COMMENTS

AUSTRALIAN FIXED TRUSTS PROPRIETARY LTD AND OTHERS v. CLYDE INDUSTRIES LTD AND OTHERS[1]

Companies—Alteration of articles—Fraud on minority shareholders—Unit trusts—Voting powers

In 1956 it was proposed that the articles of association of Clyde Industries Limited, a public company incorporated in New South Wales, should be altered by inserting a provision that if any member of the company held ordinary shares as a trustee for holders of units or sub-units[2] that member would not be able to cast a vote upon a poll unless he had received the direction of a majority of all the holders of the units or sub-units as to the particular manner in which that vote was to be cast and that he was to vote then only in accordance with the particular direction given to him. The chairman of any meeting at which a poll was demanded was to allow a period of at least twelve days within which the trustee could obtain the directions. The directors could require such evidence as they might deem proper in the circumstances to ensure that the provisions of the article had been duly complied with by the trustee. A resolution of the directors that the member had not complied with the article was to be conclusive and binding upon all members of the company and the directors were not to be bound to give reasons for their decision. The article was not to affect the right of any member to

[1] (1959) 59 S.R. (N.S.W.) 33. Supreme Court of New South Wales (in Equity); McLelland J.

[2] Basically a unit trust is an arrangement whereby property is held on trust for investors. It is set up by a deed regulating the rights, powers and duties of the parties to the arrangement. For a precedent of a fixed or flexible unit trust deed see (1956) 20 *Conveyancer (N.S.)* 765. The parties are usually the manager, the trustee and the investors, the last being known as unit holders. The manager purchases property and vests the title to it in the trustee who, at the outset, holds on trust for the manager. Sometimes the property is an estate in land or a mortgage thereof but most unit trusts are in respect of a portfolio of shares. The beneficial interest is divided into a large number of units which are sold by the manager to investors. Share-unit trusts are of two kinds, fixed and flexible. In the fixed unit trust the portfolio is fixed and not, except in special circumstances, subject to variation. The first portfolio of investments in a fixed unit trust is described as a unit and the beneficial interest is divided into sub-units which the manager sells to investors. A fixed unit trust deed will usually provide for the constitution of additional units matching the first portfolio which will be vested in the trustee and divided into the same number of sub-units. In the flexible unit trust the manager and the trustee have power under the deed to vary the nature and proportions of the shares comprising the trust fund. Unlike the fixed trust the portfolio in a flexible trust cannot be divided into rigidly constituted units but the beneficial interest in the trust fund whatever its constitution from time to time is divided into parts described as units. In both land-unit trusts and share-unit trusts the sale of units (or sub-units) is at a price fixed on the market value plus a service charge to cover the expense of the manager, a profit for the manager and the remuneration of the trustee. The manager agrees to buy back from any unit holder desiring to sell. These units may be re-sold by the manager. The trust deed will usually provide that the trust is to come to an end at a fixed date and one of several modes of dissolution will operate: the property may be realized and the proceeds distributed amongst the unit holders, the trust may be converted into an investment company or, if the property admits of division *in specie*, it may be so divided between unit holders.

be present at any meeting or to vote thereat upon a show of hands. Nor was the clause to affect the voting rights of members in respect of shares which they held as trustees for persons other than holders of units and sub-units.

The company was concerned that the growth of shareholdings on behalf of unit trusts was a threat to public companies, because it was thought to be prejudicial to the continuance of able executive management. In this case, of the company's ordinary shares issued to the number of 1,981,918 approximately 292,200 ordinary shares were held by unit and other similar trusts. There was also apparently some concern based upon the inclusion of shares in competing companies in the portfolios of unit trusts.

Suits were commenced on behalf of a number of unit trusts holding approximately 150,000 shares in Clyde Industries Limited to prevent the company and its directors from acting upon any proposed resolution purporting to amend the articles of association of the company so as to include the proposed provision. Following undertakings given on behalf of the company that there would be no declaration of the poll in respect of the new special resolution until the hearing of the suits, the company meeting was held and a majority of votes was cast in favour of the resolution for including the new article.[3] The grounds upon which the proposed resolution had been attacked were (1) that it was not a valid exercise of the power of amending the articles given by section 20 of the Companies Act 1936 (N.S.W.); (2) that it involved a modification of the class rights of the ordinary shareholders and that the provisions of an article (dealing with the modification of class rights) had not been complied with; and (3) that the proposed resolution was in conflict with section 84 of the Companies Act 1936 (N.S.W.) which provided that no notice of any trust should be entered on the register or be receivable by the Registrar-General.[4]

McLelland J. decided in favour of the plaintiffs on the first ground after applying the principles stated in *Greenhalgh v. Arderne Cinemas Limited and Others*[5] that in passing any resolution to alter articles of association, the shareholders must proceed upon what, in their honest opinion, is for the benefit of the company as a whole, that is, for the benefit of the corporators as a general body. What the shareholders are to consider is the benefit of a hypothetical shareholder who has no personal interests conflicting with those of the company and that if the resolution discriminates between the majority and the minority it would be liable to be impeached. In the instant case, the shareholders had not satisfied the requirements of that principle. The proposed article was aimed only at a certain type of shareholder, namely a custodian trustee. If the right of a shareholder-custodian trustee to vote had not in substance been taken away, that right had been greatly reduced in effective-

[3] There were 95,514 votes, representing 1,289,217 shares, in favour and 17,870 votes, representing 398,239 shares, against.

[4] *Cf.* Companies Act 1958, s. 130 (4).

[5] [1951] Ch. 286. See also *Peters' American Delicacy Co. Ltd v. Heath and Others* (1939) 61 C.L.R. 457.

ness. In so far as it had been made less effective, the right to vote by other shareholders had been made more effective and valuable. Thus the article discriminated between the majority of the shareholders and the minority so as to give the former an advantage of which the latter were deprived. There were no grounds on which reasonable men could decide that the article confined in its terms to the plaintiff shareholders was for the benefit of the company as a whole.

A custodian trustee's right to vote had been made less effective in various ways. The article was to be applied trust by trust so that in respect of shares held by one trust the majority referred to in the proposed article was the majority of holders beneficially entitled under that trust. The custodian trustee could not record a vote in respect of the shares held by it in the company, considered as a whole, unless the majority of the holders in each and every trust gave the same directions. The majority direction was to be a majority of unit holders irrespective of the amount invested by a holder so that a direction under the article could represent the direction of a minority in interest. The article deprived the custodian trustee of the right to vote at a poll and only allowed it to record as a vote the majority direction of the holders and did so without taking into account what rights the minority might have had under the trust to have the custodian trustee exercise its own discretion. Furthermore, whether a vote could be recorded would always depend on the directors who could prevent it being given without giving reasons. On the evidence, moreover, the custodian trustee could never feel reasonably sure that it could get a majority direction within the time prescribed by the articles.

Dealing with the company's point that a unit trust could hold shares in a number of competing companies, McLelland J. observed that the holding of shares by one person in more than one public company whose businesses compete is not a characteristic confined to custodian-trustee shareholders. Moreover, the company's point that the unit holders provide the capital to purchase the shares and are the only persons beneficially interested in them and yet may not interfere in the management and may not effectively complain of the use made of the voting power by the trustee was met by the statement that there was no essential difference between the position of holders under unit trusts and the position of beneficiaries under many common forms of trust instruments. The trustee would be subject to the usual liability of a trustee in relation to exercise of voting powers and[6] the holders as beneficiaries could take

[6] Because the trustee is the person registered as the owner of the shares and is a member of the company he would ordinarily be the person entitled to vote at company meetings. In the absence of special provisions in the trust deed a trustee of a unit trust, like any other trustee, would be obliged to exercise voting power so as to promote the interests of his beneficiaries. Beneficiaries who are *sui juris* and absolutely entitled may, if they are unanimous, direct their trustee as to how he should exercise voting powers. *Kirby v. Wilkins* [1929] 2 Ch. 444, 454; *Butt v. Kelson and Others* [1952] Ch. 197, 207. This subjection of the trustee to control by his beneficiaries is not based on any view that the trustee is an agent for them: it follows from the acceptance by the courts of the view that a beneficiary who is *sui juris* and absolutely entitled is an equitable owner of the trust property and, as such, is entitled to exercise powers

action in relation to abuses of power and improper exercise of discretion. The company had also pointed out that under the relevant unit trust deeds each manager had the right to direct[7] the trustee as to how the voting power should be exercised, and that the manager received at the outset a commission to cover all that the manager had done or might do, and he had, it was said, nothing to gain from considering the interests of the holders, and, unsold and redeemed units apart, had no financial interest at stake in the trust property. This comment, however, ignored the fact that the managers were under an obligation to repurchase units and sub-units and had, therefore, a real interest in the trust property.

Looking at the wider implications of this case it seems paradoxical that those whom the managerial revolution has favoured should become concerned about control being separated from ownership. It is, however, a fear which has been expressed on a number of occasions. It was suggested to the Committee which reported on unit trusts to the Board of Trade in 1936 that companies, in which unit trusts held a considerable proportion of the shares the voting rights of which were controlled by managers of unit trusts, might suffer both by the divorce of control from beneficial ownership and possibly by concentration of power in an association of managers of unit trusts.[8] The Committee proposed that in a summary of information which should be filed with the Registrar of Companies by the manager of each unit trust it should be stated by

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incidental to ownership. But, even where a sole beneficiary is *sui juris* and absolutely entitled the trustee must exercise his voting powers according to his discretion in the best interests of the beneficiary unless and until the beneficiary directs him to vote in a certain way. *Kirby v. Wilkins*, *supra*.

[7] The discussion in note 6 assumes that there is no term in the trust deed providing that the trustee shall vote as directed by the settlor or by a beneficiary or by a third person. In a unit trust deed it is usual to provide that the voting rights and the powers of engaging in shareholders' actions and meetings shall be exercised by the manager and that the trustee shall when requested to do so by the manager execute powers of attorney and proxies to the order of the manager. It is sometimes also stated that the manager shall not be liable to any holder of a unit or the trustee for not exercising such voting or other rights and that no registered unit holder shall have any right with respect to any unit to attend meetings of shareholders or to vote or to take part in or consent to any corporate or shareholders' action. Sometimes the clause provides that the voting rights 'shall' be exercised by the manager; sometimes it provides that the voting rights 'may' be exercised by the manager. Such a clause is, of course, subject to the articles of association of each company. In jurisdictions where it is possible for the articles to restrict the power to appoint proxies in such a way that only a member of the company can be appointed a proxy, the efficacy of a delegation-of-voting-power clause in the unit trust deed may be impaired. In the United Kingdom, however, it is not possible for a company to make an effective provision of this kind in its articles. Companies Act 1948 (Eng.) s. 136. The effect of the clause on an original unit holder is to bind him contractually to permit the trustee to vote as directed by the manager and without reference to unit holders. Where units can be disposed of only by re-sale to the manager a purchaser of those units from the manager would similarly be bound. If units can be sold directly to strangers any purchaser would take subject to equities including the restriction on ability to direct the exercise of voting powers.

It is noteworthy that it appeared from the *Clyde Industries* case that none of the plaintiff trustees had ever exercised their respective rights to vote at meetings of the company. In the *Sydney Morning Herald*, 3 November 1956, the general manager of another company managing unit trusts was reported as saying that 'in nine years' operation, Security Units had not exercised a single vote at any company meeting. It would do so only when it felt that the interests of unit holders were in jeopardy'.

[8] Report. Cmd 5259, para. 45.

whom the exercise of voting rights should be controlled and what, if any, right a unit holder would have to control the exercise of such voting power. The Committee, while not suggesting that it should be made compulsory, was of the opinion that there should be provision to give a holder or holders of an appreciable quantity of units the right to direct how the votes attaching to his or their holding should be exercised.[9] The Committee thought, however, that these proposals did not get over the basic difficulty that by means of the unit trust there may be a great concentration of voting power in the hands of persons having no beneficial interest.[10] The Committee's recommendations in relation to voting power were not included in the Prevention of Fraud (Investments) Act 1939 (Eng.) or its successor the Prevention of Fraud (Investments) Act 1958 (Eng.). In Victoria the Companies Act 1958, section 63 (6), requires that every unit trust deed shall contain certain covenants by the manager and that if the deed does not expressly contain these covenants it shall be deemed to contain them. Among these covenants is one 'that the company [that is, the managing company] will not exercise the right to vote in respect of any shares held by the trustee or representative at any election for directors of a company whose shares are so held without the consent of the holders of the interests to which the deed relates given at a meeting of holders' summoned in the prescribed manner 'for the purpose of authorizing the exercise of the right to vote in a particular case'. It is to be noted that this provision is concerned only with exercise of voting power for the narrow but important purpose of electing directors. Presumably the provision does not go so far as to require a company in which a unit trust holds shares to enquire whether any vote of a manager is in breach of this covenant. But failure by the manager to comply with the covenant before voting would be a breach of contract and a breach of trust.

It is not clear whether this statutory provision takes away from the trustee the discretion as to voting which belongs to him by virtue of his being trustee. The provision is concerned only with the exercise of the *manager's* right to vote. If under the unit trust deed the manager had no power to direct the trustee's vote at any election for directors this provision would have no effect and the trustee would be at liberty[11] to vote without consulting the holders of units but subject to control for misuse of power. This Victorian provision by assimilating the manager to an agent of the holders of units blurs the distinction between trust and agency, a distinction which, apart from statute, is important in keeping unit trusts outside the category of illegal partnerships.

A Western Australian Bill of 1957 designed to regulate unit trusts contained provisions about voting power which were declaratory of the general equitable principle that the trustee shall exercise his powers in the interests of the beneficiary. The provisions then sought to maintain

[9] *Ibid.* para. 92. [10] *Ibid.* para. 48.

[11] This is subject to the qualification that the trustee could be directed how to vote by a requisitioned meeting of unit holders of the kind contemplated by the Companies Act 1958, s. 63 (6) (e).

this position by providing that the trustee was not to be influenced by any party as to the manner in which he exercised any voting rights.[12]

The *Clyde Industries* case indicates that it will be extremely difficult for a company to alter its articles to ensure that unit holders direct the exercise of voting power. It leaves open the question whether an article of the kind proposed in the *Clyde Industries* case could be effectively included in the articles when the company is first incorporated. Such a situation would raise the question whether the article would be in conflict with statutory provisions that no trusts shall appear on the register of shareholders. There remains also the basic question whether beneficiaries under unit trusts should be entitled to direct the exercise of voting rights where their nearest equivalent, the shareholder in an investment company, lacks that power.

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[12] Bill to amend the Companies Act 1943-1954 (W.A.) clause 12 inserting new s. 370A. (6) (d)—

'(i) Every trustee or representative shall exercise all due diligence and vigilance in watching and protecting the rights and interests of holders of interests to which the deed relates.

'(ii) The trustee or representative shall exercise the voting rights attached to any shares the subject of a trust and shall exercise such rights in his discretion in the interests of the holders of interests to which this section applies.

'(iii) No party to a deed under this section shall directly or indirectly influence or attempt to influence a trustee or representative as to the manner in which he exercises any voting rights attached to shares and the subject of a trust.'

The Bill lapsed.

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