable flow for commercial purposes. They add that storage works are under construction in the water shed tributary to the Back River, and that they are expected to raise the dependable flow to 23,000 c.f.s. before the proposed development could reasonably be in operation. It is their opinion that a normal gross head of $26\frac{1}{2}$ feet will be available but they add that during certain seasons it may be reduced to 18 feet. If we use the formula adopted, and multiply the head by the flow and divide by 10·23, it will be seen that 23,000 c.f.s. with a head of $26\frac{1}{2}$

feet will give approximately 59,000 h.p., but this is assuming that the head is always 26½ feet and that it will never be reduced to 18 feet as pointed out in the report of the engineers. As to power available, the Power Corporation state that they provide for machinery installation to deliver 65,000 h.p. continuously, but they do not say that the development is capable of an output of 65,000 h.p. This ultimate output is based on contingencies which may never happen. None of these engineers venture to state that the proposed development is capable of furnishing 65,000 h.p. *24 hour power,* and I fail to see how their reports can be interpreted as having such a meaning.

When heard as a witness, Mr. Wurtele of the Power Corporation, who had prepared the report for this Company, repeated that the dependable flow would be raised to 23,000 c.f.s. at the time the plant is ready for operation, and that, within ten or fifteen years it might be ultimately up to 27,000 c.f.s. if storage facilities not yet decided upon, but the result of his self-made studies were available. It is only in the event of the happening of these contingencies that a firm power of 65,000 h.p. would be the output of the plant. This corroborates his report, and in the meantime for ten or fifteen years, the power developed would be approximately 59,000 h.p. *non-continuous* power on account of the frequent head reduction to 18 feet. This is far from the promised 65,000 h.p. *twenty-four hour power,* and at $19 per h.p., it makes a substantial difference in returns available for dividends.

It has been argued on behalf of the appellant that the elevation of the headrace has been determined in the three earlier reports without any definite knowledge as to what level the municipal authorities would permit, having regard to sewers discharging into the river. This point, they say, was apparently cleared up in 1926 when the Power Corporation in its report of September 28th of that year fixed the headrace level at 56·5 which was higher than the headrace level taken in any of the earlier reports. It is true that the reports prepared by Pringle, Robertson and Lea give a lower head on account of a lower headrace, but even with a higher headrace the output of power would not have been 65,000 h.p. twenty-four hour power. And the best evidence of this, is that with a headrace of 56½ feet the

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engineers of the Power Corporation do not foresee with the actual flow a 65,000 h.p. twenty-four hour power. It seems that this 65,000 h.p. continuous power is not available because the flow of the river is not sufficient.

Another of the appellant's contentions is that the Board of the Montreal Island, after the construction of the plant, was under the control of the Montreal Light, Heat, and that this Company which had purchased 125,000 h.p. from the Beauharnois, refused to permit the installation of additional units, which would have given additional power. This has been dealt with by the learned trial Judge, and the Court of Appeal, who came to the conclusion that if no additional units were installed, it is because there was not a sufficient dependable flow to justify such units, and no convincing reasons have been submitted to us why this finding should be set aside.

The circular further states that the construction is to start immediately and that 40,000 h.p. should be available for delivery by the end of 1929, and that the Montreal Light, Heat & Power Consolidated Company will purchase all the power from this development for a period of 30 years with provision for extension of the contract for a further like period. The power is to be taken in specified annual instalments until the entire capacity is absorbed. The facts are that the contract with the Montreal Light, Heat & Power provides for the purchase of 60,000 h.p., an initial block of 20,000 h.p. to be delivered by October 15th, 1930, and then a block of 10,000 h.p. annually during the four succeeding years. This means that by October, 1930, under the contract the Montreal Light, Heat & Power is to take delivery of only 20,000 h.p. and not 40,000 h.p. by the end of 1929 as stated in the prospectus. The Montreal Light, Heat & Power was not bound to take delivery and pay for 40,000 h.p. before the 15th of October, 1932. It is true that the Montreal Light, Heat & Power advanced its purchases one year, taking 20,000 h.p. on October 15th, 1929, but it is still false that by the end of 1929, 40,000 h.p. were available for delivery, and a revenue from 40,000 h.p. was not paid to the Montreal Island Company until two years after the time mentioned in the prospectus.

As to the estimated future increase in power demand and which is referred to as follows in the circular letter:

The average annual increase in demand for power for the past five years amounted to 16,000 h.p. At the same rate of increase the entire capacity of Montreal Island Power Company would be utilized and sold within four years.

I believe that the statement is misleading. It conveys the idea that within four years, that is in 1933, the plant would have an output of 65,000 h.p. all sold to the Montreal Light, Heat & Power Company, when the truth is that under the terms of the contract it was only in October, 1934, that the last 10,000 h.p. should be delivered to the purchasing Company, and making a total of 60,000 h.p.

In view of what I have said in reference to the total capacity of the development, it follows that the statement as to the net earnings of the Montreal Island Company estimated in the prospectus at "$900,000 per annum, or over seven and one-half times dividend requirements after payment of bond interest," is not according to facts, and cannot by any stretch of the imagination be termed as a true picture of the situation.

The last paragraph of the circular letter reads as follows:—

This development has been favourably reported upon by the Engineers of Power Corporation of Canada Limited, and by Messrs. J. M. Robertson, R. S. and W. S. Lea and T. Pringle & Son Limited.

I cannot agree with the suggestion of the learned counsel for the appellant as to the interpretation that should be given to this statement. The true meaning of this paragraph, and the only way it could have been read by a prospective purchaser, is obviously that all these competent and very widely known engineers had given their approval to *this development*. It conveys the idea that they all concurred in the statement "that under a head of 26 feet it was capable of developing 65,000 h.p. 24 hour power." In fact, none of the reports of these engineers substantiate this statement, and the inaccuracy of this representation certainly must have had a bearing in the minds of the investors, and developed an optimism which the disclosure of the real facts would surely not have justified.

On the whole, I come to the conclusion that the judgment of the courts below should not be disturbed, and I

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am satisfied that if the respondents had been furnished with the real facts, they would not have invested their money in this development, the possibilities of which have been unduly magnified.

As I have said already, the mere fact that statements in a prospectus are false does not necessarily render the defendant liable in damages. The false representation has to be made knowingly, or without belief in its truth, or with reckless disregard of whether it is true or false. It seems to me that the draftsman of this circular letter was at least indifferent as to whether the statements were false or true. And this frame of mind is sufficient, when the facts are proven to be false, to create civil liability. (*Derry* v. *Peek* (1)).

As to the technical objection raised by the appellant in respect of the plaintiffs' right to sue, and the defence raised on the statute of limitation, I agree with what has been said by Masten and Fisher JJ.A. of the Court of Appeal for Ontario.

I would dismiss this appeal with costs.

KERWIN J.—Having read the evidence in the light of the various submissions made by counsel for the appellant, I am satisfied that I would have arrived at the same conclusion as the trial judge. As to the right of the plaintiffs, or either of them, to sue,—the contract was made between the defendants and Joseph M. Pigott, and even though he had been a trustee for a corporation since dissolved and is now trustee for his co-plaintiff, the right of action for rescission vested in him as trustee and there it remains. The appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Tilley, Thomson & Parmenter.*

Solicitors for the respondents: *Bruce & Boyde.*

(1) (1889) 14 App. Cas. 337.