[HOUSE OF LORDS.]

H. L. (E.) 1888 June 11.

ALEXANDER ADAM & ROBERT SMITH ADAM . . . . . } APPELLANTS;

AND

WILLIAM NEWBIGGING & WALTER TOWNEND . . . . . } RESPONDENTS.

Contract induced by Misrepresentation—Rescission of Contract—Restitutio in Integrum—Indemnity—Damages—Partnership.

The respondent was induced by misrepresentations made without fraud by the appellants to become a partner in a business which either belonged to them or in which they were partners and which was in fact insolvent. The business having afterwards, owing to its own inherent vice, entirely failed with large liabilities:—

Held that the respondent was entitled to rescission of the contract and repayment of his capital, though the business which he restored to the appellants was worse than worthless, and that the contract being rescinded the appellants could not recover against him for money lent and goods sold by them to the partnership.

The decision of the Court of Appeal (34 Ch. D. 582) affirmed, but without deciding whether the appellants were liable to indemnify the respondent against the general liabilities of the firm.

APPEAL from a decision of the Court of Appeal (1) (Cotton, Bowen and Fry L.JJ.) affirming a decision of Bacon V.C.

In an action brought by the respondent Newbigging against the appellants the statement of claim alleged that the plaintiff had been induced by the defendants' misrepresentations to enter into a partnership with them and Walter Townend (the other respondent in this appeal), and claimed (inter alia) an indemnity against all claims and demands in respect of the partnership or the liabilities thereof; repayment of the capital brought in by him with interest: or alternatively damages for the misrepresentations.

The defence denied the allegations of the statement of claim, and the defendants counter-claimed (inter alia) for £16,704 1*s.* 9*d.* for money lent and goods sold by the defendants to the plaintiff and Walter Townend as partners.

(1) 34 Ch. D. 582.

The evidence given at the trial before Bacon V.C. is summarized in the report of the decision below (1), and set out in the judgments of Lord Halsbury L.C. and Lords Watson and Herschell in this House.

1888. March 16, 19, 20, 22, 23, 26. *J. B. Balfour* Q.C. (of the Scotch Bar) and *R. B. Haldane* for the appellants:—

The misrepresentations relied on by the respondent Newbigging having been (as is admitted) made innocently, no action could lie for deceit, and no damages could be recovered. Nevertheless the Courts below have given damages, though under another name. Nor is there any question of refunding, for the appellants never got anything out of the business: on the contrary they have lost money they advanced to the firm. The Courts below were wrong in holding that the appellants were either partners in Townend & Co. or concealed principals. The true result of the correspondence and other evidence is that they were nothing more than creditors who advanced money and goods for the carrying on of the business. The fact that they received a share of profits did not make them partners. The House of Lords in *Cox* v. *Hickman* (2) "decided that persons who share the profits of a business do not incur the liabilities of partners unless that business is carried on by themselves personally or by others as their real or ostensible agents:" 1 Lindley on Partnership (ed. 1878), p. 38; *Ex parte Tennant* (3). The facts here do not resemble those in *Pooley* v *Driver* (4) or *Ex parte Delhasse* (5). A mere power of nominating a partner does not constitute the nominator a partner; *Ex parte Davis* (6) per Lord Westbury. Nor does the fact of exercising control over the business: *Mollwo, March & Co.* v. *Court of Wards* (7). Here the control exercised by the appellants was purely negative. The decree in the present case follows that made in *Rawlins* v. *Wickham* (8), but that decision is not in point. There the defendants were partners and parties to the trading. In the present case they were not.

(1) 34 Ch. D. 582.
(2) 8 H. L. C. 268.
(3) 6 Ch. D. 303.
(4) 5 Ch. D. 458.
(5) 7 Ch. D. 511.
(6) 4 D. J. & S. 523, 531.
(7) Law Rep. 4 P. C. 419.
(8) 3 D. & J. 304.

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The present is not a case for rescission of the contract. Rescission is only applicable where restitutio in integrum can be made, i.e. "where the party seeking it is able to put those against whom it is asked in the same situation in which they stood when the contract was entered into:" *Western Bank of Scotland* v. *Addie* (1), per Lord Cranworth; and *Erlanger* v. *New Sombrero Phosphate Company* (2), per Lord Blackburn. In some cases equity can by its machinery in taking accounts substantially restore in integrum, though there has been some change in the subject-matter; but if the subject-matter perishes restitution is impossible, and the defendant is not liable even where the subject-matter perishes from its own inherent weakness, unless the perishing is brought about by some act of his, or from some cause as to which he has made a misrepresentation. Here the business perished, not from its own inherent weakness, but owing to Townend's frauds. The goodwill of the business is gone: there is nothing to restore. Moreover, damages cannot be given in an action for rescission where the misrepresentations are innocently made: *Redgrave* v. *Hurd* (3). Here, the decree though in name for an indemnity is really for damages. The judgment of Cotton L.J. (4) is based on a wrong principle. That of Bowen L.J. (4) is in certain passages more correct but too narrow to fit the facts here. In order to make the appellants liable for an indemnity against the obligations of the firm, the obligations must have been such as originally rested on the appellants and were by contract shifted from them to the firm. If rescission were granted Newbigging would at all events not be entitled to more than a set-off of the capital he brought in against the appellants' counter-claim for money advanced and goods sold.

The House took time for consideration without hearing

Sir *Horace Davey* Q.C. *J. G. Wood* and *George P. C. Lawrence*, for the respondent Newbigging. The respondent Townend was not represented.

(1) Law Rep. 1 H. L., Sc. 145, 164; 5 Court Sess. Cas. 3rd series, H. L. Cas. 80, 89.

(2) 3 App. Cas. 1218, 1277.

(3) 20 Ch. D. 1.

(4) 34 Ch. D. 587.

1888. June 11. LORD HALSBURY L.C.:—

My Lords, I think the most convenient course will be to consider what facts are established in this case before applying any rules of law to determine the rights of the parties.

It is clear that in April 1881, the Messrs. Adam were minded to establish for their own benefit a business out of their own immediate line as wool brokers and wool merchants at Leith. They appear to have been creditors of a firm, Hodgson & Co., and appear to have thought it to be for their advantage to purchase some of the plant and machinery, which the failure of Hodgson & Co. had brought into the market for sale. I think it is clear that, in the first instance at all events, Messrs. Adam intended that the business to be carried on at either Bradford or Sowerby should be their own business; but, inasmuch as they were wool brokers and wool merchants, it is probable they would not like to be known to be competing as manufacturers with their own customers, of whom they had many, both in Sowerby and Bradford. They appear, therefore, to have determined that the business should be carried on in some one else's name, and accordingly appear to have opened negotiations with Mr. W. Townend. The purchase of the plant and machinery appears to have been effected through a Mr. David Barker, who is described as a leading machinery dealer and valuer in Bradford. The value and efficiency of the machinery in question are so important in the determination of the question which your Lordships have to decide that it is worth while to consider at this early period of the narrative what was Mr. Barker's opinion, as reported to Messrs. Adam & Son by their solicitors, Messrs. Rawson, Guy & Wade. In their letter of the 14th of April 1881, they describe the spinning plant, both at Salterlee and Square Road, as being of an antiquated description, the frames being short and having a pitch of only $3\frac{1}{4}$ inches. The combing machinery was said to be really good, but Mr. Barker did not recommend his clients to take it. The machinery at Square Road, he said, he would not advise them to touch on any terms, as he had great doubts whether it could by any possibility be made to pay. Notwithstanding, however, this somewhat unfavourable report, the whole of the plant in question was bought by the Messrs. Adam on the

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20th of May 1881, the sale price being £1068 8s. 4½d. This, together with commission, payment for services rendered, inventory and valuation, brought up the cost price to Messrs. Adam to £1127 8s. 4½d. On the 30th of May an interview took place between Mr. Townend and Mr. Alfred Adam, and on the 31st Mr. W. Townend writes the letter of that date. "Lightcliffe, 31st May 1881. Dear Sir,—Since our interview of yesterday I have had time to consider over our conversation, and naturally that portion of it relative to my own interests. If you decide on giving the works at Salterlee a year's trial—and I think you may venture to do this without great risk—I am willing to undertake the responsibility of it entirely, to systemise and organise the machinery, the hands, the books and the castings. To do the marketing, both buying and selling, and such financial arrangements as you would think best. My practical knowledge of the trade, experience in management, and facilities of introduction, and acquaintance with business men, give me opportunities not always combined in one man, and which should have their value. As you make a venture in the undertaking, so should I in undertaking the management, as you may decide to close it in a year, and my position then would be worse than it is now. Still, if you can suggest any other terms depending on success, I am willing to arrange. It will be uphill work and require all possible energy and patience. If it were possible to come to some decision by Tuesday next or before I should be glad to know of it, as I must then put off my projected journey.—Yours truly, W. Townend.—Alfred Adam Esq." I think it is impossible to doubt, from the terms of this letter, that Townend was to be simply a salaried manager, that the business was to belong to the Messrs. Adam, that the firm Townend & Co. was to be a mere name, and that Messrs. Adam themselves were the real principals, Townend being simply their servant, and bound to obey their directions.

In the letter of the 22nd of June, Alfred Adam writes to Townend the terms on which he might take a mill, and tells him that if he has the written offers of one or more places, "we," he writes, "would be happy to see you north for final arrangements."

On the 6th of July Mr. Townend writes "that he would

recommend taking room and power for a couple of years," in the event of two mills he mentions not being available. He adds a significant paragraph: "You will see the necessity of making a definite start, first, the transfer of the machinery to Walter Townend & Co., and then giving me the needful to open a small banking account for current expenses. I have given up all my agencies and consider myself entirely at the service of the new firm."

My Lords, it is difficult to keep separate the history of the acquisition of the machinery and the hiring of Mr. Townend, for, in truth, Mr. Townend was the salaried manager for making the venture which Messrs. Adam designed to make with the plant and machinery which they purchased. What they purchased, and for how much, we have seen. What was its condition we may judge from Townend's letter of the 8th of September.

My Lords, if the transaction had been a real transaction of purchase and sale between Townend and Adam, in which Townend was considering what he had given, or agreed to give, for the machinery in question, the tone of the correspondence would have been a very different one from that which the letter in question discloses. To the cost of the machinery thus purchased, a sum of £2000 is added, for which no account has ever been given, and with a manager at £400 a year, and a business thus started, the Messrs. Adam carry it on. They have a balance sheet prepared in which it is assumed that the machinery is of the value represented in it, which is obviously, and even ridiculously, in excess of its real value.

The efficiency of the machinery to compete with other firms is clearly proved not to have been what it was represented, and thus if the true facts were known, Messrs. Adam were carrying on a losing business in which their names did not appear, and which it would certainly be very greatly to their advantage to get rid of, and which, if it were to be made to succeed, it must be by the addition of capital which the Messrs. Adam were not minded themselves to advance.

My Lords, it is not necessary in this case to impute fraud to the appellants; the relief sought was not based upon the ground of fraud; but I cannot yield to one argument which was suggested,

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that I am not to find misrepresentation proved, which is all the respondent need prove, because the facts may prove more, and shew that the appellants must have known the facts to be as they really were, and yet misrepresented them. The respondent is content to shew what the facts were, and that relying on the representations made to him, he entered into a contract from which he seeks to be relieved. Now, this being the condition of facts as I find them to be, the state of things being what I described, on the 2nd of November 1882, Mr. A. C. Newbigging encloses to his brother, the respondent, a report which he had received from the appellants, and though something was said by Mr. Balfour as to the omission of the words "or his nominee" from the copy of the report sent to the respondent, the substantial statements upon which the question turns are admitted to have come from Mr. Adam.

My Lords, I am very glad that upon this written document I am able to compare the statements made in it with the facts as they have now been proved, and to be able without any reference to the contradiction of what was alleged to have taken place by word of mouth to arrive at a conclusion sufficient to decide this case. Comparing the statement made in the prospectus or report handed to Mr. Newbigging, the brother, with the facts as they are now clearly established, I have no doubt that there were in the document most material misrepresentations. From the narrative I have sketched, it is manifest that the state of the machinery in fact was very different from that which it was represented to be in respect of its efficiency and its cost. The balance sheets (two important elements in which the machinery and the stock were most inaccurately stated), represented a gradually improving business, and there can now be no doubt the business was insolvent and gradually approaching a collapse, a collapse which on the 1st of November 1884, it reached by the firm, Townend & Co., stopping payment. Under these circumstances there can be no doubt of the right to relief; the extent and nature of the relief might be the subject of debate, but for the admissions made during the argument before your Lordships.

My Lords, I am content, after these admissions, to decide this

case simply upon the ground of the misrepresentation proved, and to relieve Mr. Newbigging from the contract which he was thus induced to enter into, and upon the very ground set forth by Mr. Adam himself. When insisting on the concluded bargain he says: "We furnished you with data sufficient in our, your, and Mr. Anderson's opinion to enable us all to judge whether the business was good or not, and Mr. H. must know well enough that if we have given untrue statements your brother would of course have ground for reducing what you and we have been about."

But I wish to guard myself against being supposed to throw any doubt upon the principles upon which a partnership can be established.

If a partnership in fact exists, a community of interest in the adventure being carried on in fact, no concealment of name, no verbal equivalent for the ordinary phrases of profit or loss, no indirect expedient for enforcing control over the adventure will prevent the substance and reality of the transaction being adjudged to be a partnership; and I think I should add, as applicable to this case, that the separation of different stipulations of one arrangement into different deeds will not alter the real arrangement, whatever in fact that arrangement is proved to be.

And no "phrasing of it" by dexterous draftsmen, to quote one of the letters, will avail to avert the legal consequences of the contract. What Mr. Adam himself thought about it, and what the object was, is sufficiently established by his letter of the 2nd of February 1883 to Mr. Drummond. In that letter he puts the scheme thus:—"A. is now arranging this on the following basis:—A deed of copartnery is being prepared between B. and C. (A.'s nominee), B. taking one-third and C. two-thirds, while C. and A. have a private arrangement by which C. divides his nett profits and losses with A., in so far as the latter are incurred in the regular way of the firm's business; but A. is not to be responsible for losses on transactions that have been concealed from him or entered into against his expressed opinion. It is contemplated that by this arrangement B. and C. will constitute the firm, and be solely responsible for its indebtedness to the public, while A. will still be out of it—so far as the public

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is concerned—and only liable to C., as an individual, for what is mentioned in the previous sentence. If there is a better method for carrying out the foregoing intentions you may be able to advise me.—Yours truly, Alex. Adam."

It is obvious to ask what is the meaning of the phrase "so far as the public is concerned," and to ask what were the "intentions."

My Lords, I do not believe that in any of the numerous cases which have been discussed in late years upon this subject there has been any real difference of view upon the principles upon which the question of partnership or no partnership is to be decided.

Doubtless in *Cox* v. *Hickman* (1) in this House it was pointed out that participation in profits is not necessarily and conclusively a test of partnership, but no one has ever doubted that if the adventure is carried on for a person so that it is his business, then he is a partner, whatever subtle contrivance he may resort to to cloak and muffle the real nature of his interest in the concern. If the problem to be solved is whose the business really is, it is obvious that many questions of fact may be material in arriving at a sound conclusion, such as the money supplied, the control of the business, the profits received, and the character in which they are received.

My Lords, I have thought it right to say so much upon the subject, because though content to decide this case without reference to the question of partnership, I am anxious that we should not be supposed to hold that these contracts did not constitute a partnership. The draftsman apparently looked at all the cases, beginning at *Waugh* v. *Carver* (2), and ran through them all, including *Pooley* v. *Driver* (3), *Mollwo, March & Co.* v. *Court of Wards* (4), *Ex parte Delhasse* (5), and *Ex parte Tennant* (6), and cleverly strives to avoid the effect of each test discussed in these cases by something which should have the same effect, but which should avoid the specific test. I wish to say every such expedient would be absolutely void in the view I take of the law.

(1) 8 H. L. C. 268.
(2) 2 H. Bl. 235; 1 Sm. L. C. 9th ed. p. 877.
(3) 5 Ch. D. 458.
(4) Law Rep. 4 P. C. 419.
(5) 7 Ch. D. 511.
(6) 6 Ch. D. 303.

My Lords, the only remaining question is one which as applicable to this case I have some difficulty in understanding. If the facts are as I have found them to be, what is the difficulty of restoring Messrs. Adam to their former position, a profitless and sinking business? If there were any value in it, any goodwill attached to it, and if it exists or ever existed, they can have it still. It surely cannot be argued because Colonel Newbigging was under the delusion, and continued under the delusion, that he had entered into a bonâ fide concern, solvent and profitable, that he is to be without remedy because he finds out that he was deluded, and continued deluded down to the breaking up of the concern. Now, what is the thing to which Messrs. Adam want to be restored? I profess myself unable to say. As I have said, I am content to modify the order of Bacon V.C., because the extent of the relief involved in that order is not now asked for or required to do justice between these parties. The modification I shall propose to your Lordships is in these terms:—that the order of the Vice-Chancellor ought to be varied by limiting the indemnity to the bills included in the balance of £16,704 1*s.* 9*d.*, which is the subject of the appellants' counter-claim; and by striking out the decree for £324 2*s.* 7*d.* and substituting a declaration that the said sum be repaid to the respondent out of the firm assets which have been realized and paid into Court. With that modification I move your Lordships that the orders appealed from be affirmed, and this appeal dismissed with costs.

LORD WATSON:—

My Lords, in the year 1881 a firm known as Walter Townend & Co. commenced business as worsted-spinners at Providence Mills, Bradford. Walter Townend, who is said by the appellants to have had one-half share of the business, was the sole ostensible partner. He appears to have been a man of great practical skill and experience, but he was destitute of means. Accordingly the machinery required for manufacturing yarns was purchased and paid for by the appellants, who are wool-brokers in Leith, having also a branch office in Bradford. They arranged, through Walter Townend, for a lease of the Providence Mills; they

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advanced cash to start the concern, and the capital requisite for carrying it on was provided by discounting bills drawn by them upon and accepted by Townend & Co. By a letter dated the 9th of July 1881 Walter Townend agreed, at any time during the currency of these bills, to assume as a partner any person whom they might appoint, giving him an interest in the firm to the extent of one-half; but from that date, until the respondent entered the firm in February 1883, they appear to have taken an active supervision and control of Walter Townend's conduct of the business.

Towards the end of October 1882 negotiations were entered into between the appellants and the respondent, which terminated in February 1883 in an arrangement by which the respondent became, from and after the 1st of that month, a partner to the extent of two-third shares in the firm of Walter Townend & Co., the remaining third being held by Walter Townend. The basis of these negotiations was a written statement furnished by the appellants, in which it was, inter alia, set forth that the business was formed by the appellants; that the practical partner was to have a half interest in the concern, and the other half was for themselves, who supplied all the funds, or their nominee; that the machinery was of the value of £6000, and was an efficient plant, capable of turning out varied yarns; that the balance-sheet of the 31st of January 1882 shewed an apparent loss of about £150, which was highly satisfactory; that a balance struck at 31st of July 1882 shewed a net profit to divide of £800; and that the divisible profits from that date till the 31st of January 1883 were estimated at £1500. It is not matter of dispute that the respondent entered into the transaction in reliance upon the substantial accuracy of these statements. Before the arrangement was finally concluded and reduced to writing, the respondent was strongly advised by his law agent, the late Charles Henderson S.S.C., to get some independent practical man, acquainted with the business of wool-spinning, to examine into the whole matter, and give his opinion and advice; but that suggestion was as strongly opposed by the appellants. The appellant, Alexander Adam, wrote to the respondent's brother, who was then conducting the negotiations on his behalf, that the

appellants had already furnished data sufficient "to enable us all to judge whether the business was good or not; and Mr. H. (i.e., Mr. Henderson) must know well enough that if we have given untrue statements, your brother would, of course, have ground for reducing what you and we have been about."

The respondent, at the time when he became a partner of Walter Townend & Co., was inexperienced in commercial business, having left the army, after attaining the rank of major, in 1882. In August 1884 he began to entertain the suspicion that all was not right with the business. On investigation it was found to be in a state of insolvency; and in November 1884 he brought this suit against the appellants for rescission of the arrangement of February 1883, and for restitution, on the ground that he was induced to become a partner by the misrepresentations of the appellants, against whom he makes no charge of intentional deceit.

That the information furnished by the appellants, with regard to the state of the business, was materially inaccurate, is conclusively established by the evidence, and was but feebly disputed at the bar. It was discovered in 1884 that Mr. Townend had been in the habit of "salting" the stock lists, or, in other words, of putting down larger quantities of goods, both manufactured and unmanufactured, than were actually in the possession of the firm. In consequence of that ingenious operation, the balance-sheet of 31 July 1882 shewed a profit of £843 instead of a loss of more than £2000; and the balance-sheet of 31 January 1883 brought out a profit of £1300 odd (which had been estimated by the appellants at £1500) instead of a loss, during the half-year's trading, of £1700. In short, the business, which was represented by the appellants to be yielding satisfactory and gradually increasing profits, amounting in all to upwards of £2500, had in reality been losing money at every balance; and on the 1st of February 1883, when the respondent became a partner, its liabilities exceeded its assets by no less than £3700. The respondent, in the course of his investigations into the affairs of the firm, also discovered, in September 1884, that the machinery, which was represented by the appellants to be thoroughly efficient, and of the value of £6000, had been bought second-hand for £1100, and

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had thereafter been from time to time repaired and renovated. Shortly after its purchase, whilst it was being placed in Providence Mills, it was thus described by their practical partner in a letter to the appellants: "Nearly every frame has been or is still to renovate and repair, for they were one and all in a most disgraceful state of dirt and breakage and neglected repair. However, we are going through each machine, and those that are worth the expense we shall put in thorough-going order, robbing a few of the worst to make up the others." In the balance-sheet of the 31st of July 1882 the machinery was entered at £6072. That sum represents its original cost, with a speculative, if not imaginary £2000 added by the appellants themselves, the balance being composed of every item expended in cleaning, repairing or renewing the plant, whilst no deduction was made on account of tear and wear. I hardly think an intending partner, if he had been informed of the history of the plant, and the method of valuing it, would have been satisfied to take it over at the sum at which it stood in the books of Townend & Co. Until 1884 the appellants neither knew, nor had reason to suspect, Mr. Townend's practice of salting the stock lists; but they did know all about the acquisition of the machinery and its valuation; and their representations with regard to it were somewhat deficient in candour.

I entertain no doubt that these misrepresentations, although not fraudulently made, are sufficient to entitle the respondent to rescind the arrangement of February 1883, if he is in a position to give as well as to demand restitution. He relied, and was entitled to rely, upon the assurances which he had received, as to the satisfactory condition of the business, until he became aware of the true state of the facts. It cannot be reasonably suggested that he ought to have known these facts before his suspicions were awakened in August 1884; and he then made a searching investigation of the affairs of the partnership, which resulted in his bringing this suit against the appellants in November 1884.

The appellants make several answers to the respondent's claim for restitution. First of all, they say that they received nothing, and have therefore nothing to restore, inasmuch as they had no

interest in the firm of Walter Townend & Co. or in its assets, beyond the bare power to nominate a partner during the currency of the bills which they drew upon the firm, and which were discounted in order to supply its capital. According to their argument Walter Townend was the only socius; and the half share which was not held by him was represented as having been "in suspense" during the two years which elapsed before the respondent became a partner; but learned counsel did not attempt to explain what was meant by that expression. It is impossible to assent to the argument, because the plain inference to be derived from the correspondence and facts in evidence, is that the appellants were either principals, Townend being merely their agent, or that they were his co-partners in the business. Both Courts below came, without difficulty, to that conclusion, which is borne out by the representations of the appellants; and it is immaterial, for the purposes of this case, in which of these relations the appellants stood to the original firm of Walter Townend & Co.

The next argument advanced by the appellants was a very extraordinary one. The agreement of February 1883, between the respondent and Walter Townend, contains a provision, usual in such cases, that the machinery, plant, and stock-in-trade should be valued as at the 1st of February 1883 (the day of the respondent's entry), and that the inventory and valuation should be signed by the parties, and the amount thereof carried to the credit of the old firm. If not broadly stated it was at least suggested by some of the appellants' witnesses that the provision was purposely introduced by Mr. Henderson, the respondent's law agent, in order to supersede the necessity for an investigation and report by an independent valuator, which he had advised his client to obtain before entering into the arrangement; and on the strength of that evidence, the appellants maintained that they were freed from all responsibility for their misrepresentations by the fact that the agreed on valuation was made, although without the aid of any one outside the firm. It is sufficient to say that the oral testimony bearing upon this matter, upon which the appellants rely, does not appear to me to be deserving of credit. The Vice-Chancellor, who saw the witnesses examined, said:

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"Having regard to the other evidence, and to the facts proved on both sides, I am compelled to say that wherever any material difference of statement occurs, the weight of evidence is in favour of the plaintiff's witnesses." In that observation I concur.

The appellants, lastly, maintained that, at the time when this suit was instituted, it was impossible for the respondent to restore the same interest which they had given him in the business of Walter Townend & Co. Admittedly the concern was then, as it had been all along, insolvent; it had never earned profits, and its losses had increased. Legal proceedings were taken by some of its creditors, during the dependence of this litigation, in the course of which assets were realized, and together with a sum of £324, advanced by the respondent, were applied in payment of the whole debts of the firm, with the exception of a balance owing by bill and otherwise to the appellants. It was argued that, in these circumstances, restitution was no longer possible, because the respondent's two-third shares of the business had practically ceased to represent an interest in a going concern such as they gave to him; and, in support of that proposition they referred to *Western Bank of Scotland* v. *Addie* (1) and similar authorities. In a question of rescission of his contract by a partner, whether in respect of fraud or of misrepresentation, there is no analogy, after insolvency, between the case of an ordinary partnership and that of an incorporated company. The difference between the two cases was clearly explained in *Tennent* v. *City of Glasgow Bank* (2), where a shareholder brought an action to have his connection with the bank dissolved, and his name removed from the register, on the ground of fraudulent misrepresentation by the directors, the very day before a winding-up resolution was passed. The Lord Chancellor (Earl Cairns) pointed out that the member of an ordinary partnership may have his relief, in that shape, against his co-partners, notwithstanding its insolvency, because his liability to creditors is not thereby affected. But dealing with the case before him, which was that of a company registered under the Act of 1862, the noble Earl said: "The repudiation of shares, which, while the company was solvent, would not or need not have inflicted any injury upon creditors, must now of necessity inflict a very serious

(1) Law Rep. 1 H. L., Sc. 145. (2) 4 App. Cas. 615.

injury on creditors." Lord Cranworth, in *Western Bank of Scotland* v. *Addie* (1), approving so far of the judgment of the Court of Session, held the circumstance that the shares, from mismanagement or otherwise, had become depreciated in value, after the date of his purchase, to be no obstacle to the shareholder's repudiation of his contract. In the present case the interests of creditors are not involved; the respondent could not, by rescinding the arrangement of February 1883 in a question with the appellants, escape from the liabilities to third parties which he incurred by becoming and continuing to be de facto a partner of Townend & Co.; and there was no change, either in the character of the business, or in the mode of conducting it, between February 1883 and November 1884. During that period the business had grown worse, because the deficit which existed, but had not been discovered at its commencement, had largely increased at its close, an increase of liability which was not owing to any fault of the respondent's, and which might probably have been anticipated if the actual state of its affairs had been known in the beginning of the year 1883. Such deterioration, for it is nothing more, cannot stand in the way of the respondent's claim for mutual restitution.

The Vice-Chancellor, whose order was affirmed simpliciter by the Court of Appeal, has set aside the arrangement of February 1883, dissolved the respondent's connection with the firm of Walter Townend & Co., and ordained the appellants to repay to him £9700, the amount of capital which he contributed, under deduction of £1700, drawn by him from the business. His Lordship likewise ordained the appellants to repay £324 2*s.* 7*d.* which was advanced by the respondent after the commencement of this suit, towards the discharge of the firm's debts; but that sum is no longer in controversy, because partnership assets have been recovered and paid into Court which are sufficient to meet the claim. The order of the Vice-Chancellor further declares that the appellants are bound to indemnify the respondent against all outstanding debts, claims, demands, and liabilities which he has become, or may become, liable to pay for or on account of the transactions of the partnership.

(1) Law Rep. 1 H. L., Sc. 166.

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A very able legal argument was addressed to your Lordships, by the appellants' counsel, against the competency of giving that general indemnity. It was said to be equivalent to giving a plaintiff, who merely seeks rescission and restitution on the ground of innocent misrepresentation, the same measure of relief to which he would be entitled in an action of damages based on fraud. The question thus raised appears to me to be one of great nicety and difficulty; and it was evidently so regarded by the Court of Appeal. None of the authorities referred to in the course of the argument go quite so far. In *Rawlings* v. *Wickham* (1) the defendants, who were held liable to indemnify the plaintiff against all the outstanding debts and engagements of a banking firm, themselves remained partners along with him, which is not clearly shewn to have been the case here. I refrain from expressing any opinion on the point, because it has become unnecessary to decide it, and the respondent's counsel were not heard in reply. It was admitted, on both sides of the bar, that the other debts of the firm have been paid out of the partnership funds, and that the general indemnity can only apply to a debt of £16,704 1*s.* 9*d.*, due to the appellants from Walter Townend & Co., which is the subject of a counter-claim by them in this suit. That claim stands in a very different position from debts and liabilities incurred by the firm to third parties whilst the respondent was a member of it. The arrangement under which he became a partner being void, in any question between him and the appellants, they are estopped from saying that he is a member of the firm, which is their proper debtor; and the consequence is that their claim, quantum valeat, must be preferred against the firm, and not against him.

I am accordingly of opinion that the orders appealed from ought to be affirmed with costs, subject to the variations which have been proposed by the Lord Chancellor.

LORD FITZGERALD :—

My Lords, at the close of the very learned and elaborate argument at the Bar in this case I had for myself arrived at a conclusion as to the proper order to be made, and had noted my

(1) 1 Giff. 355; 3 D. & J. 355.

own reasons for arriving at that conclusion; but I have since read the judgments of my noble and learned friend opposite (Lord Watson) and of the noble and learned Lord on the woolsack. My reasons have now been completely anticipated, and expressed in much better language than I could have used, and therefore I shall not take up time by expressing those reasons. I shall only say that I concur with the order which is proposed to be made.

LORD HERSCHELL:—

My Lords, in this case the appellants complain of a judgment of the Court of Appeal, affirming a judgment of Vice-Chancellor Bacon.

The action was brought by the respondent to set aside certain agreements of the 21st of February 1883 on the ground that he was induced to enter into them by the misrepresentations of the appellants, and for consequential relief. It becomes necessary, therefore, to inquire into the position of the parties at the time these agreements were executed, and into the circumstances which preceded their execution. Major Newbigging, the respondent, who was serving with his regiment in India, was desirous of leaving the army and devoting himself to commercial pursuits. His brother, A. C. Newbigging, was in business in Leith, and was a neighbour of and acquainted with the appellants, who were wool merchants there. They thus became aware of the respondent's desire. In the autumn of 1882, A. C. Newbigging, on behalf of his brother, commenced negotiations with the appellants, with a view to his becoming a partner in a business in which they were interested. In the course of the negotiations a document, which has been styled a "prospectus," was handed by one of the appellants to A. C. Newbigging. This document stated amongst other things that the spinning business of B. & Co. (i.e., Walter Townend & Co.) had been formed about fifteen months before by Mr. B. (i.e., Walter Townend) and Adam, Sons & Co.; that Mr. B., the practical partner, was to have a half interest in the concern, and the other half was for the firm of A. S. & Co., who supplied all the funds, or its nominee; that B. & Co. had put in its own machinery, which was then a thoroughly efficient plant;

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that the balance struck on the 31st of January 1882 shewed an apparent loss of about £150, whilst on the 31st of July 1882 there was shewn a net profit to divide of £800; and that Mr. B. estimated that the net profit shewn by the balance of the 31st of January 1883 would be £1500.

There is considerable controversy as to what passed between the parties by word of mouth during the negotiations, but I am content to rest my judgment upon the representations made by this and other documents, about which there can be no doubt, and which were intended to be and were relied on. In addition to the prospectus, balance-sheets were exhibited to A. C. Newbigging which represented the profit in the half year ending the 31st of July 1882 as £843 19*s.* 9*d.*, and in the half year ending the 31st of January 1883 as £1356 5*s.* 9*d.* In the latter balance-sheet the machinery was valued at £6921 7*s.* 1*d.* Representations therefore were distinctly made by the appellants that the business was solvent and profitable, that profits exceeding £800 and £1300 had been made in the two previous half years, and that the plant was thoroughly efficient. Upon these representations the respondent consented to become a partner in the firm of Walter Townend & Co. and to bring in a capital of £10,000. Whilst the deeds necessary for carrying out the agreement were in preparation, Mr. Henderson, a solicitor in Edinburgh who was being consulted by A. C. Newbigging, on the 30th of January wrote to Mr. Adam stating that he had advised A. C. Newbigging, as he had himself no knowledge of the business, to put it generally before a practical man for confidential report. To this Mr. Adam strongly objected, writing of the matter in hand as one "where the main foundation is that of mutual confidence," and adding, "We furnished you with data sufficient in our, your, and Mr. Anderson's opinion to enable us all to judge whether the business was good or not, and Mr. H. must know well enough that if we have given untrue statements your brother would of course have ground for reducing what you and we have been about." Ultimately A. C. Newbigging did not insist upon putting the matter before a practical man, and the deeds were executed. Before stating their general effect I may at once deal with the contention of the appellants, that it was agreed to substitute a valuation of the

machinery made after the execution of the agreement for that independent valuation which Mr. Henderson recommended. This is founded upon the fact that in the agreement between Newbigging and Townend of the 21st of February 1883 it is provided that the machinery, plant, and stock-in-trade should be valued as at the 1st of February, and the amount of the valuation placed to the credit of the late firm. This clause is an ordinary one, found in many such partnership agreements, its purpose being to determine the date as at which the machinery, stock-in-trade, &c., should be valued and taken over at its then value by the new firm. The suggestion that it was to be a substitute for an independent examination made beforehand to satisfy the Newbiggings as to the expediency of the partnership arrangement, and that because the respondent did not afterwards insist on an independent valuation of the machinery, but was content to accept the representation of its value put forward by the Adams, he is now precluded from objecting that its condition and value were misrepresented, appears to me without foundation, I had almost said preposterous. Indeed, I am surprised that the Messrs. Adam, who regarded the transaction as one depending on mutual confidence, and who suggested that if they had made untrue statements Major Newbigging would have ground for reducing what was agreed on, should now be found arguing that even if that gentleman was deceived he is precluded by the confidence in them which he displayed from obtaining reduction.

The agreements executed on the 21st of February are three in number. One between Townend and the respondent provided for a partnership for thirteen years from the 1st of February 1883, determinable as therein mentioned, that Townend should receive one-third of the profits, and the respondent two-thirds, and that the capital, which was to be £10,000, should all be brought in by him. Another was between the appellants and respondent, by which it was agreed that the respondent should pay to the appellants a sum equal to one-half of the net profits received by him, and which stipulated that if any loss should arise on transactions in which the appellants had not been consulted, or against which they had advised, the same should not be reckoned to diminish the sums payable to them under the agreement. The third

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agreement, which was between Townend and the appellants, related to the respondent's share in case of a dissolution of partnership, by notice or death, and is not material.

Before I deal with the events which happened after the firm was thus constituted, I must revert to the history of the business prior to February 1883, to see whether the representations made by the appellants are in accordance with fact.

It appears that in May 1881 the machinery in certain mills near Halifax, belonging to a Mr. Hodgson, who was indebted to the appellants' firm, was put up for sale by auction, and purchased on their behalf for the sum of £1080 8*s.* 4*d.*: the commission for buying, and the costs of an inventory and a valuation brought this sum up to £1127 8*s.* 4*d.* The appellants shortly afterwards entered into an arrangement with Walter Townend, by which a spinning business was to be started under the firm of Walter Townend & Co., and the machinery, obtained under the circumstances I have mentioned, was to be purchased or taken by that firm at the price of £3127 8*s.* 5*d.* This, it will be seen, was £2000 in excess of its cost, even with the expenses I have just referred to added. I shall have something to say presently as to the nature of the arrangement between the Adams and Townend, but I may at once observe that I can see no justification for such an addition, especially when I consider the description given of the condition of the machinery at the time of, and shortly after the purchase. It is said that some of it was exchanged for better machinery before February 1883, but I cannot imagine that what was received in exchange was worth more than what was given. No deduction was ever made from the £3127 8*s.* 5*d.* in the machinery and plant account, and if any sum was paid on an exchange or even for repairs it was added to the £3127 8*s.* 5*d.*, and went to make up the £6921 7*s.* 1*d.* at which the machinery stood in the balance-sheet of January 1883. It appears to me, too, to be abundantly proved that the machinery was not in a thoroughly efficient condition. The utmost that the only witness called on this point by the appellants could say was that its condition was "fairly efficient"—a very different thing, to my mind, and I believe that this was even too favourable a description of the machinery. I have no

hesitation in holding that there was a serious misrepresentation of the condition of the machinery, and of its value also. The latter point is perhaps of as great importance as the former. For if the machinery had been taken in the balance-sheet at its true value (even allowing that this was somewhat in excess of the sum paid for it) instead of a profit of £2200 having been shewn as the earnings of the year ending January 1883, a very small profit only would have appeared.

But this was not the extent of the misrepresentation as to the condition of the business. I see no reason for not accepting the evidence of Mr. Musgrave with respect to the over-valuation of the stock, and if he be correct the balance-sheet of July 1882 ought, on this account alone, instead of a profit of £843, to have shewn a loss of £2096, and that of January 1883 a further loss of nearly £1700, making the extent of the loss in the year preceding the agreement £3719. The business, therefore, instead of having been a profitable one in the year before the respondent joined it, had been carried on at a heavy loss, and it is, I think, proved that it was then insolvent to the extent of upwards of £5000.

I have said enough to shew that the conclusion cannot be resisted that the respondent was induced to enter into the agreement to become a partner by the misrepresentation of the appellants, and that he is entitled as against them to a rescission, unless there be some bar to his now obtaining it.

Exception, however, is taken by the appellants to the order appealed from on several grounds. First, it is said that the Court was not justified in ordering the appellants to pay to the respondent the sum of £9276 6*s.* 1*d.* brought by him into the business. They contend that the only agreement to which they were parties was that between the respondent and themselves, and that the payment was not made under this agreement, but under the one between the respondent and Townend, to which they were no parties. Their case is that the undertaking in which the respondent was to become a partner belonged to Townend alone, their only interest being that of large creditors with the right to nominate a partner. I cannot adopt this view. I think it clear that the manufacturing business carried on under

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the firm of W. Townend & Co. either belonged to them, or that they were interested in it as partners, it matters not which, and that the three instruments of February 1883 were only the machinery for carrying into effect an agreement made between the respondent and the appellants, by which he was to acquire a share in this business. Upon this view of the facts I agree with the Court below in thinking that it follows that upon rescission the respondent is entitled to a repayment of his capital.

The appellants further object that the respondent is precluded from now obtaining rescission because restitutio in integrum has become impossible. He cannot, they say, restore them to their former position, because at the time he brought his action and claimed rescission the business, an interest in which he agreed with them to purchase, was hopelessly insolvent and no longer a going concern. They further allege that this condition of things did not result from its inherent weakness at the time of their agreement with the respondent, but from the mode in which it was carried on by Townend. They suggest, indeed, that Townend somehow or other misappropriated the stock-in-trade, or the money which ought to have gone in payment for it. All this, however, is mere surmise. There is absolutely no proof of it beyond the fact that the stock held at the date of the several balances was overstated, and that in November 1884 the concern was insolvent to the extent of some £16,000. It is certain that the condition of the concern at that date did not result from any act of the respondent personally. Its affairs appear to have been carried on after he was a partner in precisely the same way as before. I have already pointed out that the enterprise was insolvent to a large amount when the respondent was induced to take a share in it; and I do not think the fact that the extent of its insolvency afterwards increased justifies the contention that restitutio in integrum is impossible. To hold otherwise would be to say that where a losing and insolvent business is sold by means of the representation that it is solvent and profitable, rescission could never be obtained if the loss were increased prior to the discovery of the true state of affairs. I am, of course, putting aside any question of laches, for there is no pretence in the present case for saying that the discovery would

have been made earlier had there been due diligence on the part of the respondent.

The next exception taken on behalf of the appellants is to that part of the order which dismissed with costs their counter-claim as against the respondent. This counter-claim alleged that the respondent and W. Townend, as partners in the firm of W. Townend & Co., were indebted to the appellants in the sum of £16,704 1*s.* 9*d.* for money lent and goods sold by the appellants to the said partnership. The appellants insist that even if the agreement of February 1883 be rescinded, they are entitled to recover this sum as a debt against the respondent, and that to deny them this right is in effect to award damages against them, which cannot be done in an action of this description. I am unable to accede to this view. The liability of the respondent arises, if at all, from the circumstance that he is a partner in W. Townend & Co. But the hypothesis with which we are dealing is that the respondent was not a partner, and that his agreement to become so must be treated, as against the appellants, as though it had never existed. They are, in my opinion, not entitled to claim any benefit of a contract induced by their wrongful act. I think, therefore, that it was rightly held that they could not treat the respondent as liable for the debt due to them from W. Townend & Co.

One point only remains. The order affirmed by the Court of Appeal declared that the appellants were bound to indemnify the respondent against all outstanding debts and liabilities which he had or might become subject to or liable to pay in respect of the dealings and transactions of the partnership. Unless it could be established that the appellants were, in fact, partners in the firm of W. Townend & Co. from and after February 1883, there might, perhaps, be some difficulty in supporting this part of the order. But it is not necessary to pronounce any judgment on the point, inasmuch as it was stated at the bar by the learned counsel for the respondent that there are no such debts or liabilities, and that he was content that the order should be varied by limiting the indemnity to the bills (if any) included in the debt claimed by the appellants which they had parted with to third persons. If they cannot recover their

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debt it is clear that they can have no right to impose a liability upon the respondent by transferring these bills. I am of opinion that the order of the Court below should, with the variation proposed by the Lord Chancellor, be affirmed.

Judgment of Bacon V.C. varied by limiting the indemnity to the bills included in the balance of £16,704 1*s.* 9*d. the subject of the appellants' counter-claim; and by striking out the decree for* £324 2*s.* 7*d. and substituting a declaration that the said sum be repaid to the respondent William Newbigging out of the firm's assets which have been realized and paid into Court. Subject to these variations the judgments of Bacon V.C. and of the Court of Appeal affirmed; and appeal dismissed with costs; cause remitted to the Chancery Division.*

Lords' Journals 11th June 1888.

Solicitors for appellants: *Parker, Garrett & Parker.*

Solicitors for respondent Newbigging: *W. & J. Flower & Nussey,* for *Killick, Hutton & Vint,* Bradford.