Erlanger v New Sombrero Phosphate Co (1878) 3 App Cas 1218


Facts

- Erlanger was a French banker who bought the lease for the Anguillian island of "Sombrero", phosphate mining for £55,000.
- Erlanger then established New Erlanger Phosphate Co (Phosphate), before selling Sombrero's lease to Phosphate for £110,000 through a nominee.
- One of Phosphate's directors was the Lord Mayor of London, who was independent of Erlanger's initial group of founders. Two other directors were abroad, and the other directors were puppet directors of Erlanger.
- Due to Erlanger's strong control over Phosphate, the company was essentially an extension of Erlanger. Phosphate ratified the sale of the lease.
- Many people invested in Phosphate due to Erlanger's skills at promotion. Eventually, the investors realised that Erlanger had sold the lease to Phosphate for double the price he had bought it for, and Phosphate sued Erlanger for recession due to non-disclosure and an account of profits.

Issues

- Was Erlanger liable to Phosphate due to not disclosing to his conflict of interest?

Held

- Erlanger was a promoter for Phosphate. The House of Lords unanimously held that the relationship between a promoter and a newly formed company attracts a fiduciary relationship.
- The majority (Lord Cairns LC dissenting) also held that the contract cannot be rescinded.
- A promoter owes duties of good faith and honesty to the company.
- Erlanger should have declared any conflicting interests to the company promoted and cannot make any "secret profits".
- A promoter who breaches any duty to the company by failing to disclose to the company conflicting interests would be liable. The company is able to seek remedies such as rescission of contract and recovery of profits.
- A constructive trust can also be formed for the profits gained by the promoter in breach of his or her duties.

Quotes

"It would be obviously unjust that a person who has been in possession of property under the contract which he seeks to repudiate should be allowed to throw that back on the other party's hands without
accounting for any benefit he may have derived from the use of the property, or if the property, though not destroyed, has been in the interval deteriorated, without making compensation for that deterioration. But as a Court of Law has no machinery at its command for taking an account of such matters, the defrauded party, if he sought his remedy at law, must in such cases keep the property and sue in an action for deceit, in which the jury, if properly directed, can do complete justice by giving as damages a full indemnity for all that the party has lost: see Clarke v Dixon, and the cases there cited."

(Lord Blackburn)