'The Intimate Connection of Trust and Corporation'

Constraints on the Exercise of the Constitutional Amendment Power in Managed Investment Schemes

By

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Abstract

The objectives of this thesis are twofold. The first and primary objective is the identification of the most appropriate doctrinal approach which courts must adopt in reviewing exercises of the constitutional amendment power in managed investment schemes. The second objective is to evaluate the adequacy of the applicable law in protecting the legitimate rights and interests of the scheme participants. The discussion further provides a medium upon which various underlying themes are explored. These themes include the nature of judicial review upon abuse of power generally by both fiduciaries and non-fiduciaries, the analogy between corporations and managed investment schemes, and the division of power between the two primary scheme organs, being the responsible entity and scheme members in a general meeting.

Managed investment schemes are investment arrangements in which participants forgo control over their capital contributions in consideration for a bundle of rights, derived from the Corporations Law, the scheme constitution as a commercial contract, and the law of equity. Neither the contractual nor the equitable rights of members are indefeasible, as the scheme constitution may be amended, either unilaterally by the responsible entity, or by a special resolution of scheme members.

Exercises of the constitutional amendment power are subject to various restraints, similarly derived from legislation, contract and equity. In relation to unilateral amendments, the Corporations Law provides that an amendment can only be effected where the responsible entity reasonably considers the amendment will not adversely affect members' rights. Restraints are also imposed by equity, such as the responsible entity's obligation to exercise its powers for a proper purpose, being based on the equitable doctrine of fraud on the power. Further equitable restraints placed on the responsible entity are drawn from its position as trustee of the scheme assets, such as the requirement that it act in the best interests of scheme members and treat them impartially. Amendments by members' resolution are similarly open to judicial review based on equitable obligations drawn from a company law context, being namely the requirement that the amendment not involve a fraud on the minority.

The adequacy of the above restraints is judged both by applying the identified law to various hypothetical amendment which may be instigated by scheme participants, as well as by way of a comparative analysis with the protection afforded to company shareholders. It is concluded that the interplay between explicit statutory controls and the various equitable obligations provides the appropriate balance between investor protection and allowing sufficient flexibility in order to facilitate the efficient commercial operation of the scheme.
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Bibliography
Abbreviations

ALRC/CSAC  Australian Law Reform Commission & Companies and Securities Advisory Commission


ASIC  The Australian Securities and Investment Commission

ASX  The Australian Stock Exchange Limited

CLERB  Corporate Law Economic Reform Bill 1998 (Cth)

MIA  Managed Investments Act 1998 (Cth)

The Act  Corporations Law (Cth)

Unless otherwise stated, all references to statutory provisions are references to provisions of the Corporations Law.

The law is stated as at 19 April 1999.
1. Introduction

1.1 Scope

This thesis is concerned with both the power and the various restraints placed on the exercise of the power to amend the constitution in public unit trusts. Public unit trusts are collective investment schemes which offer securities to the general public, having a large number of members and investing predominantly in marketable assets. They fall under the statutory definition of 'managed investment scheme', thereby being regulated by Chapter 5C of the Corporations Law. Common examples include cash management trusts which provide access to high-yielding money market securities, equity trusts investing in company shares, and both listed and unlisted property trusts.

The managed investment scheme provides a medium for investors with relatively small funds to have those funds pooled and managed by a professional funds manager. The scheme allows investors to gain access to financial and property markets, resulting in a diversification of risk and maximisation of return to an extent not otherwise available to retail investors. The scheme utilises a trust structure, being regulated by a statutory regime, as well as the scheme constitution and the general law of trusts and fiduciary obligations.

1.2 Justification

There are both commercial and legal justifications for this discussion. In relation to the former, the thesis finds its justification in the following:

- The increase in investments in unit trusts

  The use of unit trusts as a means of indirect investment of savings has substantially increased over recent years. Between 1980 and 1992, investments in unit trusts grew from less than $2 billion to over $38 billion. In 1998, total assets under management in unit trusts reached $81.4 billion. The level of investments is expected to continue to rise given the

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1 The term 'collective investment scheme' encapsulates other forms of investment vehicles which are not directly considered by this thesis, such as superannuation funds, statutory funds of life insurance offices, and investment companies.

2 Section 9. For convenience, the term 'managed investment scheme' is used as a reference to public unit trusts regulated as managed investment schemes in accordance with Chapter 5C of the Act. While the public unit trust is the most common and significant form of managed investment scheme, it is not the only one, other forms including time share schemes and trustee common funds: see 3.1.1 below. Only public unit trusts are considered in this thesis.


4 There may be schemes where little diversification of risk is obtained by investors, such as where the scheme invests only in a particular asset such as a particular item of real estate.

5 Australian Bureau of Statistics, Managed Funds Australia, December Quarter, 1996. These figures do not include other forms of collective investments not regulated under the former Part 7.12 as prescribed interests, such as superannuation funds, life insurance offices or friendly societies.

introduction of compulsory superannuation,\(^7\) and the continuing shift in household savings away from traditional deposit products and towards managed funds.\(^8\)

- **The recent legislative reform of the regulation of collective investments**

In response to the collapse of high profile unlisted property trusts in 1990,\(^9\) and the loss flowing to investors as a result of those crashes, the Australian Law Reform Commission, together with the Companies and Securities Advisory Committee, undertook a thorough review of collective investment regulation, producing a comprehensive report\(^10\) and draft legislation proposing fundamental reform.\(^11\)

The release of the report led to the introduction of the *Managed Investments Act* 1998 (Cth), which was enacted on 1 July 1998, implementing many but not all of the ALRC/CSAC proposals in the form of the new Chapter 5C of the *Corporations Law*.\(^12\)

The result of the above is that a significant proportion of the national savings is now invested in a vehicle which is regulated by the new statutory regime.\(^13\) The importance of ensuring certainty in the legal nature of the vehicle, and more importantly the protection afforded to investors as a result of that legal nature, cannot be understated.

There are two legal justifications for the discussion. *First*, the managed investment scheme is *sui generis* in nature, being a hybrid legal form beyond general law classification. Various rights are vested in both members and the responsible entity, being derived from the Act, the constitution and the underlying trust nature of the scheme. As a result, the applicable law in relation to exercises of the constitutional amendment power must be drawn from various sources, including trust and contract law, legislation, and the law regulating fiduciary obligations. A thorough examination of the applicable law upon certain actions is necessary in this regard. *Secondly*, the judicial pronouncements on the approach taken by courts in supervising and intervening into exercises of the constitutional amendment power in managed investment schemes is scarce,\(^14\) providing a further need to analyse the most appropriate approach given the legal and commercial nature of the scheme.

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\(^7\) ALRC/CSAC Vol 1 at 1.
\(^9\) The most well known instances involved the Estate Mortgage and the Aust-Wide trusts.
\(^10\) ALRC/CSAC Vol I.
\(^12\) See generally 3.1 below.
\(^13\) Note that the transition provisions allow schemes until July 2000 to register the scheme in accordance with the new law: s1454. Only schemes already registered under the MIA are considered.
\(^14\) Given its recent enactment, there are no decisions directly considering the issue in the context of the new statutory regime. The only directly applicable decision is *Graham Australia Pty Ltd v Perpetual Trustees WA Ltd* (1989) 1 WAR 65, relating to a public unit trust regulated under the former Part 7.12 Div 5. The decision is discussed below at 8.2.3. There are also a line of decisions relating to amendments to superannuation trust deeds and rules in the context of distribution of fund surpluses which are applicable by analogy and which are discussed at 4.2 below.
1.3 Methodology

This thesis takes the form of an analysis of both the ability of parties in managed investment schemes to alter or extinguish rights vested in other parties by instigating amendments to the scheme's constitutive document, as well as the various legal restraints placed on parties in making such amendments.

The objectives of the analysis are twofold. The first and primary objective is the identification of the most appropriate approach which courts should adopt in reviewing exercises of the constitutional amendment power. The inquiry is normative and doctrinal in nature, being a survey of the legal investigations most appropriately applicable to the judicial review of exercises of the amendment power. The relevant law is drawn from legislation, contract, and the general law of trusts and fiduciary obligations.

The second objective is to evaluate the adequacy of the applicable law in protecting the legitimate rights and interests of the parties in a managed investment scheme. This objective is inherently limited due to the doctrinal nature of the analysis. However, the adequacy of the law is tested by two means. First, the applicable law identified during the course of the thesis is applied to selected amendments which may be instigated by the scheme participants. Secondly, an evaluation of the adequacy of the restraints is conducted in the context of a comparison with the position of company shareholders, who are granted various statutory rights and protections not available to scheme members.

Part A provides the foundation for the discussion, commencing with a brief survey of the history of the investment trust, from its inception as the deed of settlement company to its current form as the managed investment scheme. This is followed by a rights based analysis of the managed investment scheme. This necessarily requires a broader exploration of the inherent nature of both the managed investment scheme and the scheme constitution. The identification and discussion of the rights afforded to scheme members provides the framework within which the various protections provided upon the extinguishment or alteration of those rights are discussed.

Part B is concerned with the power granted to the responsible entity to amend the constitution, as well as the various restraints imposed on that power. The analysis adopts the framework of discussing both the amendment power and the restraints in accordance with their source, being either statutory, contractual, or derived from equity. The various restraints on the exercise of the amendment power are then applied to selected amendments in order to canvass specific legal issues.

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15 No consideration is made of possible stamp duty and taxation implications of amendments. Where an amendment has the effect of changing the proprietary rights and interests of members, or alters the terms of the trust in a manner which goes to the foundation of the scheme, the amendment may be characterised as a resettlement for revenue law purposes: see Green P, 'Revenue Law Implications of Variations to and Resettlements of Superannuation Funds', Paper presented at the seminar Superannuation 1999: Mardi Gras of Information, February 1999, Law Council of Australia, Sydney.

16 See Ch 6 and Ch 9 below.

17 See Ch 10 below.
Part C involves a similar analysis with respect to the power granted to the scheme members by virtue of a special resolution. The same framework is adopted. The analysis focuses on whether the protection afforded to the parties is adequate, with particular reference to the comparable position of members of registered corporations as a benchmark.

1.4 Themes

While the substance of the analysis is confined to issues arising from constitutional amendments, this framework is used as a medium for a wider reaching discussion of conceptual issues arising out of actions in managed investment schemes. These issues take the form of themes underlying the substantive legal analysis, and include:

Abuse of Power

In exploring the restraints placed on parties in amending the constitution, a wider examination of the judicial review of the exercise of powers and discretions by the parties is undertaken. Both fiduciary and non-fiduciary powers are examined and the distinctions canvassed. The parties to a managed investment scheme are vested with a variety of powers and discretions which may affect the rights and legitimate expectations of other participants, the power to amend the scheme constitution being one. While the substance of the analysis is confined to this one power, the legal restraints placed on parties in exercising this power are equally applicable to other powers and discretions, such as:

- The power of scheme members to remove a responsible entity, or to select a new responsible entity upon retirement of the current company.
- The power of scheme members to direct the scheme be wound up.
- The power of the responsible entity to modify, replace or repeal the scheme compliance plan, or to remove the auditor of the compliance plan.
- The power of the responsible entity to select new appointments to the compliance committee.
- The discretion of the responsible entity in offering withdrawal opportunities to members of a scheme which is not liquid.

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18 It could be argued that the responsible entity has a general power of management by virtue of s601FB(1). As such, the discussion below on restraints placed on exercises of power may be applicable to the exercise of this general power.
19 Removal of the responsible entity currently requires an extraordinary resolution: s601FM(1). Note that the Corporate Law Economic Reform Program proposes to alter the requirement to a simple resolution where the scheme is listed on the stock exchange: CLERB, Schedule 3, s329.
20 Section 601FL(1). See also CLERB, Schedule 3, s328.
21 Section 601NB.
22 Section 601HE(1).
23 Section 601HH(1)(b). Note that consent is required from ASIC.
24 Section 601JB(5).
25 Section 601KB(1).
• The power vested in both the responsible entity and scheme members to call a members' meeting.\(^{26}\)

Other powers and discretions may also be vested in the parties by virtue of provisions in the scheme constitution, being the contractual document which governs the legal relationship between them.\(^{27}\) Constitutional powers vested in the responsible entity may include: \(^{28}\)

• A general power to invest the scheme property.
• A power to issue new units, including the ability to issue a new class of units.
• A power to consolidate or redivide the units in the scheme.
• A power to deny withdrawal rights.
• A power to refuse registration of unit transfers.
• A power to make capital distributions to members.

As well as actions by participants in managed investment schemes, many aspects of the substantive law are equally applicable to exercises of power by functionaries in other commercial trust structures such as superannuation schemes and trading trusts.

The examination further involves a discussion of the interaction between the various sources of law in controlling the exercise of power, being the interplay between the regulatory regime, the general law of equity and fiduciary obligations, and the scheme constitution as a commercial contract. In particular, the extent to which the legislation is subject to the overriding principles founded in the general law and the manner in which these principles must be moulded to accommodate the statutory and contractual nature of the scheme is explored.

The Analogy between Managed Investment Schemes and Corporations

From an investor's viewpoint, registered companies and managed investment schemes are similar, both functionally and economically. Both the company and the trust may be utilised as a vehicle for collective investments,\(^{29}\) and both may be utilised to operate a commercial venture.\(^{30}\) In many respects, acquiring a unit in a scheme or a share in a public company, either through an investment company or directly into a

\(^{26}\) Part 2G.4, Division 1.
\(^{27}\) See generally 3.2 below.
\(^{28}\) This, of course, depends on the particular scheme in question.
\(^{29}\) Investment companies are registered companies primarily engaged in the business of investing in marketable securities for the purpose of revenue and profit and not for the purpose of exercising control. Investment companies were formerly regulated under the now repealed Part 4.4 of the Corporations Law, but are now regulated by the same regime as trading companies. Although not to the same extent as unit trusts, investment companies are utilised in Australia: Stapledon G P, 'The Duties of Australian Institutional Investors in Relation to Corporate Governance' (1998) 26 CSLJ 331 at 353.
\(^{30}\) While private trading trusts are common in Australia, public trading trusts are less common due to the obligation to maintain capital, as well as their taxation treatment as companies: see Income Tax Assessment Act 1936 (Cth), Pt III Div 6C.
trading company, are alternative investments. Furthermore, the two legal institutions share a common historical and doctrinal origin and development.

Nonetheless, they each adopt distinct legal forms, the participants drawing their rights and duties from separate bodies of law. As a result of the line of company legislation and correlating case law which has developed during the past 150 years, the company form is a more developed vehicle in balancing the competing rights and interests of parties. The managed investment scheme, on the other hand, is more reliant on the general law of trusts and fiduciary obligations, a body of law developed in both a different era and a different context. While company law was formed for the purpose of regulating commercial ventures, trust law developed in the context of family settlements and dispositions, being now drawn on to regulate large commercial ventures.

However, as the trust was utilised in the doctrinal development of the company and also shared a competing popularity as the preferred vehicle for collective investments, it is submitted that the company may now provide fertile grounds from which its younger cousin, the managed investment scheme, may draw. Drawing on this analogy assists in providing certainty in the law given the absence of a substantial body of decided cases relating to unit trusts and managed investment schemes. In the current context, company law principles and approaches are imported in both the review of actions by the responsible entity, as well as obligations placed on scheme members in executing a resolution.

As the two forms may be seen as competing investments, the level of legal protection afforded to investors, whether they be in a managed investment scheme or a corporation, should be closely aligned. Therefore, as well as providing a source of law from which to draw from, the functional analogy between the company and the managed investment scheme also allows for the rights provided to the company shareholder to be used as a benchmark in measuring the adequacy of investor protection in a managed investment scheme.

The Division of Power between the Scheme Organs

In exercising their powers and discretions, parties are provided a means by which the rights vested in other parties may be altered or extinguished. The further issue of the balance between the competing rights of the various parties thereby becomes crucial.

The first division is between the responsible entity and the scheme members in a general meeting, being the two primary organs of the scheme. By definition, members of a managed investment scheme do not have day-to-day control over the operation of

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31 However, see ASC v AS Nominees (1995) 62 FCR 504 at 517 per Finn J, where his Honour imposed a higher standard of care on a corporate trustee than is applied to company directors, based on the assumption that persons investing in companies and trusts have different risk expectations. See also Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd [1986] 1 WLR 1072. See further 5.1.3 below.
32 See Ch 2 below.
33 Young in terms of maturity rather than age.
34 See 5.1 below.
35 See Ch 8 below.
36 See Ch 10 below.
the scheme, the operational function being vested in the responsible entity. Members play a passive part in the conduct of the investment activity, creating a segregation between the contributed capital and the management and custody of that capital. This division between beneficial ownership and control serves as the primary motivation for participation in collective investment vehicles, as it allows investors to obtain the benefits of a diversified portfolio of assets and securities while leaving the management in the hands of a delegated professional.

If it is acknowledged that the managed investment scheme is a passive investment vehicle, this begs the question of the extent to which the responsible entity can interfere with the vested rights of members, and conversely, the extent to which investors are legally entitled to intervene in such actions. The question is one of balance between providing adequate protection to the interests of members and allowing the responsible entity to operate the scheme as it sees fit in accordance with the powers delegated to it under the constitution and legislation. This issue is explored in the context of the ability of members to complain upon abuses of power by the responsible entity in exercising its amendment power. Furthermore, the ability of scheme members to impose the responsible entity with constitutional amendments, thereby interfering with its management rights, is also considered.

As well as the balance of power between the two primary organs of the scheme, it is necessary to examine the competing rights and interests of majority and minority scheme members. The Act imposes the principle of majority rule on managed investment schemes, being one of the pillars of company law. As a result of the legislative provisions, this concept has been applied to a trust structure, to which it is relatively foreign. In exploring the avenues for redress which are open to minority scheme members upon exercises of power by the majority, the doctrinal difficulties associated with the application of majority rule concepts to managed investment schemes, as well as the resulting practical implications, are dealt with.

Therefore, the examination of the constitutional amendment power in managed investment schemes provides a functional medium through which various doctrinal issues are explored. However, the objective of the discussion, being the identification and evaluation of the restraints placed on the participants in exercising the constitutional amendment power, remains at the foreground.

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37 See definition of 'managed investment scheme', as well as s601PB(1).
39 See ALRC/CSAC Vol 1 at 18.
40 See Part B below.
41 See 7.1.1 and 9.3 below.
43 See Part C below.
Part A - The Scheme and the Scheme Constitution

Part A provides the foundation upon which the exercise of the constitutional amendment power is examined. Chapter 2 commences with a survey of the historical origins of the managed investment scheme, illustrating the common origins, both commercially and doctrinally, between the company and the managed investment scheme. This is followed in Chapter 3 by a discussion of the legal nature of the scheme, an examination of the various rights afforded to scheme members, and the legal nature of the scheme constitution.

2. From Deed of Settlement to Constitution: An Historical Perspective

...some day when English history is adequately written one of the most interesting and curious tales that it will have to tell will be that which brings trust and corporation into intimate connection with each other..


Irrespective of their economic and functional similarities, at first glance, the legal nature of the company and that of the managed investment scheme are inherently disparate: the company is a juristic entity, the managed investment scheme is not; the managed investment scheme is a trust, while the company is merely a creature of statute; a scheme member has a direct equitable interest in the scheme property, the shareholder only holds an interest in the company; the scheme member may be held liable for the debts of the scheme, the shareholder cannot be liable beyond his or her contributions.

However, this divergence in the legal nature of the two vehicles is the result of historical incidents rather than functional development, a point which may be appreciated upon a survey of the evolution of the collective investment trust as a legal and commercial vehicle. This historical analysis assists in the appreciation of the intimacy between both the trust and the corporation in the law, and how the two legal institutions have evolved to produce the modern unit trust, and more recently, the managed investment scheme. It provides the foundation both for the importation of company law decisions and legal concepts to the unit trust sphere, as well as the use of shareholder legal protection as a benchmark when considering the protection afforded to investors in unit trusts.

1 See generally Spavold G C, 'The Unit Trust: A Comparison with the Corporation' (1991) 3 Bond LR 249.
2 This issue is discussed further at 3.3 below.
3 This issue is discussed further at 9.2 below.
Part A - The Scheme and the Scheme Constitution

The development of the two institutions has entwined in two respects, each of which will be discussed in 2.1 and 2.2 below respectively:

1. The concept of trust has been utilised in both the derivation and development of corporate law and the duties of company officers.

2. At various points in time, including the present, the trust relationship has been used as an alternative to the corporation as a vehicle for commercial and investment ventures.

2.1 The Trust in the Development of the Company

The equitable concept of trust has been of immense importance to corporate theory. Both the company itself and the company director were historically considered to hold the office of trustee.

2.1.1 The Company as Trustee

The notion that shares are an entity distinct from the corporate property is a relatively recent phenomenon. In the eighteenth century, it was commonly considered that the corporation held the company assets as trustee for the benefit of its members. For instance, in Child v Hudson’s Bay Co, it was held that ‘the legal interest of all the stock is in the company, who are trustees for the several members’. In this old view of the legal relationship between shareholder and company, the shareholders had an equitable interest in the corporate property which was held by the corporate entity for their benefit.

However, as the number and increasing fluidity of shareholders increased, the trust concept fell from favour as a means of explaining the relationship between the company and its members. The growing complexity of the corporate form and the


\(^5\) The application of the trust principle in developing company law has been attributed to the Court of Chancery having jurisdiction over both partnerships and corporations, therefore appealing to the legal concepts with which it was acquainted: Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 at 12. One ramification of this view was that companies were said not to be capable of acting as a trustee for other purposes, as they already held the property in trust for their members: Cooke C A, Corporation Trust and Company: An Essay in Legal History, Manchester University Press, 1950 at 70. Furthermore, where companies held real property, a share in the company was treated as a share of the title in the real estate, therefore requiring transfer by conveyance in the appropriate form for real property: Drybutter v Bartholomew (1723) 2 PWms 127; 24 ER 668. In certain instances, the company’s constitution vested an interest in the company property in individual shareholders: Stebbings, op cit, at 26-27. Finally, in the case of shares transferred by fraud or mistake, as the equitable interest of the shareholders did not prevent a person receiving the shares without notice from obtaining the legal title, the remedies available to shareholders were in equity for breach of trust: Hildyard v South Sea Coy and Keate (1722) 2 PWms 76; 24 ER 647.
existence of perpetual corporate succession created the need for a more intricate relational arrangement. Furthermore, the share obtained its own value, being a readily marketable commodity which could be converted to money on the open market. Shares were assets independent from the company property. The trustee-beneficiary relationship was found not to be adequate when applied to commercial activity undertaken on behalf of a large and continually changing body of contributors.

The disfavour may also be attributed to the increasingly recognised distinction between the capital fund constituting the resources of the company, and the actual business and property held by the company. Rights of shareholders were originally attributed to their status as members of the corporation rather than mere investors. However, as the size of corporations grew, shareholders were no longer seen as participating members of the business itself, but merely contributors to the pooled capital fund.

By the beginning of the nineteenth century the idea was repudiated. The company was recognised as a juristic person and shareholders were denied any interest, legal or equitable, in the company undertakings and property. Their proprietary interest was personal in nature, limited to the right to receive a payment of dividends which had been duly declared and to the repayment of capital upon winding up of the company, together with ancillary rights to protect those interests. The trust concept was replaced by fiduciary obligations owed to the company by the directors.

2.1.2 The Director as Trustee

The second historical application of trust concepts to corporate theory saw the consideration of the company director as trustee for the benefit of shareholders. Charitable Corporation v Sutton involved the first recognition of this relationship, being an action in fraud against committee-men (being effectively directors) of a

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6 Ireland, op cit, at 68.
7 Cooke, op cit, at 72. See Ireland, op cit, at 62-69 who attributes the changing legal nature of the joint-stock share to the changing commercial environment of the times and the correlating qualitative change in the economic nature of the share.
8 Cooke, op cit, at 73.
9 It is interesting to note that the characteristics of corporations which rendered the trustee-beneficiary structure inadequate, such as perpetual succession, fluidity of members and a lack of participatory rights granted to members, have now been inherited by the modern investment trust. This poses the question of whether the trust institution is suitable for the purposes for which it is utilised in unit trusts and managed investment schemes.
10 Ex parte The Lancaster Canal Co (1832) Nont & BI 94; The Attorney-General v Giles (1835) 5 Law J (NS) Ch 44; Bligh v Brent (1836) 2 Y&C Ex 268; 160 ER 397; Bradley v Holdsworth (1838) 3 M&W 422; 150 ER 1200; Duncraft v Albrecht (1841) 12 Sim 189; 59 ER 1104; Walter v Milne (1849) 11 Beav 507; 50 ER 913; Bulmer v Norris (1860) 9 CB(NS) 19; Ackland v Lewis (1860) 9 CB(NS) 32; Entwistle v Davis (1867) 4 LR Eq 272; Bank of Hindustan v Allison (1870) 6 LR(CP) 222. Compare Thompson v Thompson (1844) 1 Coll 381; 63 ER 464; Ware v Camberleage (1855) 20 Beav 503; 52 ER 697. See Sibblings, op cit, at 27-29; Ireland, op cit, at 50-53.
11 One ramification was the finding that shareholders did not have an insurable interest in the company property: Macaura v Northern Assurance Co [1925] AC 619. See Pennington R R, The Investor and the Law, MacGibbon & Kee, London, 1968 at 410.
12 See Bowman v Secular Society Ltd [1917] AC 406.
13 (1742) 2 ATK 400; 26 ER 642. See also R v Watson (1788) 2 Term Rep 199; 100 ER 108; Mayor of Colchester v Lowten (1813) 1 V&B 226; 35 ER 89; Attorney General v Compton (1842) 1 Y & CCC 417; 62 ER 951; York and North Midland Railway v Hudson (1853) 16 Beav 485; 51 ER 866.
charitable joint stock company. The action was said to lie in breach of trust, Lord Hardwicke stating that the committee-men were 'within the case of common trustee'. Since this decision, the concept of director as trustee has continued through the cases. For instance, in York and North Midland Railways v Hudson, it was observed that:

The directors are persons selected to manage the affairs of the company for the benefit of the shareholders. It is an office of trust, which, if undertaken, is their duty to perform fully and entirely. A resolution by the shareholders, therefore, that shares or any other species of property should be at the disposal of the directors, is a resolution that it shall be at the disposal of the trustees, in other words, that the persons entrusted with that property shall dispose of it within the scope of the functions delegated to them in the manner best suited to benefit their cestui que trust.

Professor Gower has attributed this view to the existence of unincorporated joint stock companies during this period being associations which operated under a deed of settlement vesting the legal interest of the business property in the directors. In such cases, the directors were trustees in the literal sense. The use of the trust concept has further been explained as merely a result of the limited legal vocabulary of the times. As the concept of fiduciary relations was yet to be developed, the only office of responsibility which could be attributed to directors was that of trustee. The position of the trustee in the strict sense as understood today was not to be confined until the nineteenth century. However, even after it was acknowledged that directors were not strictly trustees in the sense that they did not hold legal title to the company property, courts continued to impose obligations of trust based on the effective control of assets which were vested in the directors.

As commercial practices developed, the trust concept, and the duties and obligations ascribed to it, became too stringent for the operation of corporate ventures. The position of directors as trustees was rejected in Percival v Wright and Re Kingston Cotton Mill Company (No 2). It was recognised that the function of a trustee to preserve property and to act in accordance with the directions of the settlor was not appropriate for the operations of a commercial enterprise, where the correlation between risk and return necessarily required a wider scope for discretion.

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14 (1742) 2 Atk 400 at 405-406.
15 (1853) 16 Beav 485; 51 ER 866.
16 Gower L C B, Gower's Principles of Modern Company Law, 5th Edition, Sweet & Maxwell, London, 1992 at 550. See also Keeton G W, 'The Director as Trustee' (1952) 5 CLP 11 at 11. This explanation has been refuted by Professor Sealy (see Sealy L S, 'The Director as Trustee' [1967] CLJ 83 at 84-85) on the following grounds:

1. Charitable Corporation v Sutton, being the first recognition of trust principles in this context, predated any judicial recognition of directors in deed of settlement companies as trustees.
2. In deed of settlement companies, the trustees and directors were not the same group of persons, the deed making specific provisions for the powers, duties and obligations of each group. Therefore, as a general rule, the directors were not in a trust relationship with members.

17 Sealy, op cit, at 85-86.
18 See for instance Re Lands Allotment Co [1894] 1 Ch 616.
19 [1902] 2 Ch 421. See also Smith v Anderson (1880) 15 ChD 247 at 275 per James LJ.
20 [1896] 1 Ch 331.
As remains the case in the modern law, directors were said to stand in a fiduciary relationship with the company rather than a strict trust relationship. While the obligations arising from each legal relationship may overlap, such as in the requirement to act in good faith, the analogy is of only limited utility, particularly breaking down when considering the objective requirements of care and skill. The New South Wales Court of Appeal recently described the disparity as follows:

...while the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgements, the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested.

Nonetheless, while the functional disparity between the director and the trustee has widened, the contribution made by the latter in the development of the former cannot be denied. Furthermore, as is discussed in later chapters, the acceleration in the development of company law over the past century has created an opportunity for the tables to be turned, the trust now picking from the fertile grounds of company case law and principles in order to hasten its own legal development as an investment vehicle in the form of the managed investment scheme.

2.2 The Historical Development of the Managed Investment Scheme

In tracing the development of investment trusts, from their inception in the form of a particular subspecies of the deed of settlement company to the recently created managed investment scheme, the parallel theoretical development of both companies and trusts as vehicles for commercial enterprises is again apparent. Although divergent in their legal nature, both have competed and both have enjoyed relative popularity during various points in time as the chosen institution for both the operation of commercial enterprises and, more relevantly, legal structures for collective investments.

It will also become apparent that the trust is a reactionary structure, being utilised in order to either circumvent the burdens imposed by the law or take advantage of particular legal opportunities peculiar to the times. Avoiding the rigidity of the law is a common theme in the development of the trust itself, dating back to their first

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22 Daniels v Anderson (1995) 16 ACSR 607 at 658. See also Re International Vending Machines Pty Ltd (1961) 80 WN(NSW) 465 at 473 per Jacobs J; Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd [1986] 1 WLR 1072. In relation to the standard of care of corporate trustees in unit trusts, see ASC v AS Nominees (1995) 62 FCR 504 at 516-519 per Finn J. Note that s601FC(1)(b) imposes a statutory duty of care on the responsible entity requiring it to 'exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position'. The provision is phrased in identical terms to the correlative duty placed on company directors in s232(4). However, it is submitted that given the above decisions, the standard of care and diligence required of the responsible entity will exceed that of a company director, irrespective of the similar wording of the provisions. See further Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 79-80; Hanrahan P, 'Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law' (1999) 17 CSLJ 67 at 72-74.
inception in the form of the use, created to circumvent the rigidity of the feudal system by avoiding inheritance duty, the law of succession, and later the Statute of Uses.  

2.2.1 The Bubble Act and the Rise of the Deed of Settlement Company: 1719-1825

The unit trust finds its origin in a form of trading trust which emerged in England during the eighteenth and nineteenth century. The trading trust was a subspecies of the unincorporated joint stock company, arising out of the commercial and legal environment of the early eighteenth century in order to subvert the restrictions imposed by the Bubble Act.  

As such, both unit trusts and corporations have a common origin.

The early eighteenth century saw a boom in company flotations and an increasing market in joint stock trading. The continual upward movement in the stock market bred speculation, as there lay a common belief that investment in corporate capital funds would assure the generation of wealth.  

Furthermore, a market in corporate shells, being charters in companies which had ceased to trade, developed as partnerships sought the new found advantages of obtaining the corporate form.  

Companies became widely associated with fraud, speculation, monopoly and inefficiencies.

As a reaction to the perceived dangers of this highly speculative and volatile environment, the legislature enacted the Bubble Act in 1719. The Bubble Act was intended to protect the public from the fraud and negligence of company promoters and directors by prohibiting joint stock companies which were not legally incorporated.  

It was passed in the early stages of the boom in an attempt to avoid the perceived inevitability of a major crash in joint stock prices. By deliberately making it difficult for associations to undertake the corporate form, it succeeded in suppressing confidence in the joint stock company.

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25 Cooke, op cit, at 81.

26 This period also saw the foundation of the South Sea Company, a joint stock company which had the ambitious aim of resuming and trading the national debt. The company resumed the debt by either purchasing the liability or exchanging it for South Sea stock, with the hope that due to the continuous bull market, the relative cost of obtaining the debt would fall: Holdsworth W, A History of English Law, Volume VIII, Sweet & Maxwell, 1908 at 210.


28 Incorporation could only be achieved by a charter from the Crown or a private Act of Parliament, both of which required extensive petitioning. Grants of incorporation were each considered on their own merits, the criteria being based on uncertain and vague public policy criteria: Cooke, op cit, at 92. Furthermore, the legislation itself was ambiguous in its drafting, prohibiting '. . . the acting or presuming to act as a corporate Body or Bodies, the raising or pretending to raise transferable Stock or Stocks, the transferring or pretending to transfer or assign any Share or Shares in such Stock or Stocks without Legal Authority, either by Act of Parliament or by any Charter from the Crown to warrant such acting as a Body Corporate . . .'. DuBois states that the legislation's restraining force was in fact enhanced by the doubt surrounding its exact scope: DuBois A B, The English Business Company after the Bubble Act 1720-1800, Oxford University Press, 1938 at 2. Only one case was prosecuted under the Act in the century of its enactment: R v Cawood (1724) 2 Ld Ray 1361; 92 ER 386.
Whilst the *Bubble Act* made the operation of companies illegal without authorisation from Crown or parliament, it did not prevent persons from utilising an equitable form. The result was an influx of unincorporated business ventures, relying on equity's recognition of the trust, and acting for all purposes as their incorporated equivalent.\(^29\) Utilising a combination of a contract under seal and a settlement of trust by way of a carefully worded deed of settlement, property was conferred on a body of trustees and management delegated to a committee of directors. The unincorporated joint stock company\(^30\) was successful in approximating the benefits of incorporation, while at the same time avoiding the bureaucratic process necessary to achieve those advantages under *Bubble Act*.\(^31\) As a result, a second breed of company, under the equitable jurisdiction, entered the commercial arena. DuBois states:\(^32\)

> The not unexpected result of government policy was that business men and lawyers, in starting new business enterprises, impatient of the long and expensive process of applying for a charter of incorporation, and of the nebulous chance of success, would risk proceeding as an unincorporated association.

**The Structure of the Deed of Settlement Company**

The unincorporated joint stock company was essentially a trust with a large number of proprietors. The trust property was vested in the trustee for the benefit of the members of the company for the time being.\(^33\) It was not a separate juristic person like its incorporated counterpart, but was equal in commercial utility and able to mingle freely with incorporated entities. It had arrogated itself all the outward symbols of incorporation, from common seal to transferable shares.\(^34\)

The deed of settlement, being a hybrid of the modern company articles and a trust deed, provided mutual covenants between members and trustees, with the trustees covenanting to observe the terms of the deed and apply the fund settled upon them for

\(^29\) [Re Agricultural Cattle Insurance Company (Baird's Case)](1870) 5 Ch App 725; [Re European Assurance Society (Grain's Case)](1875) 1 Ch D 307.

\(^30\) The term 'company' was used as an economic rather than legal term, referring to large business enterprises, whether they were incorporated or formed under a deed of settlement: Ireland, *op cit*, at 44.

\(^31\) In *Buck v Buck* (1808) 1 Camp 547; 170 ER 1052, unincorporated bodies with transferable shares were held to be illegal under the *Bubble Act*. However, later cases limited the reach of the Act by focussing attention on the mischief it set out to prevent, requiring proof that the company's operations involved some danger or mischievous undertaking to the common grievance before a prosecution would be successful: *R v Webb* (1811) 14 East 406; 104 ER 658. Therefore, unincorporated companies could avoid falling within the prohibition by operating under deeds which provided objectives which were beneficial to the public. Furthermore, companies fell outside the Act where shares were only transferable with the permission of the trustee: *Pratt v Hutchinson* (1812) 15 East 511; 104 ER 936. See Cooke, *op cit*, at 98.

\(^32\) DuBois, *op cit*, at 40.

\(^33\) If the property were vested in the trustee for a purpose rather than for the beneficiaries, the formation of the trust would have failed for uncertainty of object and for breaching the rule against perpetuities: *Carne v Long* (1860) 2 De GF & J 75; 45 ER 550, Stebbings, *op cit*, at 30-31.

\(^34\) DuBois, *op cit*, at 216.
the purposes specified. The deed commonly contained the following clauses and covenants:35

- A provision settling the property on trust.
- The appointment of managers, directors and auditors.
- Provisions regulating the management of the business affairs.
- The powers, responsibilities and conduct of directors.
- A definition of the shares, as well as the methods and restrictions on their transfer.
- The mode of calling general meetings, the rights of members at meetings, procedures for arbitration, and rules regulating internal management.
- A specified limit on the liability of member.

Whilst the provision requiring the trustees to hold the property on trust for members was imperative to the effective operation of the company, the trust settlement was merely one aspect of a larger contractual framework, the trust being used simply as a holding device for the property.36 The rights of the beneficiaries were governed by the contract they had entered into.37 Beneficiaries were denied rights to the trust property. Effective commercial control was placed in the hands of a body of directors rather than the trustees, members having no right of management in the capital fund or the direction of the business.38 For instance, in *Ex Parte Chippendale; Re German Mining Co*, a clause of the deed of settlement of a mining company read:39

That the affairs and business of the company shall be under the sole and entire control of the directors...and that the directors shall appoint and remove all officers and servants of the company, and award to them such salaries, wages, or other compensation as they shall think fit...

What members did have was the right to begin an action in Chancery to recover compensation for breach of trust where the trustee failed to observe the provisions of the trust instrument.40

The trust structure provided an efficient means for the deed of settlement company to deal with property and commence and defend suits relating to the trust property. As there were no mutual rights between them, the members were not partners, therefore not having the ability to legally bind each other. As such, the company was able to deal with property effectively and administer legal proceedings under the name of the trustee, unlike partnerships which required the names of all partners to be joined to an action.41 Furthermore, there was no limit on the personal liability of members,

36 Sin, *ibid*, at 15. As is the case with the MIA, the trust provisions only occupied a small proportion of the regulating provisions, being two clauses at most.
37 Stebbings, *op cit*, at 31.
38 Sealy, *op cit*, at 84.
39 (1853) 4 De GM&G 19; 43 ER 415.
40 Cooke, *op cit*, at 95.
41 *Ibid* at 221-222.
although it was common for deeds to contain a clause limiting liability to their share in the capital.\(^{42}\)

Although not a separate juristic entity like its incorporated equivalent, beneficiaries in deed of settlement companies were found to hold an interest in the profits of the enterprise rather than the trust property, a position analogous to incorporated companies.\(^{43}\) A share in an unincorporated company was a form of personal property. In this regard, Stebbings states:\(^{44}\)

> The conclusion that a shareholder in a joint stock company, whether incorporated or unincorporated, was entitled only to a share of the profits and had no interest in the company’s land was consistent with the wishes of both the mercantile community and the investing public. Investors certainly had no wish to invest in real property, with all the burdens that entailed, when they purchased company shares. They wanted the share of the profits of a going concern, and this they achieved, the law recognising their intentions and construing their constitutions accordingly.

The practical result was that members in both chartered corporations and trusts operating a joint stock fund were in similar positions. Both had a claim against the operators of the fund, a claim to share in the profits, an obligation to meet losses incurred by the fund, and an ability to sell their interests in the corporation or trust.\(^{45}\)

For this reason, the unincorporated joint stock company has been referred to as the equitable company,\(^{46}\) serving as an effective means of approximating the benefits of incorporation. The position was aptly described by Maitland as follows:\(^{47}\)

> In truth and in deed we made corporations without troubling king or parliament though perhaps we said we were doing nothing of the kind.

\(^{42}\) Some Chancery decisions upheld such exclusion clauses: Re Waterloo Life Assurance Co (1864) 33 Beav 542; 55 ER 525; Re Medical, Invalid and General Life Assurance Society (1871) 6 Ch App 374. However, it was held in Sea Fire and Life Assurance Co (1854) 3 De GM&G 459; 43 ER 180 that the purported exclusion of liability was ineffective for lack of privity of contract between members and creditors: see Cooke, op cit, at 87; Hughes R A, The Law of Public Unit Trusts, Longman Professional, 1992 at 29. Irrespective of this decision, the practical difficulties in suing a fluctuating body of members and of levying execution made the absence of limited liability largely illusory: Gower, op cit, at 33. Furthermore, at this stage in time, limited liability of chartered corporations was only on the horizon.

\(^{43}\) Bligh v Brent (1836) 2 Y&C Ex 268; 160 ER 397, in which the proprietary interest in a share was recognised, was applied to an unincorporated joint-stock company in Humble v Mitchell (1839) 11 AD & E 205; 113 ER 392. See also Myers v Perigal (1850) 16 Sim 533; 60 ER 981; Ashton v Lord Langdale (1851) 4 De G & Sm 402; 64 ER 888; Watson v Spratley (1854) 10 Ex 22; 156 ER 424; Powell v Jessop (1856) 18 CB 336; 139 ER 1400; Hayter v Tucker (1858) 4 K&J 242; 70 ER 101. Compare Baxter v Brown (1845) 7 Man & G 198, 135 ER 86. See further Stebbings, op cit, at 33; Ireland, op cit, at 53.

\(^{44}\) Stebbings, op cit, at 33.

\(^{45}\) Cooke, op cit, at 186.

\(^{46}\) Ibid, at 124.

Due to the skill of the drafters of settlement deeds, the *Bubble Act* was rendered obsolete, and was repealed in 1825. Between 1834 and 1862, parliament enacted a series of company statutes which provided ease of company registration, as well as offering companies the unique advantage of limited liability. In order to obtain the various statutory privileges derived from registration, all companies were required to operate under a deed of settlement. The result was an assimilation of the two entities and a demise of the comparative attractiveness of operating otherwise than by virtue of incorporation.

With the repeal of the *Bubble Act*, the introduction of complete limited liability to incorporated companies, and the ease at which incorporation could be obtained, the advantages of carrying on business in the corporate form far outweighed what could be achieved by way of trust. While being capable of approximating the advantages offered by incorporation in the eighteenth century, the attainment of full statutory limited liability was unattainable through a deed of settlement alone. During this short space of time, equitable and common law companies were fused into what we now understand to be the modern corporation. This position was finally made certain with the House of Lords recognising the individual nature of the corporate entity as being separate and distinct from its members in *Salomon v Salomon & Co Ltd*.

From this progression it is clear that it was the unincorporated joint stock company which formed the basis of and out of which arose both the modern corporation and the unit trust, the deed of settlement providing the framework for the modern company articles of association. This position has been judicially recognised on several recent occasions.

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48 6 Geo IV, c.91 (UK).
49 The development of modern company legislation commenced with the *Trading Companies Act* 1834 (UK) (4 & 5 Wm. IV, c.94) and the *Chartered Companies Act* 1837 (UK) (7 Wm. IV & I Vict, c73), recognising the existence of unincorporated companies and empowering the Crown to grant them certain privileges previously only obtainable through incorporation. This was followed by the *Joint Stock Company Act* 1844 (UK) (7 & 8 Vict, c.110) which effectively assimilated incorporated and unincorporated companies by requiring all companies to act under a deed of settlement. The latter statute opened the path to limited liability by placing a three year sunset clause on the personal liability of members. The concept of limited liability was taken to its modern position by virtue of the *Limited Liability Act* 1855 (UK) (18 & 19 Vic, c.133) which also allowed for incorporation by simple registration rather than onerous petition. Twelve months after its enactment, the legislation was repealed and incorporated into the *Joint Stock Company Act* 1856 (UK) (19 & 20 Vict, c.47) which provided the first complete statement of company law, and was later consolidated into the *Companies Act* 1862 (UK) (25 & 26 Vict, c.89).
50 Hughes, *op cit*, at 32. Furthermore since the decision in *Holroyd v Marshall* (1862) 11 ER 999, coincidently in the same year as the *Companies Act* 1862 (UK), the trust structure was deprived of the advantages of the floating charge as a means of debt finance.
51 [1897] AC 22.
52 *Elders Trustee and Executors Co Ltd v E.G.Reeves Pty Ltd* (1987) 78 ALR 193; *Perpetual Trustees WA Limited v Corporate Management Limited* [1989] WAR 117; *Gra-ham Pty Limited v Perpetual Trustees* (1989) 1 WAR 65. Note that it has been suggested that a motivation for the move to limited liability was a desire to protect trust funds which invested in company shares. As trustees had a lack of control in the management of the companies in which they invested, it was seen as only fair that they be secured from loss beyond the value of the investment. Once again, this illustrates the impact companies and trusts have had on their respective development: Sin, *op cit*, at 20-21.
2.2.3 The Management Trust: 1868-1880

Early unincorporated companies were used as a means of conducting business enterprises rather than mere investment, the registered company being utilised for collective investments in the form of investment companies as early as 1860 in Scotland and 1863 in England. It was not until the second half of the nineteenth century, when the trust form enjoyed an impromptu, albeit brief, popularity, that the vehicle was used exclusively as a means of facilitating collective investment under the guise of the management trust. Rather than operating its own commercial enterprise, the management trust merely invested in the businesses of others, attracting a new breed of retail investors by allowing for a diversification of investment risk. From this period, the unit trust emerged.

The first trace of the investment trust in Britain was the Foreign and Colonial Government Trust, being formed in 1868. The success of the trust was sufficient to induce the same trustees to introduce five further trusts within the following five years. Between March 1868 and January 1875, fifteen new trusts were established for the purpose of holding securities on behalf of members.

The motivation for the resurgence at this time has not be adequately documented or explained. The popularity has been attributed by some commentators to the ability of investors to have their interests repurchased by the trustee. The unincorporated structure avoided the legal prohibition on companies redeeming their share capital and distributing assets to shareholders, thereby providing a mechanism for investments to be realised without resorting to a ready secondary market. However, whilst this avoidance of the capital maintenance requirement would seem the most obvious motivation, it was unlikely to have been the case given that the doctrine of capital maintenance was yet to be developed.

It has been further suggested that the growth was primarily due to the management trust offering fixed interest returns by investing solely in fixed interest securities. This was in contrast with the perceived volatility of company dividend returns at that time, leading to a fear of the high risk associated with company investment. As such, the investment trust was labelled 'an evident attempt to avoid the now unpopular name of Company'.

54 The trust was stated to have the following purpose: '...to give the investor of moderate means the same advantage as the large capitalist in diminishing the risk of investing in Foreign and Colonial Government Stocks by spreading the investment over a number of different stocks': Times, 20 March 1868, extracted in Walker C H, 'Unincorporated Investment Trusts in the Nineteenth Century' [1940] Economic History 341 at 341; Day & Harris, Unit Trusts, Oyez, 1974 at 2-5.
55 Walker, ibid, at 344-345.
56 Pennington, op cit, at 217-218; Day & Harris, op cit, at 1.
57 The first recognition of the inability of companies to reduce their capital was in Guinness v Land Corporation of Ireland (1882) 22 Ch D 349, to be further developed in Trevor v Whitworth (1887) 12 App Cas 409. See Sin, op cit, at 23.
58 Pennington, op cit, at 346.
Part A - The Scheme and the Scheme Constitution

The Structure of the Management Trust

As with the unincorporated deed of settlement company before it, the management trust took the form of a deed of mutual covenant between the trustees and certificate holders. Management was vested in the hands of the trustee to manage the portfolio of investments. While no directors were appointed, an elected committee of certificate holders were given an oversight role. Units were treated in all respects as shares, and were issued to the public in the same manner.60

The managed trusts of the times were fixed investment trusts.61 The trust deed provided a predetermined list of securities which were included in the portfolio, with a limited power to amend the constituent investments by the disposal of securities and the purchase of others in replacement. The securities were divided into units, which were in turn divided into sub-units which were issued to investors. Each investor thereby had an interest in a designated bundle of securities rather than the assets as a whole. This may be compared with the modern flexible investment trust which vests a large discretion in the trustee to alter the constituent securities, is open ended in terms of the number of units issued and the number of securities held, and where the interest of members is not specified to correlate with particular securities.62

The Smith v Anderson Decision

The first litigation relating to management trusts, involving the Governments' and Guaranteed Securities Permanent Trust, led to the well-known decision of Sykes v Beardon,63 in which Jessel MR found the trust to be an illegal association of more than twenty persons under section 4 of the Companies Act 1862 (UK).*

In contemplation of injunctions being issued preventing trustees dealing with trust property, this decision led to the winding up or incorporation of all but one unit trust, the Submarine Cables Trust, which successfully challenged the decision within one month of it being handed down. The English Court of Appeal reversed Sykes v Beardon in Smith v Anderson, where it was found that the lack of contractual link between unitholders and the independence of the trustee and manager resulted in the structure not being an association in contravention of the Companies Act.64 It was held that:

60 Sin, op cit, at 24-25; Walker, op cit, at 342.
61 Day & Harris, op cit, at 2-5.
62 See further 3.3.2(a) below.
63 (1879) 11 Ch D 170.
64 Companies Act 1862 (UK), s4: 'No company, association or partnership of more than twenty persons shall be formed after the commencement of this Act for the purpose of carrying on any other business...that has for its object the acquisition of gain by the company, association or partnership or by an individual member thereof unless it is registered.' The modern Australian equivalent of the prohibition is found in s115 of the Corporations Law.
65 (1880) 15 Ch D 247.
66 The trust deed limited the rights of unitholders to the receipt of the trustee report on the state of the investments, the appointment of auditors, and the appointment of a new trustee to fill a vacancies that may arise. The fact that a procedure was put in place allowing a decision of a majority of members to bind dissenting members who were not present at a meeting, similar to provisions found in company articles, was said to merely be a matter of form. Members attended meetings in their capacity as cestui que trust, and not partners carrying on a business.
• The trust was not an ‘association’, as there were no mutual rights or obligations between unitholders, being strangers to one another. Members merely had a common interest which was to be divided between them.\(^{67}\)
• The trust was not formed for the purpose of carrying on a business, as it merely invested in and held securities in other businesses.\(^{68}\)
• If a business were carried on, it was conducted by the trustee and not the members.\(^{69}\)

Irrespective of this decision, as the virtues of limited liability became better understood, the trust fell from commercial favour as a vehicle for public investment.\(^{70}\)
Most trusts had already wound up or had reorganised themselves into the corporate form. As Pennington notes:\(^{71}\)

This decision should have stimulated a revival of investment trusts, but in fact it did not, and until 1930 all of them chose the form of the investment trust company. What the decision in Smith v Anderson did do was to clear away any legal difficulties to the setting up of unit trusts when they eventually appeared...

After 1880, the only managed trust which remained was the Submarine Cables Trust, being the subject of the Smith v Anderson litigation, which survived until its final units were redeemed in 1926.\(^{72}\)

2.2.4 The Modern Unit Trust: 1930-

The unit trust made a return to the investment arena early this century. The concept was introduced through the United States where commercial investment trusts were utilised for the preceding twenty years.\(^{73}\) In Britain, the First British Fixed Trust commenced operation in 1931, being a fixed trust modelled on the United States investment trust.\(^{74}\) The flexible trust made its debut in 1934 in the form of the Foreign

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\(^{67}\) (1880) 15 Ch D 247 at 274 per James LJ.
\(^{68}\) Ibid, at 283 per Cotton LJ; at 276 per James LJ.
\(^{69}\) Ibid, at 283 per Cotton LJ; at 275 per James LJ.
\(^{70}\) Gower, op cit, at 247; Walker, op cit, at 349-350.
\(^{71}\) Pennington, op cit, at 219.
\(^{72}\) Walker, op cit, at 354; Pennington, op cit, at 218-219. See Walker, op cit, at 352 who tables all the investment trusts which were terminated or converted between 1868 and 1875. Interestingly, The Economist reported the reorganisation of the trusts as follows (The Economist, 24 July 1880, extracted in Walker, op cit, at 351-352): ‘What we wish to point out is that registration as Companies has not interfered with the usefulness of such trusts...It is not desirable that such absolute powers as are possessed by trustees under a settlement should be accorded to trustees of the certificate holders...The principle of the trust is good, but their organisation is faulty, and it is to be hoped that the litigation now going on will lead to its amendment’.
\(^{73}\) Commonly referred to in the United States as the Massachusetts Trust. Ironically, the vehicle was superseded in the United States in the 1940s by incorporated bodies called mutual funds which were misleadingly referred to as investment trust companies. The move to incorporation was primarily due to the existence of open-ended investment companies which have the ability to redeem units, a flexibility not available in Australia or England due to the maintenance of capital restrictions. The trust particularly flourished in Massachusetts in order to circumvent state laws prohibiting corporations from dealing in real property, hence it being referred to as the Massachusetts Trust: Hughes, op cit, at 32.
\(^{74}\) Day & Harris, op cit, at 4.
Government Bond Trust. The first public unit trust in Australia, *The Australian Fixed Trust*, commenced operations in 1936. The unit trust has grown in popularity to the present day.\(^5\)

The resurgence of the unit trust for investment purposes this century has been attributed to several factors. *First,* as was the case in the nineteenth century, the new popularity during the 1930s has been attributed to the high speculation and failure associated with investment companies. Offering investors the security of fixed interest investments by investing in bonds and other fixed interest securities, the unit trust was perceived as being relatively safe.\(^6\)

*Secondly,* the popularity has been explained by the ability of promoters to issue units to the public without needing to comply with the statutory prospectus requirements.\(^7\) This advantage no longer exists, as the issue of interests in a scheme must comply with the prospectus provisions of the Act.\(^8\)

*Thirdly,* the success was partially owed to the liquidity of unit trust investments as compared to investment in their incorporated counterparts. The legal requirement of maintenance of capital creates a restraint on shareholders’ ability to redeem their investment;\(^9\) the only option being to sell the shares on the secondary market. Unitholders, on the other hand, could either have their units repurchased by the manager, redeemed out of the trust assets or, in the case of listed trusts, sell them on the secondary market.\(^6^0\) In effect, the manager created a market for units by buying them back and reselling them.\(^6^1\) Having units repurchased also provided the opportunity to receive the value of the underlying assets rather than a market determined price. Hence, while the public unit trust offered redeemability and transferability, companies only offered the latter.\(^6^2\)

\(^{5}\) In particular, the 1960s and 1970s saw an acceleration in growth of the trust structure, motivated primarily by taxation considerations: Spavold G C, ‘The Unit Trust: A Comparison with the Corporation’ (1991) 3 Bond LR 249 at 252.

\(^{6}\) Sin, *op cit,* at 28.


\(^{8}\) Part 7.12.


\(^{10}\) Under the former s1069(1)(c), unit trust deeds were required to contain a buy-back covenant requiring the manager to either repurchase units upon demand, or cause them to be repurchased. However, while not required by the Act, as a result of stamp duty consequences it is more common in practice that withdrawal requests are satisfied by a redemption of the units out of the trust fund and a cancellation of the interest. A buy-back covenant is no longer required under the MIA where the scheme constitution may, but is not required to provide a right of withdrawal for scheme members: s601KA(1). See further 6.2 below.

\(^{11}\) See *Gra-Ham Australia Pty Ltd v Corporate West Management Pty Ltd* (1990) 1 ACSR 682 at 683 per Brooking J.

\(^{62}\) The importance of this motivation is illustrated by the United States position. Whilst the flexible trust had its origins in the United States, its importance as a medium for mutual funds is less important
However, the primary motivation for the rise of the unit trust as an investment vehicle this century would seem to be the relative taxation advantages afforded to trusts as opposed to companies.\footnote{Ford H A J, 'Public Unit Trusts', in Austin R P & Vann R (eds), \textit{The Law of Public Company Finance}, Law Book Company, 1986 at 397; Ford & Hardingham, \textit{op cit}, at 54; Spavold, \textit{op cit}, at 252.} As a trust is not a separate legal entity, distributions from the trustee to the unitholders maintain their character in the hands of the unitholders who are taxed at their personal rate for the income they are presently entitled to receive under the trust, capital distributions therefore maintaining their tax-free status.\footnote{Income Tax Assessment Act 1936 (Cth), s97. This may be contrasted to the position of shareholders, who are taxed on distributed dividends irrespective of whether the funds used to issue the dividends are capital or income in nature. This advantage has somewhat diminished since the introduction of taxation levied on capital gains: Income Tax Assessment Act 1936 (Cth), Part IIIA; Income Tax Assessment Act 1997 (Cth), Parts 3-1, 3-2.} A further taxation advantage of utilising a trust structure was the avoidance of double taxation.\footnote{Ibid, Part IIIAA. Furthermore, since 1981, ‘corporate unit trusts’ and ‘public trading trusts’ have been treated as corporations for tax purposes by virtue of Divisions 6B and 6C of Part III. These divisions were enacted in response to the practice of corporations reorganising their affairs and transferring assets to unit trusts to take advantage of the relative tax position. The enactments attempted to counteract these activities by ensuring that trusts which had a substantial corporate base were taxed as companies. However, the definition of ‘trading business’ excludes ‘eligible investment businesses’, which captures the investment trust schemes we are currently concerned with: s102M. Therefore, provided the trust does not fall within the ‘corporate unit trust’ definition in s102J, a unit trust or managed investment scheme will be taxed as a trust.} The introduction of the imputation system largely diminished this advantage in 1987.\footnote{For instance, the \textit{Submarine Cables Trust} in \textit{Smith v Anderson}, supra, involved a deed between the six trustees and a single covenantee ‘for and on behalf of all the holders for the time being of the certificates hereinafter mentioned’.}

The Structure of the Unit Trust

The contractual structure of modern unit trusts was inherently different to their nineteenth century predecessor. For the first time, the trust deed was executed as a contract between the manager and the trustee. This can be compared to the deed of settlement companies which contained a deed of mutual covenants between the trustee and a certificate holder on behalf of all certificate holders.\footnote{Gower L C B, \textit{Principles of Modern Company Law}, Stevens & Sons Limited, London, 1954 at 230} This dual party deed between the manager and the trustee has only recently changed with the introduction of a single responsible entity under the MIA, undertaking the roles previously ascribed to the individual trustee and management companies.

Irrespective of this distinction, the trust structure which emerged was both derived from and similar to the unincorporated joint stock company. Professor Gower has referred to the modern unit trust as a ‘refinement’ of its nineteenth century counterpart.\footnote{Ibid, Part IIIAA. Furthermore, since 1981, ‘corporate unit trusts’ and ‘public trading trusts’ have been treated as corporations for tax purposes by virtue of Divisions 6B and 6C of Part III. These divisions were enacted in response to the practice of corporations reorganising their affairs and transferring assets to unit trusts to take advantage of the relative tax position. The enactments attempted to counteract these activities by ensuring that trusts which had a substantial corporate base were taxed as companies. However, the definition of ‘trading business’ excludes ‘eligible investment businesses’, which captures the investment trust schemes we are currently concerned with: s102M. Therefore, provided the trust does not fall within the ‘corporate unit trust’ definition in s102J, a unit trust or managed investment scheme will be taxed as a trust.} Both structures involved a joint stock devoted to the conduct of a business, granting the investors ability to transfer stock, and both were reliant on a trustee for holding the property in a convenient manner.\footnote{Ford H A J & Hardingham, \textit{op cit}, at 52.}
2.2.5 The Regulation and ‘Corporatisation’ of Unit Trusts

The need for regulatory controls over investment trusts was recognised in the United Kingdom by the Anderson Committee on Fixed Trusts in 1936, leading to the enactment of the Prevention of Fraud (Investments) Act 1939 (UK). The legislation prohibited unit trusts from operating without the official sanction of the Board of Trade, imposed substantial regulatory provisions over the internal management of funds and dictated content requirements for authorised trust deeds. The provisions were eventually incorporated into the Prevention of Fraud (Investments) Act 1958 (UK).

In Australia, the first attempted regulation can be traced to provisions incorporated into the Companies Act 1955 (Vic), resulting from recommendations made by the Statute Law Revision Committee of the Victorian Parliament. The legislation required the registration of an approved deed and the appointment of a manager and approved trustee before any public offering of units. The structure of these provisions was adopted by the various state company Acts between 1971 and 1976 and eventually incorporated into the Companies Code 1981, and subsequently into the prescribed interest provisions in Division 5 and 5A of Part 7.12 of the Act. Although the provisions were incrementally amended and refined over time, the underlying regulatory premise remained intact until the repeal of Part 7.12 and the enactment of the MIA. The primary change introduced by the MIA was the replacement of the dual party structure in favour of a single responsible entity.

The legislative intervention in the investment trust has resulted in what has been referred to as the corporatisation of funds management. This is first evident by the fact that the regulatory provisions for managed investments are contained within the body of the Corporations Law. The regime provides for the registration of schemes, the requirement for a constitution to be lodged, and various rights and powers of the respective parties. The Act adopts regimes similar to those applied to corporations with respect to securities issues and dealings, meetings and related party transactions. Further changes are proposed by CLERB which will apply the company takeover provisions to interests in managed investment schemes which are

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90 Haddon, op cit, at 411-412; Ford, op cit, at 398-399.
91 The legislation was not enacted until 1944. See Day & Harris, op cit, at 6.
95 However, it could also be argued that the regulation is contained in the Corporations Law because it regulates the conduct of a company, ie, the responsible entity, and its relationship with outside parties, ie, members.
96 Part 5C.1.
97 Part 5C.3.
98 Part 5C.2.
99 Part 7.12.
100 Part 7.13.
102 Part 5C.7.
listed on the ASX. Therefore, while the legal forms of the company and the managed investment scheme are separate and distinct, the legislation does create a distinct corporate flavour in the form of the regulatory structure.

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From this cursory survey of both the doctrinal interrelationship of the trust and the company, as well as the historical development of the investment trust since its inception as the deed of settlement company to the modern managed investment scheme, it becomes clear that the trust structure as a means of collective investment has had a sporadic and reactionary life, swaying in popularity with changes in the regulatory and revenue law landscape, and re-emerging as the preferred legal structure in order to circumvent the various legal and commercial anomalies of the time. As Haddon notes:

The distinction between investment companies and unit trusts, which clearly serve a similar function, is largely a historical accident.

The two vehicles, in their current form, are no doubt divergent in their legal structure. In many respects, the courts have refused to assimilate the trust and the company, irrespective of their functional similarities. The distinction between the trust as a legal vehicle for the preservation of trust property and the company as a medium for entrepreneurial action remains, reinforcing the view that the two legal institutions are not interchangeable.

However, upon viewing these structures in the context of their fluid historical development, the significance of these divergences diminishes. The corporate form is both derived from the trust and at various times competed with the trust for commercial popularity. As a result of both recent and proposed legislative development, the trust, as utilised for collective investments, is incrementally adopting a corporate-like form.

These observations provide the foundation for much that is argued in the remaining chapters. The shared history and analogous commercial nature of the scheme and the

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103 CLERB, s604. The Corporate Law Economic Reform Program was announced by the Treasurer on 17 March 1998 and draft legislation was presented for public comments on 21 May 1998. The draft legislation was introduced into Parliament on 2 July 1998 and referred to the Joint Committee on Corporations and Securities on 10 December 1998 for report by 22 April 1999.

104 It was further initially proposed to tax trusts as a separate entity such as is currently the case with corporations, thereby furthering the corporate flavour of managed investment schemes. However, the current proposal is to retain the flow-through characteristic of taxation on widely-held collective investment vehicles, tax to be paid on income in the hands of the investor rather than the responsible entity: Review of Business Taxation, A Platform for Consultation, February 1999, Ch 16.


106 See for instance ASC v AS Nominees (1995) 62 FCR 504 at 516-519 per Finn J in relation to the standard of care applied to trustees in a unit trust arrangement. Compare the willingness of the Supreme Court of Western Australia to apply company law principles to unit trusts in Graham Australia Pty Ltd v Perpetual Trustees WA Ltd (1989) 1 WAR 65, discussed below at 8.2.3.

107 ASC v AS Nominees, ibid, at 517 per Finn J.
company allows legal doctrines and principles to be shared between the two vehicles. With respect to judicial intervention into exercises of power by company participants, being both company directors and shareholders, a distinct body of law has developed in order to strike an appropriate balance between the competing rights and interests of those parties. It is submitted that an analogous approach be adopted with respect to powers exercised by scheme participants, and in particular, in the context of purported amendments to the scheme constitution. The analogy further provides a benchmark by which the adequacy of protection afforded to scheme members upon constitutional amendments may be evaluated.
3. The Managed Investment Scheme

Constitutional amendments may alter or remove substantive rights previously enjoyed by participants in a managed investment scheme. Before commencing the exploration of restraints placed on amendments to the constitution, it is first necessary to examine the source and nature of those rights which may be susceptible to such amendments. This chapter explores the nature of the various rights held by scheme members with reference to their sources, being either legislation, contract or equity. This necessarily requires a broader examination of the legal nature of the managed investment scheme generally, and the scheme constitution in particular.

As a form of collective investment, managed investment schemes facilitate the division of ownership and control of the fund. This allows investments to be pooled and professionally managed in order to diversify risk and maximise return. Upon forgoing a direct right of participation in the management of the fund, investors receive certain rights and correlating remedies which ensure that the responsible entity is adequately accountable and the powers and discretions vested in it are legitimately exercised. While the responsible entity must be provided with sufficient freedom in order to ensure return is maximised, investors must be ascribed adequate protections, as they bear the capital risk of the venture.

While a trust mechanism is utilised as the machinery facilitating the holding of the scheme property, it is not the sole source of substantive rights relating to the scheme as a whole. The rights which investors receive in consideration for forgoing direct control are derived from three sources: statute, contract and equity. The trust does not govern the statutory and contractual relationship between the parties, but rather is subject to it. As is the case with corporate shareholdings, membership confers a bundle of rights. The scheme is therefore sui generis and outside general law classifications. Each of the three sources of rights will be examined in turn.

3.1 Rights Derived from Statute

3.1.1 The Statutory Regime

The Act was amended by the Managed Investments Act 1998 (Cth), inserting a new Chapter 5C dedicated to the regulation of managed investment schemes. The

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1 See Glover J, 'Lock v Westpac Banking Corporation and the Problem of Superannuation Fund Surpluses' (1992) 9 Australian Bar Review 172 at 180-181, where a similar observation is made with respect to superannuation schemes.

2 Kam Fan Sin proposes that the legal nature of the unit trust is in the form of 'a trust embedded in a contract', the primary source of legal rights and responsibilities being the contractual relations between the parties. The trust is utilised as a holding device for the scheme property, being merely a term of the contract created by mutual consent between the trustee and beneficiaries rather than by the unilateral intention of the settlor, as is the case in traditional trusts for the disposition of property. This results in the nature of the trust being far removed from that of a common private trust. This distinction is grasped by Dr Sin in order to distinguish the property rules applicable to trusts, such as the rule against perpetuities the rule in Saunders v Vautier (1841) 4 Beav 115; 49 ER 282 and the creation of resulting trusts: Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 at 101-104.
amending legislation was assented to on 29 June 1998 and commenced operation on 1 July 1998.

The MIA is unique in its approach to regulating collective investment schemes. Unlike the United States, where collective investment schemes invariably take the form of registered companies, managed investment schemes in Australia maintain their trust structure. As is the case in Australia, collective investment schemes in the United Kingdom are operated as either unit trusts or investment companies, the former being the more dominant legal form. Unit trusts in the United Kingdom are regulated by the Financial Services Act 1986 (UK) in a manner similar to the former Part 7.12 of the Corporations Law in Australia. Unlike the MIA, the United Kingdom legislation maintains the requirement for both a trustee and management company, as well as an authorised trust deed.

The MIA prohibits a person from operating a managed investment scheme unless the scheme is registered where either it has more than twenty members, was promoted by persons in the business of promoting managed investment schemes, or a determination by ASIC requires registration. Schemes involving only excluded issues of securities are not required to be registered. To fall within the definition of 'managed investment scheme' the following characteristics must be present:

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3 Although commonly referred to as unit investment trusts, collective investment schemes in the United States are established as corporations and regulated under the Investment Company Act 1940. Investment companies can either be open-ended or closed-ended. Open ended schemes, commonly known as mutual funds, provide investors with the ability to have their shares redeemed at their current net asset value: Australian Law Reform Commission & Companies and Securities Advisory Commission, A Review of Collective Investment Schemes in Overseas Jurisdictions, 1993, Chapter 4.


6 Section 601ED.

7 Section 601ED(2), s66(2). Where a scheme is operated in contravention of the registration requirement, the court may make an order to wind up the scheme upon application by ASIC, the person operating the scheme or a member: s601EE.

8 Section 9. Compare the prior definition of 'prescribed interest' which provided the basis of the present definition: ALRC/CSAC Vol 1 at 19. The definition included a 'participation interest', being any right to participate, or any interest in either:

(a) any profits, assets or realisation of a financial or business undertaking or scheme.
(b) any common enterprise in relation to which the holder of the right or interest is led to expect profits, rent or interest from the efforts of the promoter or a third party.
(c) any investment contract, being a contract, scheme or arrangement involving the investment of money where the investor acquires an interest or right in respect of property, which may be used or employed in common with other interests or rights in respect of property.
1. Members contribute money or moneys worth to acquire rights to benefits produced by the scheme.\(^9\)

2. Any of the contributions are pooled or used in a common enterprise to produce financial benefits, or benefits consisting of rights or interests in property, for the members.\(^10\)

3. Members do not have day to day control over the operation of the scheme (not including the right to be consulted or to give directions).

The definition encapsulates not only public unit trusts, being the subject of this paper, but a diverse range of other collective investments such as trustee common funds and some limited partnerships.\(^11\) The Act also potentially regulates enterprise schemes where assets are managed on behalf of several people, such as time share schemes, property syndicates and agricultural schemes. The legislation excludes certain collective investment vehicles from the regime, either because they are already prudentially supervised under other Acts of Parliament, such as superannuation funds under the *Superannuation Industry (Supervision) Act 1993* (Cth) and statutory funds under the *Life Insurance Act 1995* (Cth), or because they provide for a level of investor participation, such as partnerships and corporations.\(^12\) ASIC has power to grant exemptions from compliance with the Act.\(^13\)

Unlike the two-party structure under the former Part 7.12, the MIA requires there to be a single responsible entity who is responsible for operating the scheme,\(^14\) as well as holding the scheme property on trust for the benefit of member.\(^15\) As such, the responsible entity is the company primarily responsible to scheme members for the management and operation of the scheme and the scheme property. The employment of a single party responsible for both the management and trust aspects of the scheme was implemented in order to overcome the perceived problems inherent in the prior two-party system, being namely that separate parties responsible for the commercial operations and the holder of fiduciary obligations towards members tended to cause confusion when ascribing ultimate legal responsibility.\(^16\) A further motivation was that

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\(^9\) See *Australian Softwood Forests Pty Ltd v Attorney-General* (NSW) 148 CLR 121 at 129; *ASC v United Tree Farmers Pty Ltd* (1987) 24 ACSR 94.

\(^10\) See *Munna Beach Apartments Pty Ltd v Kennedy* [1983] 1 Qd R 151; *Co-op Building Society of South Australia Ltd v ASC* (1993) 10 ACSR 89; *Australian Softwood Forests Pty Ltd*, ibid, at 133.

\(^11\) ALRC/CSAC Vol 1 at 19-29.

\(^12\) See reg 5C.11.01 for further exclusions.

\(^13\) See *Section 601QA*.

\(^14\) Section 601FB(1).

\(^15\) Section 601FC(2). ASIC has stated that in most cases, the standards required for the proper safe keeping of scheme property could only be met by the appointment of a third party custodian: *ASIC Policy Statement 133.5*. Where a custodian is appointed, the responsible entity remains primarily responsible for the acts of that custodian: s601FB(2). As such, the custodian would hold the property on a bare trust, while the responsible entity would hold the beneficial title to the scheme property for the benefit of scheme members: Hanrahan P, "Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law" (1999) 17 CSLJ 67 at 68.

\(^16\) This motivation for implementing a single entity structure has been challenged on the basis that there would have been no confusion under the prior law provided managers and trustees had been adequately advised as to their rights and responsibilities: Hanrahan P, "(Ir)responsible Entity: Reforming Manager Accountability in Public Unit Trusts" (1998) 16 CSLJ 76 at 84.
a single-party structure would harmonise managed investment regulation with the regulation of trustee companies in the superannuation industry.\textsuperscript{17}

The MIA requires that the responsible entity be a public company and hold a relevant dealer's licence.\textsuperscript{18} Although it has power to delegate any aspect of its role, the responsible entity remains primarily responsible for the acts of the agent.\textsuperscript{19} However, it may seek indemnification from the scheme property if appropriate provisions are included in the scheme constitution.\textsuperscript{20} The legislation imposes a series of duties on the responsible entity,\textsuperscript{21} such as the duty to act honestly,\textsuperscript{22} not to make improper use of information,\textsuperscript{23} and to exercise care and diligence.\textsuperscript{24} Further duties include the duty to segregate scheme property,\textsuperscript{25} to act in the best interests of members and to give priority to members' interests where a conflict arises,\textsuperscript{26} and the obligation to act impartially. Similar duties are imposed on both the officers and employees of the responsible entity.\textsuperscript{27}

Investor protection is enhanced by the introduction of the requirement for a scheme to maintain a compliance plan,\textsuperscript{28} which must be lodged upon registration,\textsuperscript{29} audited,\textsuperscript{30} and which the responsible entity is under a duty to comply with.\textsuperscript{31} Where less than half of directors of the responsible entity are external directors, a compliance committee must be established in order to monitor and assess the operation of the scheme and the execution of duties by the responsible entity.\textsuperscript{32} Furthermore, a modified version of the related-party provisions in Part 3.2A is applied to schemes by virtue of Part 5C.7, as well as the introduction of Part 2G.4 which regulates the conduct of scheme meetings.

\textsuperscript{17} This motivation for reform was supported by proposal 89 of the Wallis Report: Financial Systems Inquiry, Final Report, Australian Government Publishing Service, March 1997 at 480. Hanrahan has also challenged this motivation given the inherent differences between superannuation and public unit trusts: \textit{ibid} at 85.

\textsuperscript{18} Section 601FA. See \textit{ASIC Policy Statement} 130-131 for the criteria used to assess applications for licences.

\textsuperscript{19} Section 601FB(2).

\textsuperscript{20} Section 601GA(2). However, where the agent indemnifies the responsible entity, the money recovered forms part of the scheme property where the loss or damage relates to a failure by the responsible entity in performing its duties: s601FB(4).

\textsuperscript{21} Section 601FC. Unlike the prior sl069 and reg 7.12.15 where duties were imposed indirectly by way of compulsory covenants included or deemed to be included in the trust deed, the current legislation imposes duties in the form of provisions of the Act, thereby being the subject of the legislation's penalty provisions. This may also be contrasted with s52 of the \textit{Superannuation Industry (Supervision) Act} 1993 (Cth).

\textsuperscript{22} Section 601FC(1)(a).

\textsuperscript{23} Section 601FC(1)(e).

\textsuperscript{24} Section 601FC(1)(b).

\textsuperscript{25} Section 601FC(1).

\textsuperscript{26} Section 601FC(1)(c), which was previously required under reg 7.12.15(1)(f)(i).

\textsuperscript{27} Sections 601FD and 601FE respectively. Note that any duties placed on the responsible entity by virtue of s601FC(1) override any conflicting duties its officers may owe to the company under s232. In relation to the duties and obligations of directors of the responsible entity generally, see Hanrahan P, \textit{Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law} (1999) 17 CSLJ 67.

\textsuperscript{28} Section 601HA.

\textsuperscript{29} Section 601EA(4)(b).

\textsuperscript{30} Section 601HG.

\textsuperscript{31} Section 601FC(1)(h).

\textsuperscript{32} Sections 601JA and 601JC.
Finally, Part 5C.6 creates a new regime for withdrawal by members from the scheme. While the scheme constitution may make provisions for members to withdraw when the scheme is liquid, members cannot withdraw from a scheme which is not liquid except in accordance with a specified statutory system of offers. This new regulation attempts to prevent a recurrence of the property trust collapses in the late 1980s.

3.1.2 The Act as a Source of Rights

The legislation creates a plethora of legal rights and correlating obligations on members in managed investment schemes. For instance, members may vote at a members meeting on a resolution in order to replace the responsible entity, amend the scheme constitution, or to approve a related party transaction. Either 100 members or members holding at least 5% of the votes which may be passed are granted the right to request or call and arrange a meeting to consider a resolution. A member holding 5% of the votes may call a meeting to consider directing the winding up of the scheme. Furthermore, in relation to the receipt of information, members have the right to receive yearly financial statements, to inspect any registers held by the responsible entity and the minutes of members' meetings, and to seek an order for the inspection of the books of the scheme.

As well as the responsible entity being liable for a civil penalty order and possibly a criminal sanction upon breach of its statutory duties, a member who suffers loss due to the conduct of the responsible entity in contravention of the Act has a statutory right to seek compensation, as well as standing to seek an injunction or a wide variety of other orders. These remedies are equally available to members upon a

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33 Section 601KA. 'Liquid scheme' means a scheme in which 80% of the assets are liquid, being assets which can reasonably be expected to be realised within the period specified in the constitution in order to satisfy withdrawal requests: s601(4), s601(6).
34 Sections 601KB-601KE.
36 Section 601FM.
37 Section 601GC(1). It is uncertain whether members have a power to propose amendments to be considered by a members' meeting. If not, the amendment power in s601GC(1) will operate as a veto mechanism for amendments introduced by the responsible entity. See further 7.1.1 below.
38 Parts 5C.7 and 2E.5.
39 Section 252B.(1).
40 Section 252D.
41 See further 7.1.1 below.
42 Section 601NB.
43 Section 314.
44 Section 173(1).
45 Section 253N.
46 Section 247A(1). As beneficiaries under a trust, scheme members also have a general law right to inspect the trust accounts and documents: Hartigan Nominees Pty Ltd v Rydge (1992) 29 NSWLR 405.
47 Sections 1317DA and 1317FA.
48 Section 601MA.
49 Section 1324.
50 Section 1325. Reg 5C.11.07 deems s1325 to apply to contraventions or likely contraventions of Chapter 5C. The types of orders include a declaration that the contract is void, a variation of the contract or arrangement, the deeming of certain provisions of the contract to be unenforceable and the directing that the contravening person pay money or supply specified services: s1325(5). Hanrahan has observed that as s1325 is drafted in substantially wider terms than s601MA(1), it may
breach of duties ascribed by the scheme constitution, provided that such duties are not inconsistent with the Act.  

Therefore, the Act provides an ample source of rights to be enjoyed by members upon entrusting their funds to the responsible entity. As these rights are derived from an Act of Parliament and not expressed to be subject to the scheme constitution or the general law, they are indefeasible and cannot be excluded or diminished.

3.2 Rights Derived from Contract

The constitution of a managed investment scheme, like documents governing other forms of associations and business enterprises, establishes the rules governing the activities of the scheme, as well as the relationships between the various parties within it. It is the source of contractual rights and obligations between the parties, and moulds the incidents of trust such as the fiduciary obligations imposed on the responsible entity.

3.2.1 The Scheme Constitution

Under the statutory regime, the scheme constitution must be lodged with ASIC upon application to register the scheme.  The legal nature of the constitution is not specified, the Act only requiring that it be legally enforceable as between scheme members and the responsible entity. The following subsection examines how this requirement can be complied with.

In order to comply with s601GB, the constitution must be enforceable bilaterally by both scheme members as against the responsible entity, as well as by the responsible entity as against scheme members. This is important where the constitution contains covenants made by members in favour of the responsible entity, such as:

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entirely subsume its operation: Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 131.

Section 601FC(1)(m).

Section 601EA(4). If this requirement is not satisfied, ASIC will not register the scheme: s601EB(1)(e). For listed schemes, see ASX Listing Rules 13.1 and 15.11.

Compare the prior requirements under Division 5 Part 7.12 for a unit trust to have an approved deed upon issues of prescribed interests. Trust deeds under the old regime invariably took the form of a deed executed between the trustee and management companies.

Section 601GB.

While the Act requires that the constitution be binding as between members and the responsible entity, it does not require that it be binding between members inter se. Such enforcement may be an issue where there are covenants made between members, such as a provision for pre-emptive rights. This may be compared with the corporate statutory contract which is binding 'between a member and each other member': s140(1)(c). As a result of the decision of Smith v Anderson (1880) 15 Ch D 247 it is generally believed that a unit trust deed, and therefore a scheme constitution, is not binding between members, as there are no mutual rights and obligations created between members, and the acknowledgment of such mutual rights would result in the trust being an illegal association under the current s115: see Smith v Anderson, supra, at 274 per James LJ; AF & ME Pty Ltd v Aveling (1994) 14 ACSR 499 at 519 per Heerey J. However, it has been argued that a multipartite contract does in fact exist between the parties in a unit trust, therefore being enforceable between unitholders inter se: see Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 a: 83-92; Sin K F, 'Enforcing the Unit Trust Deed Amongst Unitholders' (1997) 15 CSLJ 108. It is also arguable that the responsible entity holds the benefit of contractual promises between members on trust for
• a covenant that members are not to exercise their right to vote their interest where they are an associate of the responsible entity.\textsuperscript{56}
• a covenant that members are not to exercise their right to vote their interest where they are likely to benefit from a proposed transaction.\textsuperscript{57}
• a covenant that members are to notify the responsible entity of any change in details for the purpose of the members register.\textsuperscript{58}
• a covenant requiring members to pay money upon the responsible entity making calls on unpaid or partly paid units.
• a covenant preventing members from acquiring more than a certain proportion of the units in the fund.\textsuperscript{59}
• notice and procedural requirements for the transfer of units by members to third parties.

If it were possible for the constitution to be executed by both members and the responsible entity, bilateral contractual enforcement would not pose a problem. However, it is not practical for members to individually be parties to the constitution for two reasons. First, in order to comply with the legislation, the constitution must be executed and lodged with ASIC for registration prior to an offer being made to the public to subscribe for units.\textsuperscript{60} This being the case, it would be impractical for each member to individually execute the document given they have not subscribed for units at that point in time. Secondly, difficulties arise in the case of listed schemes due to interests being readily transferable and the body of members being fluid.\textsuperscript{61} Where interests are transferred on secondary markets it would be inconceivable for each new holder to individually execute the constitution. Members would therefore not be privy to the constitution as a contract.

These difficulties may be resolved by the unilateral execution of a \textit{deed poll} by the responsible entity.\textsuperscript{62} Upon execution, the constitution may be enforced on four basis, thereby satisfying the statutory requirement. Each basis will be dealt with in turn:

(a) Enforcement by virtue of the \textit{Corporations Law}.
(b) Enforcement by members as beneficiaries.
(c) Enforcement by virtue of an express contract.
(d) Enforcement by virtue of an implied contract.

other members: \textit{West Merchant Bank v Rural & Agricultural Management Ltd} CLS 1996 NSWSC CA 45, 4 April 1996 per Sheller JA (with whom Mahoney JA and Power JA agreed).

This covenant was formerly required by reg 7.12.15(3). The covenant is now rendered redundant as a result of s253E, which prohibits associates of the responsible entity from exercising their vote on a resolution where they have an interest in the resolution in a capacity other than a member.

Former reg 7.12.15(4) required deeds to contain a covenant preventing interested members from voting at a resolution seeking approval for the disposal of real property either amounting to greater than 50% of the real property holdings or which involved a disposal to the manager or trustee companies. No such provision is required under the MIA.

Section 168(1) requires the responsible entity to maintain a register of members.

As was the case in \textit{AF & ME Pty Ltd v Aveling} (1994) 14 ACSR 499 and \textit{West Merchant Bank v Rural & Agricultural Management Ltd} CLS 1996 NSWSC CA 45, 4 April 1996.

There is no ready secondary market for interests in \textit{unlisted} schemes.

Where there are other parties to the deed, such as a custodian or other agent of the responsible entity, the constitution may be construed as an indenture \textit{inter partes}.\textsuperscript{62}
(a) Enforcement by Virtue of the Corporations Law

The responsible entity is under a duty to carry out or comply with any duties stipulated in the scheme constitution, provided they are not inconsistent with the Act.\(^{63}\) By virtue of this requirement, certain provisions of the constitution, being a private agreement, are given statutory force.\(^{64}\) As such, as well as having the status of civil penalty provisions under the Act, scheme members may seek statutory compensation for loss resulting from a breach of constitutional provisions by the responsible entity,\(^{65}\) and may approach a court for other remedies such as an injunction to prevent such a breach,\(^{66}\) a declaration that the contract is void, a variation of the contract or arrangement, the deeming of certain provisions of the contract to be unenforceable or the directing that the contravening person pay money or supply specified services.\(^{67}\)

However, these courses of action are only available upon breaches or prospective breaches of provisions which may be properly described as duties ascribed to the responsible entity. This requires a distinction to be drawn between duties and mere contractual undertakings, only the former being enforceable by virtue of the legislation. Furthermore, the statute does not provide for a means of enforcement by the responsible entity against scheme members,\(^{68}\) but only enforcement by scheme members.

(b) Enforcement by Members as Beneficiaries

Even though not a party, the members may enforce the terms of the trust by virtue of their position as beneficiary, as expressed by Cotton LJ in Gandy v Gandy:\(^{69}\)

Now, of course, as a general rule, a contract cannot be enforced except by a party to the contract; and either of two persons contracting together can sue the other, if the other is guilty of a breach of or does not perform the obligations of that contract. But a third person - a person who is not a party to

\(^{63}\) Section 601FC(1)(m).
\(^{64}\) Note that the ALRC/CSAC recommended against this provision, as it would result in ASIC prosecuting for breaches of a private agreement: ACLR/CSAC Vol 1 at 95.
\(^{65}\) Section 601MA.
\(^{66}\) Sections 1324.
\(^{67}\) Section 1325. Reg SC.11.07 deems s1325 to apply to contraventions or likely contraventions of Chapter 5C.
\(^{68}\) Section 601MA is limited to claims by 'members'. Sections 1324 and 1325 are not so limited, providing a means by which the responsible entity can enforce the provisions of the Act against members. Section 1324 gives standing to 'a person whose interests have been, or are would be affected by the conduct', while s1325 provides standing to a person who is a party to the proceedings who 'has suffered, or is likely to suffer, loss or damage because of conduct of another person'. However, the sections only provide recourse where there is a breach of the 'Law', being the provisions of the Corporations Law: s8(2). Unlike the responsible entity, scheme members are not under a statutory obligations to comply with duties ascribed by the scheme constitution: s601FC(1)(m). As such, in order to assist the responsible entity in enforcing the constitution under these provisions, it must be shown that the members were in some way also in contravention of provisions of Chapter 5C. As there are no duties placed on scheme members by virtue of the Act, this cannot occur.

\(^{69}\) (1885) 30 Ch D 57 at 66-67. See also Sacher Investments Pty Ltd v Forma Stereo Consultants Pty Ltd [1976] 1 NSWLR 5 at 12.
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the contract – cannot do so. The rule, however, is subject to this exception: if the contract, although in form it is with A, is intended to secure a benefit to B, so that B is entitled to say he has a beneficial right as cestui que trust under the contract, then B would, in a Court of Equity, be allowed to insist upon and enforce the contract.

Therefore, as scheme members are placed in the position of beneficiaries under the trust, the covenants being made for their benefit, they may enforce the terms of the trust as against the responsible entity, irrespective of the fact that they are not a party to the deed.

However, enforcement by virtue of the trust relationship is only possible for provisions of the constitution which relate to the trust and the trust property. Any other obligations or rights provided by the constitution must rely on contractual principles for their enforcement. Furthermore, as is the case with enforcement by virtue of statutory standing, covenants made by scheme members would not be enforceable by virtue of the trust relationship alone and would require the existence of a legally binding agreement between the responsible entity and scheme members.

(c) Express Contract formed upon Application

It is common practice that upon becoming a member, an investor will sign an application form either incorporating the terms of the deed or undertaking that they are bound by the terms of the constitution.™ Similarly, provisions in the deed usually provide that members are entitled to the benefit of and are bound by the terms and conditions contained in the deed as if they were a party to it. As such, the covenants will be enforceable against members by virtue of an individual contract between the responsible entity and each member, incorporating the terms of the constitution. On this point, Professor Ford states:71

So far as legal relations between the manager and the unit holders are concerned they would appear to arise from the acceptance of the application of units made by an investor to the manager. A contract comparable to the contract which arises upon allotment of shares in a company would result from that acceptance. By the common form of application the applicant agrees to be bound by the provisions of the trust deed and the terms of the offer of units. The manager’s acceptance of the application and the allotment of units is likely to be regarded as a contract on the terms of the trust deed so far as it imposes obligations on the manager vis-à-vis unit holders and vice versa.

This position was accepted by Brooking J of the Supreme Court of Victoria in Graham Australia Pty Ltd v Corporate West Management Pty Ltd, and remains the position in relation to members and the responsible entity under the single-party regime. Therefore, irrespective of the members not being a party to the constitution itself, the provisions of the constitution may be enforceable by virtue of individual

70 Stewart R, ‘Unit Trusts – Legal Relationships of Trustee, Manager and Unitholders’ (1988) 6 CSLJ 269 at 270.
72 (1990) 1 ACSR 682 at 687.
contracts created upon the application and allotment of units. Undertakings made by both scheme members and the responsible entity will be contractually enforceable in this regard.

However, the issue is somewhat more difficult with regards to listed schemes. Where a person acquires their interest on the secondary market, no formal application form is signed, there being no privity of contract between the acquirer and the issuer of the units. In such cases, recourse may arguably be made to the existence of an implied contract between the responsible entity and members.

(d) Implied Contract

In the above case, Brooking J observed that irrespective of such contracts, the parties may still be bound by the provisions of the constitution, stating:73

One way or another the plaintiff could enforce against the manager the repurchase provisions of the deed, if not on the basis suggested by Ford, then in consequence of the parts of the deed to which I have earlier referred. In the circumstances, consideration of how the law stands after the momentous decision of the High Court in Trident General Insurance Co Ltd v McNiece Bros Pty Ltd (1988) 165 CLR 107; 80 ALR 574, is unnecessary.

These comments, although obiter, hint at the possibility that the requirement for there to be privity of contract between members and the responsible entity may be departed from in certain circumstances. The terms of the constitution evidence a manifest intention by both parties that the provisions bind the parties.74

Content Requirements

Unlike the former Part 7.12 which imposed a series of covenants required to be incorporated into the deed,75 the MIA does not mandate extensive content requirements for the constitution. There is a wide scope for the constitution to be tailored to the nature of a particular scheme. All that is required is that ‘adequate provisions’ be made for the following:76

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74 A further possibility, discussed by Professor Ford in the context of two-party unit trusts, would be to recognise the creation of a trust of the contractual promises. This would require the manager or trustee to be a trustee of the other’s promises for the benefit of unitholders: Ford, *supra*, at 410. In relation to promises made by the trustee to unitholders, the manager would hold the benefit of those promises on trust for the benefit of unitholders. The manager can thereby be bound by a court of equity to enforce those promises as against the manager. Evidence of an intention by the parties to create such a trust would be satisfied by a provision that the deed is intended to bind and benefit unitholders. However, this construction is dependant on there being two parties to the deed. Given that there is no longer a manager to enforce the promise, this basis has no application under the present law.

75 Section 1069(1)(b); Regs 7.12.15 and 7.12.15A.

76 ASIC may refuse to register a scheme if the above requirements are not satisfied: s601EB(1). Furthermore, the responsible entity is under a duty to ensure the constitution meets these content requirements: s601FC(1)(f).
(a) the consideration paid by members to acquire their interest in the scheme.  

(b) the powers of the responsible entity in investing and dealing with scheme property.  

(c) the method complaints by scheme members are to be dealt with.  

(d) winding up of the scheme.  

(e) rights of the responsible entity to be paid fees and be indemnified out of scheme property.  

(f) powers of the responsible entity, if any, to borrow or raise money for the purposes of the scheme.  

(g) the rights of members to withdraw from the scheme and the procedures for making and dealing with withdrawal requests.  

In order to assist in the interpretation of the requirements, ASIC has released a policy statement dealing with the content of the constitution. The requirement that there be 'adequate provisions' is interpreted as meaning 'certain and complete in a contractual sense', allowing the reader to determine how a matter is to be dealt with without having to rely on extrinsic material or on further agreements between the parties.  

In relation to the requirement to provide for the consideration to be paid for acquiring an interest, it is sufficient if the constitution provides for an independent verifiable price. Requirement (b) above will be satisfied where the responsible entity has been granted the capacity to deal with property as if a natural person, such as the capacity of a company in s 124(1). Therefore, the scheme's investment policy need not be stipulated in the constitution. The provisions relating to complaints procedures must provide for a method which is consistent with the Australian Standard on Complaints Handling. The only requirement in relation to the winding up of the scheme is that the provisions deal with the possible range of circumstances under which a scheme may be wound up, being consistent with Part 5C.9, and provide for an independent audit by a registered company auditor of the final accounts after winding up.  

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77 Section 601GA(1)(a).  
78 Section 601GA(1)(b).  
79 Section 601GA(1)(c).  
80 Section 601GA(1)(d).  
81 Section 601GA(2).  
82 Section 601GA(3). Note that of the scheme is listed, liabilities are restricted to 60% of total tangible assets: ASX Listing Rule 13.2.  
83 Sections 601GA(4) and s 601KA(1).  
85 Ibid, PS 134.18.  
86 Ibid, PS 134.19. Class Order 98/52 provides relief from this requirement in certain circumstances.  
87 Ibid, PS 134.22. While all aspects of the Standards need not be included, the constitution must at least contain provisions for the following:  
   a) acknowledgment of complaints.  
   b) consideration of complaints within a reasonable timeframe.  
   c) communication with members.  
   d) advising members for any further avenues for complaint.  
88 Ibid, PS 134.23.  
89 Ibid, PS 134.24.
Finally, requirement (g) above is satisfied where the rights of withdrawal set out how members can withdraw, and what exit price will apply. The method of calculating the exit price must be fair to all members and independently verifiable. Fairness requires that the price be determined on an appropriate and reasonably current valuation of the scheme property. Provided they meet the above criteria, withdrawal provisions will be treated as complying with the Act unless they unreasonably disadvantage one group of members. Where the scheme is listed, no right of withdrawal can be granted.

3.2.3 The Constitution as a Source of Rights

In light of the foregoing, it can be concluded that members receive various contractual rights by virtue of the scheme constitution as a commercial contract. Common provisions include the right of members to receive distributions of income during the course of the scheme, as well as a distribution of surplus funds upon its winding up. Also, depending on the terms of the particular constitution, members may be provided with a right to withdraw from the scheme or a right to transfer their interest to a third party. The extent of these rights obviously depends on the provisions of the particular constitution in question.

The constitution may also impose further duties on the responsible entity, going above and beyond the duties imposed by the Act and the general law. As discussed above, as well as by contractual enforcement, constitutional duties are enforceable by virtue of the statutory standing provided by s601FC(1)(m), s1324 and s1325. The enforcement of such duties is therefore more correctly described as a statutory rather than contractual right.

3.3 Rights Derived from Equity

The Act maintains the trust nature of the scheme by requiring that scheme property be held on trust. Therefore, members are also provided with various rights arising from their position as beneficiary under a trust.

90 Ibid, PS 134.25.
91 ASX Listing Rule 1.1, Condition 5(b). Listed schemes must also comply with further content requirement. ASX Listing Rule 15.12 requires the scheme constitution to contain various restrictions relating to the disposal of 'restricted securities'. ASX Listing Rule 15.13 requires provisions relating to the transfer of small interests in the scheme. ASX Listing Rule 15.14 restricts the inclusion of penalties or sanctions in the constitution relating to the acquisition of units above a certain limit.
92 Where the scheme is not liquid, the constitutional provisions relating to withdrawal must comply with the statutory regime in Part 5C.6.
93 Where a right of transfer is provided, scheme constitutions commonly reserve a discretion in the responsible entity to refuse transfers without furnishing reasons.
94 See 3.2.1(a) above.
95 This paper is only concerned with public unit trusts regulated by the MIA and not other forms of managed investment schemes such as those governed by contract alone. However, as a matter of interest, it is uncertain whether schemes not based on a trust structure are available under the MIA, as the responsible entity is deemed to hold the property on trust: s601FC(2). As s601FC(2) is located under the heading 'Duties of Responsible Entity', it could be argued that the responsible entity is under a duty to hold the scheme property, and is thereby deemed to be a trustee. However, this interpretation would seem inconsistent with the ALRC/CSAC recommendation that the legal form of the scheme should not be prescribed: ALRC/CSAC Vol 1 at 30. This is also supported by the
3.3.1 The Statutory Trust

Under the prior Part 7.12, unit trust deeds contained a declaration of trust. This practice is likely to continue under the MIA regime. However, s601FC(2) provides that the responsible entity holds the scheme property on trust. It is submitted that a managed investment scheme constitution need not contain a declaration of trust, the legislation deeming a statutory trust to exist upon the formation of the scheme and receipt of contributions.96

The requirements for the formation of a valid trust are satisfied by the participation in a managed investment scheme alone. Registration and commencement of a scheme in itself satisfies both the three certainty requirements for trust formation, as well as the statutory requirements for writing. First, with respect to certainty of intention,97 as a trust relationship necessarily flows from the registration of a scheme by virtue of the MIA, choosing to adopt the managed investment scheme as a vehicle for investment services would be adequate evidence of an intention by the parties to have the property held on trust.98 Secondly, certainty of subject matter, being simply a matter of ascertaining the identity of the property at the time of creation,99 is satisfied by the identification of the initial contribution made by the first scheme member. Thirdly, certainty of objects requires the identity of the beneficiaries to be ascertained with certainty.100 The test is whether a complete list of beneficiaries can be drawn up.101

Explanatory Memorandum to the MIA (at 8.7), which acknowledges that a trust structure may not be the only form of managed investment scheme. The better view would therefore be that the responsible entity is not under a duty to hold scheme property as such, but where it does hold property, that property is deemed to be held on trust for scheme members: see Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 67-68; Australian Corporations and Securities Law Reporter, Volume 2, CCH at [183-200]. Irrespective of this, as has been the case prior to the new regime, the trust structure is likely to remain the preferred vehicle for retail managed funds: Hanrahan P, 'Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law' (1999) 17 CSLJ 67 at 68.

This interpretation would seem not to have been intended by the legislature, as the explanatory memorandum to the MIA states that the responsible entity will be 'under a duty' to hold scheme property on trust, rather than stating that it actually holds the property on trust: para 8.13. Furthermore, ASIC has stated that it expects most constitutions to contain a declaration of trust: ASIC Policy Statement 134.11.

96 Walsh Bay Developments Pty Ltd v Federal Commissioner of Taxation (1995) 130 ALR 415 at 422.
97 It is the intention of the settlor which is relevant in determining certainty of intention: Walsh Bay Developments, supra. It is uncertain which party is the settlor in a managed investment scheme. In two-party unit trusts under the former prescribed interest regime, it was held that the manager was the settlor: Famel Pty Ltd v Burswood Management Ltd (1989) 15 ACLR 572 at 574 per French J. Under the MIA, as the definition of 'scheme property' encapsulates contributions by members, it is better to view the first member as the settlor, the trust being created upon the deposit of the first contributions which are to be held by the responsible entity on trust for that member. It would be expected that this first member would commonly be a party related to the responsible entity under the constitution. Note that Dr Sin has argued that a unit trust constitutes a trust without a settlor, the trust being created by the mutual contractual intentions of all the parties involved: Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 at 50-55. Irrespective of the identity of the settlor, it is submitted that the requisite intention exists in respect of all parties in the scheme in order to satisfy the certainty requirement.
98 Federal Commissioner of Taxation v Clarke (1927) 40 CLR 246.
99 Kinsela v Caldwell (1975) 5 ALR 337.
There would seem little difficulty in satisfying this requirement given the responsible entity is obliged to maintain a register of members.\(^{102}\)

The final issue in relation to the validity of the statutory trust is the requirement for writing where the scheme assets include real property. Section 23C(1)(a) of the Conveyancing Act 1919 (NSW)\(^{103}\) requires that an interest in land can only be created or disposed of by either a written instrument, a will, or by operation of law. Where the MIA is relied on to declare the trust, the trust would be created by operation of law, thereby satisfying this provision.

Furthermore, s23C(1)(b) requires that any declaration of trust be evidenced in writing. This requires evidence of not only the existence of the trust, but also the terms, particularly the identity of the beneficiaries, the trust property, and the nature of the trust.\(^{104}\) The terms need not be embodied in a single document, provided the documents can be connected by reference or if it is clear on their face that they may be connected to other documents.\(^{105}\) The relevant terms of the trust in the case of a managed investment scheme are embodied in both the Act and the scheme constitution. One would assume the court would connect the terms found in these two sources when interpreting the terms of the trust. That being the case, the terms would be sufficiently evidenced by the scheme constitution and the Act.

Therefore, upon a scheme being registered by ASIC, complying with the statutory requirement, and receiving the first subscription moneys from a member, a trust is validly created by virtue of the MIA. No separate declaration of trust is needed in the constitution.

3.3.2 The Trust as a Source of Rights

As a result of the trust relationship, general equitable rights afforded to beneficiaries are enjoyed by scheme members. Rights \textit{in personam},\(^{106}\) such as the right to compel performance of the trust and protect their beneficial interest,\(^{107}\) the right to pursue equitable compensation for breaches of trust or fiduciary obligations,\(^{108}\) the right to inspect trust documents\(^{109}\) and the right to seek an injunction restraining such a

\(^{102}\) Section 168(1).

\(^{103}\) In other jurisdictions, see Imperial Acts (Substituted Provisions) Act 1986 (ACT), Sch2, Pt 11, cl 1(1)(a); Property Law Act 1974 (Qld), s11; Law of Property Act 1936 (SA), s29; Conveyancing and Law of Property Act 1884 (Tas), s60(2); Property Law Act 1858 (Vic), s53; Property Law Act 1969 (WA), s34. For the Northern Territory, see Statute of Frauds 1677 (UK) (29 Chas II c3), s7.

\(^{104}\) Ryder v Taylor (1935) 36 SR(NSW) 31.

\(^{105}\) Forster v Hale (1798) 30 ER 1226.

\(^{106}\) Rights \textit{in personam} are personal rights to enforce obligations placed on the trustee to not use its common law rights as owner of the trust property in order to abuse the intentions underlying the acquisition and possession of those rights and to hold the land for the benefit of beneficiaries: Muschinski v Dodds (1985) 160 CLR 583 at 613 per Deane J. This may be compared with rights \textit{in rem}, being interests which are proprietary in nature and which attach to the trust property rather than merely fastening to the conscience of the trustee: Baker v Archer-Shee [1927] AC 844.

\(^{107}\) Store v Ford (1844) 7 Beav 333, 49 ER 1093.

\(^{108}\) Section 601MA(3) preserves liabilities under the general law. However, many of these obligations have now been given statutory expression, and therefore provide a statutory rather than equitable right of action: s601FC(1).

\(^{109}\) Hartigan Nominees Pty Ltd v Rydge (1992) 29 NSWLR 405.
breach,\textsuperscript{110} may be exercised by scheme members. Although the legal incidents of trust law flow from the creation of the relationship of trust, these incidents may be altered by the Act, as well as the provisions of the scheme constitution where they are incompatible with the mutual intentions of the parties.

A Member’s Rights in Scheme Property

Although it is clear that rights \textit{in personam} arise by virtue of a member’s beneficial position, it is arguable whether the trust relationship in a managed investment scheme also vests proprietary rights in members against the underlying scheme property. A finding that rights \textit{in rem} exist has various implications. For instance, members would have rights which can be exercised directly against the scheme property, such as the right to trace the property into the hands of a third party or into a different form upon a misappropriation by the responsible entity.\textsuperscript{111} This would provide remedies beyond mere actions against the responsible entity, providing rights of action against the world at large\textsuperscript{112} in order to enforce proprietary rights and insist that equitable interests are respected.

It is a common premise with respect to unit trusts, and therefore managed investment schemes, that as the trust is not a separate legal entity, the members have direct proprietary rights against the scheme property.\textsuperscript{113} As the legal title is held by the trustee or responsible entity, the equitable title must be held by the members. This can be compared to the position of a shareholder who has a legal interest in the corporate entity by virtue of his or her shareholding, but no direct proprietary interest in the underlying assets held by the company.\textsuperscript{114}

The conventional view, that unitholders are in the same position as beneficiaries under a common private trust and therefore obtain proprietary rights, has gained both academic\textsuperscript{115} and judicial support. The High Court decision of \textit{Charles v Federal Commissioner of Taxation}\textsuperscript{116} involved a claim by the Commissioner of Taxation that all distributions made to the appellant as a unitholder were assessable, including the distribution of profits on the realisation of various capital investments, the winding-up of companies in which shares were held, and the sale of rights in respect of shares. In

\textsuperscript{110} Attorney-General \textit{v Aspinall} (1837) 2 My & Cr 613; 40 ER 773.

\textsuperscript{111} \textit{Frith v Cartland} (1865) 2 H&M 417; 71 ER 525.

\textsuperscript{112} With, of course, the exception of a \textit{bona fide} purchaser for value with no notice of the interest.

\textsuperscript{113} As to fixed bare trusts, see \textit{KLDE Pty Ltd \textit{v Commissioner of Stamp Duties (Qld)}} (1984) 155 CLR 28. Compare the position of beneficiaries under an unadministered testamentary trust: \textit{Commissioner of Stamp Duties (Qld) v Livingston} [1965] AC 694. This can also be compared to beneficiaries of a discretionary trust, who do not have any proprietary interest in the subject matter of the trust, but merely a right to require the trustee to consider whether to exercise its discretion: \textit{Gartside \textit{v IRC}} [1968] AC 553. As managed investment schemes usually contain a predetermined means of calculating distributions, they are fixed rather than discretionary trusts.

\textsuperscript{114} \textit{Macaura v Northern Assurance Co Ltd} [1925] AC 619.


their joint judgment, Dixon CJ, Kitto J and Taylor J made the following observations:\(^\text{117}\)

...a unit held under this trust deed is fundamentally different from a share in a company. A share confers upon the holder no legal or equitable interest in the assets of the company; it is a separate piece of property, and if a portion of the company's assets is distributed among the shareholders the question whether it comes to them as income or as capital depends upon whether the corpus of their property (their shares) remains intact despite the distribution...But a unit under the trust deed before us confers a proprietary interest in all the property which for the time being is subject to the trust of the deed: Baker v Archer-Shee [1927] AC 844; so that the question whether moneys distributed to unit holders under the trust form part of their income or of their capital must be answered by considering the character of those moneys in the hands of the trustee before the distribution is made.

In Costa & Duppe Properties Pty Limited v Duppe,\(^\text{118}\) Brooking J of the Victorian Supreme Court took the proposition one step further. The unit trust deed in question contained a provision acknowledging a member's beneficial interest in the trust fund as an entirety, but excluded any rights in relation to any particular asset constituting the fund. His Honour held that a unitholder had a caveatable interest in an individual item of trust property, stating that 'if there is a proprietary interest in the entirety, there must be a proprietary interest in each of the assets of which the entirety is composed'.\(^\text{119}\) Therefore, as well as reinforcing the High Court's finding in Charles v FCT that a proprietary interest exists in all the scheme assets, the Court went further in finding a proprietary interest in each individual article of property.

Applying the above decisions to the managed investment scheme context, the position would seem to be that members in a managed investment scheme have an equitable proprietary interest in the scheme property. In the absence of a constitutional provision to the contrary, the interest is not merely in the assets as an entirety, but in each individual asset which constitutes the fund. However, several arguments may be canvassed in opposition to this view:

(i) The interest of members is dependent on the rights provided by the scheme constitution.
(ii) The recognition of a proprietary interest in large schemes does not reflect commercial reality.
(iii) The manner interests in schemes are dealt with is more akin to a property interest in the unit itself.
(iv) Commonly, the constitution will explicitly exclude a direct interest in the scheme assets.

Each of the above arguments will be dealt with in turn.

\(^{117}\) (1954) 90 CLR 598 at 609 (emphasis added).
\(^{118}\) [1986] VR 90.
\(^{119}\) Ibid, at 96.
(i) The Rights Provided by the Scheme Constitution

Depending on the relevant terms of the constitution, schemes may be categorised as either fixed investment trusts or a flexible investment trusts. While the first unit trusts introduced into England and Australia this century took the form of fixed investment trusts, the flexible investment trust has been the predominant form of unit trust since the 1950s.

Fixed investment trusts place limited discretion in the trustee to determine the scope of investment activities, such as trusts formed in order to invest in a particular property or body of securities. The scheme assets are divided into sub-units, being a block of securities constituting only one part of the larger fund. Furthermore, fixed trusts often provide members with direct rights in relation to the scheme assets, such as the ability to exchange their investment for a proportion of the assets. Therefore, investors know what underlying investments their interest represents.

Flexible investment trusts, on the other hand, are open-ended in the sense that the trustee has a wide discretion to invest in a broad range of securities and assets, resulting in a fluid portfolio of underlying investments and a greater ability to take advantage of the market conditions due to the wider discretionary powers vested in the operator of the trust. There is no direct correlation between an investment and an identified block of securities.

Given this distinction, saying that beneficiaries in unit trusts hold proprietary interests in the underlying property is far too sweeping a proposition. Whether a proprietary interest exists is an issue of construction of the relevant terms of the trust and dependent on the rights provided to the unitholder by virtue of the trust document.

For instance, the scheme in Charles v FCT was a fixed investment trust, having the following characteristics:

- investments were limited to shares and debentures in specified companies and securities authorised under the trust deed.
- holders of 3,000 units had a right to exchange their investment for the underlying securities, forming their proportion of the trust fund.
- the trustee had no right to be remunerated out of the trust fund, the fund therefore staying in tact.

Given these characteristics, it is not surprising that the Court found members to have a direct interest in those securities, as members were granted direct rights as against a generally static body of securities. The Court could not have intended its finding to later be applied to trust schemes generally. This is illustrated by their Honours'
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continual reference to 'this trust deed' and 'the trust deed before us', emphasising the limited lateral applicability of the decision.

In contrast, the unitholders in Costa & Duppe Properties were denied any direct rights against the property by virtue of the trust deed. The provision in the deed was intended to have the effect of preventing unitholders from having any rights whatsoever in any specific part of the trust fund, having a bare right to receive their share of the gain and the return of their capital. Nonetheless, the Court acknowledged a proprietary interest existed. This decision would seem to be wrongly decided. The assumption made by the Court was that Charles v FCT was directly binding, which was not the case given the divergence in the nature of the schemes.

Hence, it is incorrect to say carte blanche that members in a managed investment scheme have a proprietary interest in the scheme property. The position will depend on the extent and nature of the rights available to members by virtue of the scheme constitution. In cases where members have the ability to exchange their interest for a proportion of the underlying securities, or where their interest can otherwise be ascribed to a defined portion of the assets, a proprietary interest may exist. However, as would be expected to be the case in modern public funds, where the responsible entity has a wide discretion to vary the portfolio of investments, members are prohibited from interfering with the management of the scheme, and no direct connection between a member's interest and a particular portion of the assets can be made, acknowledging members have a direct interest in the underlying assets would not be justified.

(ii) Commercial Reality

Unlike the unit trust which was the subject of the Charles v FCT litigation, modern collective investment schemes are flexible in nature, involving both an open-ended and fluid body of securities, as well as a fluid body of investors. The responsible entity is vested with a virtually unfettered discretion in its investment activities and members are denied any direct rights against the trust property by virtue of the scheme constitution. Apart from the information provided in financial statements, investors have little knowledge of the identity of the underlying assets.

Given these factors, ascribing members a direct proprietary interest in the underlying scheme assets, irrespective of the size of their investment, would seem contrary to the commercial nature of large schemes. Commercially, investors expect to receive a regular return, receive a distribution if the scheme were to wind up, and have the ability to sell or redeem their investment. They invest into a collective fund, forgoing control over the assets to the responsible entity. The scheme assets have the same function as the capital of a company, fluctuating from time to time without the knowledge of investors. The investor entrusts money in the responsible entity, and expects money to be returned.

123 (1954) 90 CLR 598 at 609 per Dixon CJ, Kitto J, Taylor J.
124 Sin, op cit, at 288.
As such, it is more appropriate to view the interest as being in a proportion of the fund rather than the underlying assets. As well as the ability to enforce the terms of the trust and enjoy the various rights provided by statute and the constitution, members have a right to the income and surplus after realisation of the assets and the satisfaction of all liabilities. They have no specific title to the assets.\(^{126}\)

(iii) Dealings in Scheme Interests

The Act deems company shares to be personal property.\(^{127}\) No such provisions exist in relation to an interest in a managed investment scheme. Irrespective of this, a unit in a managed investment scheme may possibly be, depending on the specific terms of the constitution, a separate article of property distinct from the underlying scheme assets.

This position is supported by the methods by which scheme units may be transferred. A transfer of units may be effected in accordance with provisions in the scheme constitution. In practice, it is usual for trust deeds to provide members with a right to transfer units to third persons by providing the manager with appropriate documentation such as a transfer notice executed by both the transferor and the transferee, although a discretion is commonly retained by the manager to refuse the transfer without providing reasons.\(^{128}\) Therefore, a unit is transferable as if it were a separate article of property in much the same way as a company share.\(^{129}\) This can be compared to an interest in a traditional private trust which may only be alienated by way of an equitable assignment.\(^{130}\)

Furthermore, where the scheme property includes realty and a member is acknowledged to have a direct interest in the underlying assets, a transfer of the holdings would only be effective if made in writing by virtue of s23C(1)(c) of the Conveyancing Act 1919 (NSW), or its equivalent in other jurisdictions.\(^{131}\) However, units in listed schemes may be readily traded on the Stock Exchange,\(^{132}\) including by way of electronic transfer through CHESS.\(^{133}\) As the transfer is not executed in writing, it would be ineffective if a proprietary interest in the underlying real property was held.

\(^{126}\) This would be analogous to the position of partners: Kriewaldt J & Hemmings S, 'A Unitholder’s Interest (and Relevant Interest) in Trust Property' (1994) 12 CSLJ 451; Starke J G, ‘Extent of Interest of Unit-Holder in Particular Assets of Trust Fund’ (1987) 61 ALJ 147 at 147.

\(^{127}\) Section 1085.

\(^{128}\) As an interest in a scheme falls under the definition of ‘securities’, the Act dictates a minimum evidentiary requirement that a ‘proper instrument of transfer’ be delivered to the responsible entity: s1091. What constitutes a ‘proper instrument of transfer’ will depend on the requirements of the constitution.

\(^{129}\) However, unlike a company where investors do not obtain the status of ‘member’ until they are entered on the register of members (s246A(b)), a person becomes a ‘member’ of a managed investment scheme immediately upon receiving a right to benefit from the scheme: see s9 definitions of ‘member’ and ‘interest’. Compare this with the United Kingdom position, where reg 6.12.3 of the Financial Services (Regulated Schemes) Regulations 1991 (UK) requires trust deeds to provide that membership is achieved only upon being entered on the register of unitholders.

\(^{130}\) Comptroller of Stamps (Vic) v Howard-Smith (1936) 54 CLR 614 per Dixon J at 621-623.

\(^{131}\) PT Ltd v Maradona Pty Ltd (1992) 27 NSWLR 241.

\(^{132}\) Part 7.13 Division 3.

\(^{133}\) Clearing House Electronic Subregister System.
Finally, it is common for unit trust deeds to contain a provision limiting the rights and interests in relation to the scheme property. The nature of such clauses will vary as between constitutions. At one end of the spectrum, a provision may state that members have no right to claim any interest in the assets or otherwise interfere with the management of those assets (such as lodging a caveat). On the other end, the constitution may deny unitholders an interest in the individual assets of the trust, or any interest in the property at all. One would assume similar provisions to be contained in scheme constitutions registered under the MIA.

Depending on the particular wording of the relevant provisions, such clauses may have one of two effects on the legal rights of members. The clause may be seen as excluding or limiting proprietary rights and interests of members to those rights and interests provided for in the scheme constitution, excluding any direct equitable interest in the underlying asset. Alternatively, the clause may be viewed as a contractual undertaking by members that they will not exercise their beneficial rights where such rights are inconsistent with the constitution.

However, irrespective of the nature of the particular provisions in question or the legal effect of those provisions, the fact remains that the constitution is likely to either exclude or limit the extent of rights available to scheme members with respect to the scheme property.

The Rule in *Saunders v Vautier*

A final issue relating to whether a member has any proprietary rights in the scheme property is whether the rule in *Saunders v Vautier* is applicable to managed investment schemes. The rule establishes a right in equity to prematurely bring the trust to an end. The rule states that a sole beneficiary of full legal capacity may put an end to a trust by directing the trustee to transfer the trust property to him or herself or a nominee. The principle extends to the situation where there is more than one beneficiary. As such, it would seem to be applicable to the trust embedded in a managed investment scheme. If applicable, members will not only have personal rights against the responsible entity, but also a direct action to call for the scheme property.

However, there are two factors, one legal and the other practical, which restrict the likelihood of this occurrence. First, in relation to the legal constraint, it has been argued that the rule in *Saunders v Vautier* does not apply to unit trusts. The rule is concerned with trusts utilised to effect gifts, and has no application in the case of a

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135 (1841) 49 ER 282. See also *Queen Street Hotels Pty Limited v Byrne* [1980] ACLC 40-611.
136 *White v Edmond* [1901] 1 Ch 570.
137 *Sin, op cit*, at 114-120. However, the rule was assumed to apply to unit trusts in *Re AEG Unit Trust (Managers) Ltd’s Deed* [1957] Ch 415. See also Ford H A J, ‘Public Unit Trusts’, in Austin R P & Vann R (eds), *The Law of Public Company Finance*, Law Book Company, 1986 at 400; Hughes R A, *The Law of Public Unit Trusts*, Longman Professional, 1992 at 41.
trust which is formed by the mutual contractual relations between the parties. In this regard, Sin states:138

If the relationship of the trustee, the manager, and the unitholders are contractual, it follows that the contract must be terminated in the manner agreed between the parties or by mutual consent. It also goes against common sense to say that the unitholders can together terminate the trust, ignoring the wishes of the manager (and the trustee)...By reason of the contractual nature of the unit trust deed, it naturally follows that in the absence of unanimous agreement for variation amongst all parties (the manager, the trustee, and all unitholders), they are all bound to observe the termination provisions in the unit trust deed.

In managed investment schemes, members have a statutory right to direct that the scheme be wound up by passing a special resolution.139 Unit trust deeds commonly also provide members with a contractual right to direct the winding up of the scheme. Following from Sin’s argument, except by virtue of these statutory and contractual powers, members cannot prematurely bring the trust to an end unless the consent of all parties is obtained. This would require the consent of the responsible entity.

The second restriction on the applicability of the rule in Saunders v Vautier is that, irrespective of whether it is applicable at law, this power is unlikely to be utilised in the case of a managed investment scheme due to the impracticality of securing unanimous consent of a large body of members. If unanimous action by all the beneficiaries who are sui juris is not obtained, the courts will not assent to the request.140 In reality, such a right would largely be illusory due to the size and fluctuating nature of members as a body.141

Conclusion

Given the above, an interest in a managed investment scheme is more akin to a proprietary interest in the unit itself rather than an interest in the underlying scheme assets, as is the case with corporations.142 Members do not hold a direct proprietary interest, and therefore do not enjoy direct proprietary rights against the underlying scheme assets per se, unless such rights are provided contractually by virtue of the constitution. It is the fund, represented by the units held by the member and not the scheme property, which is subject to a member’s proprietary interest. This construction is supported by the following observation of Bryson J in Elkington v Moore Business Systems Australia Ltd:143

The units are a species of property created by the deed; by the whole of the deed and not by any particular part of it, and their nature as property is created by and can be understood only from the whole of the deed. They are

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138 Sin, op cit, at 117.
139 Section 601NB.
142 In several respects, taxation legislation equates a unit with a form of property analogous to a share: see Scholtz W, ‘The Unit as Share: Anomalies in the Treatment of Unit Trusts’ (1993) 10 Australian Tax Forum 139.
143 (1994) 13 ACSR 342 at 350 per Bryson J (emphasis added).
Part A – The Scheme and the Scheme Constitution

trust interests, derive their existence from the trust and are conditioned by whatever conditions the trust imposes on the them.

The result is that equitable rights vested in scheme members are personal rather than proprietary in nature. Members receive a right to be paid money, to ensure the proper administration of the trust, and to receive the benefit of the various rights ascribed by the MIA, the scheme constitution and the general law. Unless expressly or implicitly provided for in the scheme constitution, members have no direct rights in relation to the scheme property.

3.4 Amendments to the Scheme Constitution

The preceding discussion describes an interest in a managed investment scheme as conferring a bundle of rights on its members, derived from statute, contract and equity. The scheme constitution, being a deed binding the responsible entity and scheme members, provides both the source of contractual rights, as well as moulds the nature of equitable rights arising from the trust relationship. However, the constitution may be amended after its inception. Both contractual and equitable rights may be affected by such an amendment. Therefore, many of these rights are contingent, as they may be divested or diminished by virtue of a constitutional amendment.

This unilateral right to alter the bargain between the parties is unusual for contractual relations, the general rule being that an enforceable agreement cannot be varied at the will of one contracting party. A similar unilateral right is provided to company shareholders under s136(2), whereby the statutory contract may be modified or repealed by the company by way of a special resolution and without the consent of the other parties, ie, minority members or officers. However, given that the company contract is itself created by virtue of the legislation, a statutory power to modify that contract is somewhat more justified. Furthermore, no right is given to the board of directors, as the functionally equivalent body to the responsible entity, to amend the company constitution.

Given that both organs in a managed investment scheme (the responsible entity and scheme members in general meeting) are vested with a power to amend the scheme constitution and thereby affect the rights of other participants, it must be ensured that the judicial constraints placed on the exercise of the amendment power are adequate in order to protect the legitimate interests and expectations of the parties. The remainder of this thesis is concerned with the protection afforded to participants in a managed investment scheme who are subject to a modification to the scheme constitution.

134 Re Schebsman [1944] 1 Ch 83 at 102-3. In superannuation schemes, an amendment power may generally be provided for in the trust deed itself, provided the power does not allow for amendments without the consent of the trustee: Superannuation Industry (Supervision) Act 1993 (Cth), s60(1). Under the common law, deeds which are altered by one party without the consent of the persons taking the benefit under it, in a manner which affects the legal relations previously existing, are rendered void from the time of the alteration: Pigot's Case (1614) 11 Co Rep 26b at 27a; 77 ER 1177 at 1178; Armor Coatings (Marketing) Pty Ltd v General Credits (Finance) Pty Ltd (1978) 17 SASR 270 at 281-282 per Bray CJ; Warburton v National Westminster Finance Australia Ltd (1988) 15 NSWLR 238 at 244-248 per Hope JA.

145 Section 140(1).
constitution, and therefore a modification of their rights as members, after obtaining membership.
Part B - Amendments by the Responsible Entity

This Part is concerned with amendments to the scheme constitution effected unilaterally by the responsible entity. Both the sources of the responsible entity's constitutional amendment power and the restraints placed on that power are considered.

Chapter 4 examines the nature and scope of the power vested in the responsible entity to amend the constitution. This examination is conducted by exploring the ability to amend the constitution by virtue of the MIA, contractual provisions in the constitution itself, and rights of amendment derived from equity. What follows is an examination of the approaches to interpreting the statutory power. The third part of the chapter deals with the various restraints placed on the power, once again analysed in accordance with the sources of the restraints: statute, contract and equity.

The restraints placed on the responsible entity by equity are further the subject of Chapter 5, while Chapter 6 applies the relevant restraints discussed in these preceding chapters to particular selected amendments which may be instigated by the responsible entity.

4. The Power to Amend the Scheme Constitution

4.1 The Source of the Power

Before analysing the restraints placed on the responsible entity in seeking to alter the constitution, the source and nature of the power must first be identified. Each of the three possible sources of power, being legislation, contract and equity, are dealt with in turn.

4.1.1 Power Derived from the Legislation

Section 601GC(1) of the MIA provides that an alteration to the constitution may be effected unilaterally by the responsible entity where it 'reasonably considers the change will not adversely affect members' rights'. As such, the responsible entity has a broad power to alter the constitution without consultation with members. The only rights afforded to members in this respect is to receive a copy of the constitution upon request, provided any fees required by the responsible entity are paid. The modification does not take effect until it is lodged with ASIC.

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1 Section 601GC(1)(b). The Act provides a further supplementary transitional power to modify the trust deed in order to comply with the new regime, irrespective of any provision in the trust deed to the contrary: s1460(3); ASIC Class Order 98/53.
2 Section 601GC(4).
3 Section 601GC(2).
Part B – Amendments by the Responsible Entity

Section 601GC(1)(b) is more appropriately construed as the source of the statutory amendment power rather than the imposition of a duty upon the responsible entity exercising the power. The result is that where the responsible entity seeks to amend the constitution in circumstances where it does not reasonably believe members' rights will not be adversely affected, the purported amendment will be ultra vires and therefore void. Both statutory and equitable compensation may also accrue to members where the purported action results in a breach of the responsible entity's statutory and equitable duties to act in the best interests of the members.\(^6\)

The ALRC/CSAC Proposals

The ALRC/CSAC proposed a stricter regime for the amendment of scheme constitutions in their report on managed investment schemes.\(^7\) This proposed regime was reflected in the preliminary Bill drafted by the ALRC/CSAC,\(^8\) but did not find its way into either the initial Bill which was presented before Parliament\(^9\) or the final legislation as enacted.

In relation to amendments made by the responsible entity, the ALRC/CSAC proposals required that each director of the responsible entity certify in writing that they are satisfied, after due inquiry, that the amendment is minor and does not prejudice the interests of investors.\(^10\) The amendment is not effective unless notice of the proposed amendments is given to scheme members and a resolution accepting the proposed amendments is passed.\(^11\) If a meeting is not requisitioned within 28 days of the notice being issued, either by members, the responsible entity, or ASIC, the amendments will automatically take effect.

The resolution requirements for a members meeting under the ALRC/CSAC proposals was also more onerous than the special resolution required by the MIA as enacted. The ALRC/CSAC proposed that votes be cast by more than 25% of the total interest in the scheme, and that 75% of the votes are cast in favour of the resolution.\(^12\) This quorum requirement of 25% is not necessary under the current legislation.

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\(^{4}\) Statutory compensation may be available under s601MA(1) and s1325 where a breach of s601FC(1)(c) has occurred. However, s601FC imposes duties on the responsible entity 'in exercising its powers and carrying out its duties'. As such, it could be argued that as the action is ultra vires, it is not an effective exercise of power, thereby not resulting in a breach of s601FC(1)(c). On the other hand, it could be argued that irrespective of whether the action is ultra vires, any injury borne by members is the result of the responsible entity exercising its general power of management in s601FB(1). It could further be argued that statutory damages would accrue irrespective of a breach of the s601FC duties. Section 601MA and s1325 provide damages resulting from the conduct of the responsible entity that contravenes a provision of Chapter 5C. As the s9 definition of 'contravene' includes a failure to comply with a provision, this would encapsulate a failure to comply with the statutory requirement in s601GC(1)(b). Statutory damages would therefore arguably be available. This position is supported by the Explanatory Memorandum to the MIA (at 9.6).

\(^{5}\) Nocton v Lord Ashburton [1914] AC 932 at 952 per Viscount Haldane LC.

\(^{6}\) On the duty to act in the best interests of members, see below at 5.3.

\(^{7}\) ALRC/CSAC Vol 1.


\(^{9}\) Managed Investments Bill 1997 (Cth).

\(^{10}\) Section 183A(1)(a)(ii) Collective Investment Scheme Bill 1995 in ALRC/CSAC Vol 2 at 115.

\(^{11}\) Ibid, s183A(2), s183A(3).

\(^{12}\) Ibid, s183A(4).
Therefore, the proposed regime differs significantly from the legislation as enacted. Under the MIA, no consent from members is required, nor is there a requirement that the amendment be minor. Unlike the ALRC/CSAC proposals, the current law allows amendments to be made unilaterally by the responsible entity without the need for referral to a members’ meeting. Furthermore, the express restraint on the power differs in its terminology: the ALRC/CSAC proposals require amendments to ‘not prejudice the interest of investors’ while the MIA requires it to not ‘adversely affect members’ rights’. Finally, the current statutory restraint is satisfied if the responsible entity itself rather than individual directors of the responsible entity company holds the belief that members’ rights will not be adversely affected.

4.1.2 Power Derived from Contract

As the responsible entity is provided with the power to unilaterally amend the constitution, one must query whether the constitution may provide for a further contractual right to effect an alteration. For instance, it may be possible for the constitution to provide for a means of amendment which is less onerous than the procedure under s601GC(1), such as an ability to amend the constitution without the need for the responsible entity to be satisfied that the amendment will not adversely affect members’ rights.\(^{13}\)

It is submitted that upon a natural reading of s601GC(1)(b), a clause circumventing the legislative provision would be inconsistent with the Act and therefore not enforceable. The legislation states that the responsible entity may amend the constitution if the stated criteria are satisfied. This negative criterion cannot be circumvented by a constitutional provision. For an amendment to be made by the responsible entity, the statutory requirement must be complied with.\(^{14}\)

4.1.3 Power Derived from Equity

It must also be queried whether the responsible entity has a right to amend the constitution by virtue of its position as trustee of the scheme property. In the absence of a sufficient power of variation conferred on a trustee, the court has an inherent jurisdiction to order a variation.\(^ {15}\) However, the application of this jurisdiction is limited to minor variations to the trust instrument which are of a crucial nature. It would moreover seem unlikely that this jurisdiction will be made available to a trustee such as the responsible entity, who has an express power of variation, as such an action would result in a circumvention of the requirements of that express power.

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\(^{13}\) Constitutional provisions imposing a more onerous requirement for amendments are considered at 4.3.2 below in the context of restraints on the amendment power.

\(^{14}\) This position is the same as under the prescribed interest regime. The former s1069A(2) provided that unit trust deeds could not be amended unless the issue was voted on by a general meeting of unitholders. However, where the trustee reasonably believed the modifications would not adversely affect the rights of unitholders, a unitholders’ resolution was not required. Therefore, unless the trustee reasonably believed the amendment would not be adverse to the rights of unitholders, the amendment required the consent of unitholders. Any provision in the trust deed purporting to allow an amendment by the trustee without complying with these provisions would be of no effect.

Part B – Amendments by the Responsible Entity

Trustee legislation confers a further power on the courts to vary trusts where it is deemed expedient by reason of an absence of a power of variation in the trust instrument or by law.\(^{16}\) Once again, given that an express statutory power is granted to the responsible entity without the need to approach the courts, these legislative provisions will be of no application in this respect.

Therefore, it can be said that the only power vested in the responsible entity to seek amendments to the scheme constitution are derived from the relevant provision of the MIA.

4.2 Interpretation of the Power

As the power of amendment is vested in relatively brief terms, the scope of the power, as well as the implication of any restraints on it, will be a matter of construction of the statutory provision. This section is concerned with approaches which may be adopted by the courts in interpreting powers vested in parties to managed investment schemes generally, and the power of amendment in particular. It is argued that a distinct approach to interpretation should be adopted due to the inherent contractual and commercial nature of the scheme. In this regard, superannuation and pension scheme cases involving the application of fund surpluses assist in determining the manner in which the courts should interpret both the scope of and any restraints placed on the power.

4.2.1 Superannuation and Pension Cases\(^{17}\)

There have been several decisions by courts in Australia, England and Canada considering the scope and interpretation of the power of amendment to trust deeds in superannuation schemes. The facts the subject of litigation predominantly relate to the treatment of fund surpluses in defined-benefit schemes, being funds held by the scheme which are over and above the funds payable to members as a pension or lump sum entitlements.\(^{18}\) While this scenario is not possible in a managed investment

\(^{16}\) Trustee Act 1925 (NSW), s81; Trustee Act 1893 (NT), s50A; Trustee Act 1936 (Qld), s94; Trustee Act 1936 (SA), s59B; Trustee Act 1898 (Tas), s47; Trustee Act 1958 (Vic), s63; Trustee Act 1962 (WA), s89. The NSW provisions apply to the ACT by virtue of s8 of the Trustee Act 1957 (ACT). See Harris J W, Variation of Trusts, Sweet & Maxwell, 1975, Chpt 3.

\(^{17}\) The terms ‘superannuation’ and ‘pension’ are used interchangeably, depending on the jurisdiction being discussed.

\(^{18}\) In defined-benefit superannuation schemes, employee benefits are calculated by a formulae related to the amount of the employee’s salary, and is therefore not related to the value of the assets held by the trustee. Monetary contributions are made by the employer to ensure the scheme holds sufficient assets to meet benefit entitlements. The surplus results from there being a surplus of assets over and above benefits payable to employees. This may be compared to a defined-contribution fund (or accumulation fund), in which fixed contributions are made by members and the employer and the balance of that member’s account is distributed to him or her upon retirement: O’Connell A, ‘Superannuation – Protection for Investors’ (1995) 23 ABLR 436 at 438.
scheme, these decisions provide assistance in the likely approach the courts will take in interpreting a power of amendment.

Re Courage Group's Pension Schemes

Re Courage Group's Pension Schemes: Ryan v Imperial Brewing and Leisure Ltd involved three contributory pension schemes operated by the employer company, Imperial Brewing and Leisure Ltd ('IBL'). The schemes each had individual trust deeds, two of which contained the following amendment clause:

The Company may at any time by deed supplemental hereto add to or vary all or any of the provisions of this Deed or of the Rules and the Committee of Management shall concur in executing any such supplemental deed PROVIDED THAT no addition deletion or alteration shall be made which would (a) have the effect of altering the main purpose of the Fund namely the provision of pensions on retirement at a specified age of Members...

The issue before the Court was the appropriate interpretation of the provision in respect of the requirement for the Committee of Management to concur in the amendment. Counsel for IBL submitted that the amendment clause should be interpreted as requiring the Committee to concur in executing the supplementary deed, or else equity will treat them as having done so. Therefore, the requirement that the Committee 'shall' concur was argued to mean the Committee 'must' concur. Counsel for the members, however, argued that the Committee was vested with a discretion and unless it concurs, the supplementary deed would be invalid.

Millett J stated that as the interests of members do not necessarily coincide with the interests of IBL, these interests cannot be protected if the 'all-important' amendment power is left to the sole discretion of IBL. The second interpretation was held to apply. Given the provisions of the trust deed and the allocation of powers vested in each party, his Honour was unwilling to confer absolute control on the employer to give effect to amendments without the consent of the Committee. In this regard, his Honour stated:

In a managed investment scheme, unlike a defined-benefit superannuation scheme, members' distribution rights correlate to the proportion of their interest in the scheme assets. As the beneficial entitlement to the whole of the fund is divided between members, no surplus can arise. It is not required for present purposes to examine the issue of pension fund surpluses in detail, as the cases are used merely to extract basic principles of interpretation and approaches by the court in applying traditional trust law to modern collective investment trusts. In this regard, the superannuation scheme provides the closest analogy to the managed investment scheme which has been the subject of significant judicial examination. For general discussions on the legal implications of fund surpluses, see Glover J, 'Lock v Westpac Banking Corporation and the Problem of Superannuation Fund Surpluses' (1992) 9 Australian Bar Review 172; Austin R P, 'The Role and Responsibilities of Trustees in Pension Plan Trusts', in Youdan T G (ed), Equity, Fiduciaries and Trusts, Carswell & Law Book Company, 1989; Dickson M L, 'Pension Surplus', in Youdan T G (ed), 'Equity, Fiduciaries and Trusts', Carswell & Law Book Company, 1989; Walker R, 'Some Trust Principles in the Pensions Context', in Oakley A J (ed), Trends in Contemporary Trust Law, Clarendon Press Oxford, 1996. See also Superannuation Industry (Supervision) Act 1993 (Cth), s117(5) which limits the circumstances in which a trustee of a standard employer-sponsored fund can pay amounts of the fund to an employer-sponsor.

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21 [1987] 1 All ER 528.
22 Ibid, at 536.
23 Ibid, at 536.
What I find decisive is that there is no readily apparent reason to require the committee of management to join in executing any amending deed if this is a mere formality, while to exclude any discretion in the committee will not only deny any effective protection to the members, but would make nonsense of the careful allocation of power found elsewhere in the trust deeds and rules. What is the point of conferring a power on the committee, or requiring the committee's consent to be obtained, if the power can be assumed by the company or the committee's consent can be dispensed with by an amendment by the company alone in which the committee is bound to concur? I conclude, therefore, that in the case of these two schemes also the committee of management has a discretion and is not bound to concur in executing the amending deeds.

Millett J proceeded to offer several observations with respect to the construction of trust deeds and rules of pension schemes:

...there are no special rules of construction applicable to a pension scheme; nevertheless, its provisions should wherever possible be construed to give reasonable and practical effect to the scheme, barring in mind that it has to be operated against a constantly changing commercial background. It is important to avoid unduly fettering the power to amend the provisions of the scheme, thereby preventing the parties from making those changes which may be required by the exigencies of commercial life.

This approach to interpretation of superannuation trust deeds was followed by Waddell CJ of the Supreme Court of New South Wales in Lock v Westpac Banking Corporation and by the New Zealand Court of Appeal in Re UEB Industries Ltd Pension Plan. In the latter decision, Richardson J stated:

Pension plans are different in nature from traditional trusts. There is an interrelationship of contract law and trust law in any pension scheme. Their contractual and commercial origin makes a practical and purposive approach to the interpretation of the document constituting a pension scheme particularly appropriate.

This quote highlights one of the crucial distinctions between superannuation schemes and traditional private trusts. Traditional trusts are predominantly formed as a means of disposing property. The trust beneficiaries are therefore volunteers. This is not the

24 Ibid, at 537.
25 (1991) 25 NSWLR 593. See also the following English decisions: Mettoy Pension Trustees Ltd v Evans [1990] 1 WLR 1587 at 1610-1611 per Warner J; Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd [1991] 2 All ER 597 at 605-606 per Browne-Wilkinson VC; Davis v Richards & Wallington Industries Ltd [1991] 2 All ER 563 at 590; Thrells Ltd v Lomas [1993] 2 All ER 546 at 557; British Coal Corp v British Coal Staff Superannuation Trustees Ltd [1993] PLR 303; LRT Pension Fund Trustee Co Ltd v Hatt [1993] PLR 227. In the United States, pension plans are construed, where possible, to avoid the forfeiture of vested rights from employees: see the United States Court of Appeal decision of Hoefel v Atlantic Tack Corp 581 F.2d 1 (USCA First Circuit, 1978) at 6, cited by the Ontario Court of Appeal in Re Bathgate and National Hockey League Pension Society (1994) 110 DLR (4th) 609 at 617.
27 Ibid, at 306.
case in superannuation schemes where members provide valuable consideration in the form of employment services. This mutuality, resulting from the contractual relationship between the parties to the scheme, provides a basis upon which courts adopt a distinct approach in the construction and interpretation of provisions contained in superannuation trust deeds.\footnote{Mettoy Pension Trustees Ltd v Evans [1991] 2 All ER 513 at 537 per Warner J. However, irrespective of the structural differences between pension schemes and traditional private trusts, the courts have persistently continued to categorise superannuation and pension schemes as merely a form of trust, thereby applying traditional trust law doctrines: see for instance Cowan v Scargill [1985] 1 Ch 270 at 286-293 per Megarry VC. However, see the general comments of Lord Browne-Wilkinson in Target Holdings v Redfern [1996] AC 421 at 435: 'It is important if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind'. Compare Wilson v Law Debenture Trust [1995] 2 All ER 337 per Rattee J at 348. Irrespective of this reluctance to move away from traditional trust concepts, the courts have nonetheless adopted a distinct approach in construing amendment powers, being the issue of direct concern for the present purpose.}

An Approach to Interpreting Superannuation Scheme Amendment Powers

Several principles can be drawn from the above decisions in regards to interpreting trust deed amendment powers in superannuation schemes. First is the necessity to examine the commercial context in which the scheme is operating when determining the most appropriate characterisation of an amendment power. A practical and purposive approach must be adopted in order to give reasonable and practical effect to the scheme.\footnote{See Pollard D, ‘An Update from the United Kingdom’, Paper presented at the seminar Superannuation 1999: Mardi Gras of Information, February 1999, Law Council of Australia, Sydney at 7.6.} The cases illustrate how courts view superannuation schemes as relationships governed by a combination of contract and trust principles, construed against the background of industrial law considerations. Secondly, acknowledging the fluid nature of superannuation schemes, a purported amendment to a scheme must be examined in the commercial context at the time of the amendment and not the time the scheme is created.

Thirdly, where there are competing interpretations to a provision of a superannuation trust deed, and in particular the amendment power, the construction which is most congruous with the balance of power between the organs of the scheme will be adopted. Superannuation schemes are not merely construed as private trusts in which power must be exercised wholly in the interests of the beneficiaries, but as mutual arrangements between the various stakeholders, each having legitimate interests in the operation of the scheme. Therefore, the powers will be construed in a manner consistent with the intended balance struck by the provisions of the scheme deed and rules in order to give effect to the intended contractual and industrial purposes for which the scheme is brought into existence.

The judgment of Millett J in Re Courage Groups Pension Schemes provides an illustration of this approach. Two competing interpretations were offered for the amendment power by counsel, one vesting absolute power in the employer company to make amendments, and the other reserving a discretion in the Committee of Management to veto changes. His Honour was unwilling to interpret the amendment clause in a manner which would vest absolute power in the employer in the light of
the scheme documents read as a whole. It would be inconsistent with and would undermine the intricate balance created by the trust deed and rules to allow the company to unilaterally amend the constitutive documents. In this regard, Nobles offers the following observations on Millett J's decision:31

…the judge's perspective on what the entitlements of the parties ought to be forms a crucial background matrix to the interpretation of the words in dispute. Such perspectives do not determine the outcome, in the sense that they overwhelm all forms of words and all arrangements of rules. But they do influence the outcome, in the sense that the duties, powers and consequent balance of power found within pension schemes will be affected by the judicial view of what entitlements the parties can reasonably expect to enjoy.

Put another way, the courts may investigate the contractual intentions of the parties in determining the appropriate construction of the amendment provision. If, for example, the constitutive documents provide for a detailed balance of power between the trustee, employer company and members in the operation of the scheme, interpreting a power of amendment as vesting absolute power in the company to alter the scheme would be viewed as inconsistent with the contractual intentions of the parties and not in line with their reasonable expectations. The provisions must be interpreted in the light of the contractual and commercial nature of the scheme.

4.2.2 Application to Managed Investment Schemes

The are differences between superannuation schemes and managed investment schemes,32 the most notable being that, first, superannuation schemes have an element of compulsion33 while investments in managed investment schemes are voluntary, and secondly, unlike interests in managed investment schemes, superannuation schemes are related to the investor's employment situation. However, irrespective of these differences, for the reasons discussed below, the approach with respect to the interpretation of the amendment power in superannuation schemes is equally applicable to the constitutional amendment power in managed investment schemes.

As discussed above, the amendment power in superannuation schemes is construed in a manner which gives effect to both the commercial and contractual nature of the scheme. Unlike traditional beneficiaries who are the subject of a disposition in the form of a trust, superannuation scheme members are not volunteers, but provide valuable consideration for their rights and benefits in the form of their employment services. This distinction between traditional and superannuation trusts forms the basis of applying a practical and purposive construction to the power.

These characteristics are equally present in managed investment schemes. Rather than providing employment services, members in managed investment schemes provide valuable consideration in the form of their investment contributions. In return, they receive a bundle of statutory, contractual and equitable rights.34 As there is mutuality between scheme members and the responsible entity arising from their contractual

34 As to which see Ch 3 above.
relationship, the considerations adopted by the courts with respect to superannuation schemes are equally applicable.

As such, the courts will take into account the fact that the responsible entity is vested with the operational role of the scheme and must be provided adequate scope to conduct the scheme in an efficient and effective commercial manner. The power cannot be unduly fettered. However, it would be inconsistent with the balance of power created by the legislation and the scheme constitution to vest absolute control in the responsible entity as this would undermine the rights and powers vested in scheme members. A characterisation of the power which is most consistent with this balance will be preferred, giving reasonable and practical effect to the scheme.\textsuperscript{35}

Unit Trust Decisions

Although not relating to an amendment power, the adoption of this approach to unit trusts is supported by the New South Wales Court of Appeal decision of Parkes Management Ltd v Perpetual Trustee Co Ltd.\textsuperscript{36} The decision relates to a trustee-manager unit trust regulated under the former Companies Act 1961 (NSW). A provision in the trust deed required the manager to retire if and when required to do so by the trustee, provided the trustee certified in writing that the retirement would be in the interests of unitholders. The manager sought an injunction preventing the trustee from issuing a retirement notice.

The manager argued that the trustee had a duty to exercise the power to give the certificate only in good faith and for the purpose of the proper management and administration of the trust property or otherwise in the interests of unitholders. It was further argued that at no material time did the trustee actually hold the opinion, nor was it in fact in the interests of the unitholders that the manager retire.

Hope JA proceeded to examine the trust deed. His Honour noted that while the trustee was to have powers over the trust property and assets, the manager had full and complete power of management. His Honour stated:\textsuperscript{37}

The deed did not simply provide for the creation of a trust, the appointment of a trustee, and the employment by the trustee of some person as manager, as might occur in other forms of trust. The manager was the source and origin of the trust, and subject to what might be regarded as supervision by the trustee, substantially carried out the trust. In effect, the manager was the entrepreneur of an investment scheme, which contemplated that both it, and those who contributed money to the scheme, should derive financial benefit. The appointment of the trustee is understandably required by statute in these cases as a safeguard to ensure that the interests of the unitholders are maintained, but the manager also had this obligation, and in a sense also supervised the activities of the trustee. To the unitholders, the identity of the manager must have been a matter of considerable significance. To the manager, its office was a source of valuable rights.

\textsuperscript{35} Re Courage Group’s Pension Schemes [1987] 1 All ER 528 at 537.
\textsuperscript{36} (1977) 3 ACLR 303.
\textsuperscript{37} \textit{Ibid}, at 310-311.
Following from this, his Honour stated that it could not have been contemplated by the parties that the manager would be required to cease its position simply upon receiving notice from the trustee. In order to give effect to the terms of the deed, and by its very nature, the power vested in the trustee was subject to those constraints applicable to all such powers by a trustee. His Honour concluded:38

The position of the trustee as the body appointed to safeguard the interests of the unitholders, the agreement by the manager to its appointment for that purpose, the reference to promptitude in the covenant itself, the nature of the trust, the necessity appearing from the terms of the deed for the unitholders' interests to be protected by an independent and responsible person, the prospect of urgent action, and the choice of language lead me to the conclusion that [the retirement power] was adopted by the parties with the intention of placing the responsibility of giving the certificate upon the trustee, in reliance upon its judgement in the exercise of that responsibility.

Therefore, the notice was effective in requiring the manager to retire. Such an action, however, was subject to recourse in the event of a wrong approach to the facts, an absence of the appropriate opinion by the trustee, improper motives, or other equitable considerations. The determination of these issues was remitted to the Equity Division for further hearing.

Two points are worth noting in the present context with regard to this decision. First, the primary issue which was decided by the Court of Appeal related to the balance of power between the manager and the trustee of a unit trust. Since the enactment of the MIA, the substance of the Court's discussion is no longer directly applicable, as a dual management-trustee structure is no longer required. However, the approach taken by the Court may still be relevant in construing powers in a manner which gives effect to the balance of power between the two primary organs of a managed investment scheme: the responsible entity and a resolution of scheme members. As with the superannuation cases discussed above, Hope JA adopted a functional and purposive approach to the interpretation of the power under question, analysing the provisions of the trust deed as a whole and the commercial context in which the deed operated. His Honour determined the relative competing rights of the trustee and the manager and attempted to give effect to their relative positions in the interpretation of the provision. This approach is equally applicable when interpreting powers and considering the relative rights as between the responsible entity and scheme members under the MIA.

Secondly, the decision is instructive as an examination of the position of the responsible entity in a managed investment scheme. Hope JA recognised the importance of the manager in a unit trust, describing it as the 'source and origin' and the 'entrepreneur' of the trust. The office is a 'source of valuable rights'. Under the MIA, the responsible entity undertakes the role of both the trustee and the manager, therefore remaining the entrepreneur of the scheme, while also now holding the legal title to the scheme property on trust for members. Furthermore, in certain circumstances the responsible entity will itself be a scheme member by virtue of unit holdings. These observations are relevant in determining the relative position of

38 Ibid, at 313.
scheme members and the responsible entity, as well as giving effect to it upon interpreting and characterising the powers vested in the parties.

A second unit trust decision which is instructive in relation to the approach taken in interpreting powers is *Equitable Group Ltd v Pendal Nominees Pty Ltd.*[^39] The case involved a provision in a unit trust deed which provided unit holders with a power to requisition the manager and trustee to convene a meeting for the purpose of presenting accounts and audited financial statements 'and for the purpose of giving to the trustee such directions as the meeting thinks proper'. The members contended that the latter part of the provision was to be read disjunctively, providing members with a broad power to requisition meetings for the purpose of giving directions.

Helsham CJ rejected this interpretation, observing that upon a natural reading of the clause the ability to give directions was consequential to the rest of the provision. Only directions with regard to accounts could be given. Of more interest, however, is his Honour's supplementary reasoning. If the members' interpretation were to be adopted:[^40]

...there would be conferred by those words very wide powers indeed for unitholders to interfere in every aspect of the operation of the trust. There would be no limit to the purposes for which the manager would be bound to convene a meeting if requisitioned.

Once again, the power was construed in the context of the larger commercial arrangement. The interpretation which was most congruous with the balance of power otherwise provided by the trust deed was preferred.

### 4.3 Restraints on the Power

Both the source of the power of amendment and a discussion of possible approaches to constructing the statutory power have been examined. The final section of this chapter analyses the restraints placed on the responsible entity upon amending the scheme constitution. The examination is divided according to the source of the restraint - statute, contract and equity.

#### 4.3.1 Restraint Derived from Statute

In order to instigate an alteration to the scheme constitution, s601GC(1)(b) requires that the responsible entity 'reasonably considers the change will not adversely affect members' rights'.[^41] Although discussed here in the context of a restraint on the power, the requirement is more appropriately construed as being a limit on the scope of the power itself, purported amendments not satisfying the requirement being *ultra vires* and void.[^42]

[^40] Ibid, at 551.
[^41] Compare the ALRC/CSAC proposal which required the directors of the responsible entity to be 'satisfied, after due inquiry' of the stated considerations: s183A(1)(a)(ii) *Collective Investment Scheme Bill 1995* in ALRC/CSAC Vol 2 at 115.
[^42] Statutory damages would arguably also be available under s601FM(1) and s1325, as ‘contravene’ is defined in s9 to include a failure to comply with a provision.
The power is clearly aimed at minor alterations, such as those required in order to comply with changes in the law. Where the requirement is not satisfied, the only means by which an amendment can be made is by referring it to the general meeting in order to obtain a special resolution. However, unlike the Bill proposed by the ALRC/CSAC, the power is not explicitly limited to 'minor' changes. As such, it is necessary to determine the scope to which amendments may be made under this power without reference to scheme members. This requires a detailed examination of the statutory requirement. Three issues arise with regard to the construction of the restraint, each of which will be dealt with in turn:

(a) How can a company have a consideration?
(b) When can a consideration by the responsible entity be subject to judicial review?
(c) What is the meaning of 'adversely affect members' rights'?

(a) Considerations by Companies

The first and simplest issue is how the responsible entity, being a company, can form a reasonable consideration on a matter. Bryson J in the Equity Division of the New South Wales Supreme Court offered the following observations in Dillon v Burns Philp Finance Ltd:

The concept of an opinion formed by a company is rather artificial but in my opinion must be a reference to an opinion formed by the directors of the company acting by resolution as a Board, the directors being an organ of the company itself and not delegates of it.

Therefore, it is required that the directors of the responsible entity, by resolution of the Board, reasonably consider the amendment will not adversely affect members' rights.

(b) Judicial Review of a Decision by the Responsible Entity

An opinion held by the responsible entity that an amendment will not be adverse to members' rights may be open to judicial review upon three bases, being namely:

- The opinion was not made bona fide.
- The opinion was not reasonable.
- The opinion was not formed on a proper construction of the question to be asked.

43 Amendments passed by special resolution of scheme members are considered below in Part C.
45 Note that the responsible entity has further statutory duties found in s601FC(1). However, as these duties are predominantly based on correlating fiduciary obligations, they will be discussed in that context in the following chapter.
46 Section 601FA requires the responsible entity to be a public company.
48 Judicial review may also be conducted on the basis of there being a breach of the responsible entity's fiduciary obligations in exercising the amendment power, as well as the statutory duties in s601FC(1) which are derived from these obligations. These duties and obligations are considered separately below at 4.3.3 and Ch 5.
In relation to the first requirement, the responsible entity is imposed with an obligation, derived from its position as trustee, to act bona fide. This equitable duty is reinforced by the responsible entity's statutory duty to act honestly. Where there is a lack of honesty, the decision may be set aside.

Secondly, an amendment may be challenged where the opinion was not reasonable. The phrase 'reasonably considers' contains both a subjective and an objective element. On the one hand, the consideration must actually be held by the responsible entity. On the other hand, such consideration must be reasonable. What is required is that the responsible entity both considers that the given facts exist, namely that the amendment will not adversely affect the rights of members, and that the circumstances which it knows or ought to know are such as to cause a reasonable person placed in its role to so believe. The belief is open to challenge if it is not reasonably open to the responsible entity to hold the view given all the circumstances of the case.

Thirdly, where the opinion is objectively reasonable, the exercise of power by the responsible entity may nonetheless be challenged based on the decision making process conducted by the responsible entity. The responsible entity must act on a proper construction of the statutory requirement when forming the requisite opinion. Where the opinion is formed based on an incorrect understanding of what is required, the decision will be open for judicial review.

In this regard, assistance may be sought from the Supreme Court of New South Wales decision of Wilson v Metro Goldwyn Mayer, which involved a purported expropriation of a superannuation surplus by an amendment to the trust deed. The deed contained the following amendment provision:

The trusts declared by this Deed may be altered or amended by a deed executed by the Company and the Trustee in any respect which would in the opinion of the Company not prejudice any benefits secured by contributions made on behalf of any member prior to the date of such alteration...

The deed provided that upon winding up of the trust, any portion of the fund remaining in the hands of the trustee or which it obtains after the date of winding up must be applied to the provision of benefits to members as directed by the employer company. The trustee and employer company sought to amend the provision such that any money in excess of benefits payable to members upon winding up was to be paid to the employee company. The trustee approached the Court for a determination as to the validity of the purported amendment.

49 In relation to equitable fraud generally, see Nocton v Lord Ashburton [1914] AC 932 at 954 per Lord Haldane LC.
50 Section 601FC(1)(a).
51 Eagle Star Trustees Ltd v Heine Management Ltd (1990) 3 ACSR 232 at 238 per Phillips J; Opera House Investment Pty Ltd v Devon Buildings Pty Ltd (1936) 55 CLR 110 at 116 per Latham CJ. See also Re A Solicitor [1945] KB 368 at 371: 'The word 'reasonable' has in law the prima facie meaning of reasonable in regard to those existing circumstances of which the actor, called on to act reasonably, knows or ought to know'.
52 (1980) 18 NSWLR 730.
The employer company argued that the phrase 'any benefits secured by contributions made on behalf of any member' in the amendment clause only referred to benefits derived by members upon making contributions on their behalf and did not include any excess funds after accounting for all benefits payable to members. The latter were merely potential windfall gains which may be received by members upon the accidental circumstance of them being employees on the date the trust is wound up. After considering the amendment provision in the light of the wording in the other clauses of the deed, Keamey J rejected the submissions of the employer company, the deed being found to envisage the securing of not only benefits members are entitled to by virtue of their contributions, but also excess benefits.

The employer company further submitted that the reasonable opinion of the company could not be challenged as the amendment provision was expressed in the widest form, vesting the company with an absolute discretion and not being subject to fiduciary obligations inhibiting its exercise. Keamey J also rejected this proposition. His Honour stated that the company's opinion in exercising the amendment power must be founded upon a consideration of the correct question which has to be determined in forming the opinion. If an erroneous view is formed with regard to the construction of the amendment power and the stated requirements for the exercise of the power, there is no valid opinion in law. As the employer company misinterpreted the meaning of 'benefits', the decision was open to challenge. His Honour stated:

...the company must reach its opinion on the basis of a correct understanding of the question to be considered and, hence, must act upon a correct construction in forming its opinion. Correspondingly, an opinion formed on the basis of an erroneous construction of [the amendment provision] could not in my opinion constitute a relevant opinion for the purpose of [that provision].

Similarly, Eagle Star Trustees Ltd v Heine Management Ltd, concerned a statutory restraint on amendments to a unit trust deed. Amendments were prohibited where the trustee held the opinion that the rights of unitholders 'may be adversely affected'. Phillips J found that the trustee had addressed the wrong question, being whether the unitholders' rights would be affected rather than whether they may be affected by the amendment. As such, the opinion held was not reasonably open to the trustee given its mistaken construction of the requirement, the amendment being invalid.

These decisions may be explained by virtue of the so-called rule in Hastings-Bass. Where a trustee acts under a discretion given to it by the terms of the trust, the courts will interfere with its action if it is clear that it would not have acted as it did had it not failed to take into account considerations which it ought to have taken into account. In Mettoy Pension Trustees Ltd v Evans, Warner J described the rule as follows:

53 Ibid, at 735.
54 (1990) 3 ACSR 232.
56 Re Hastings-Bass [1975] Ch 25. The rule is a consequence of the right of beneficiaries under a trust to require the trustee to address its minds to the true effect of any exercise of a discretion vested in it.
I have come to the conclusion that there is a principle which may be labelled 'the rule in Hastings-Bass'... For the principle to apply however, it is not enough that it should be shown that the trustees did not have a proper understanding of the effects of their acts. It must be clear that, had they had a proper understanding of it, they would not have acted as they did... In cases such as this, where it is claimed that the rule in Hastings-Bass applies, three questions arise: (1) What were the trustees under a duty to consider? (2) Did they fail to consider it? (3) Is so, what would they have done if they had considered it?

As such, where it can be shown that the responsible entity has exercised the power of amendment upon a misconstruction of the stated requirements, the decision is bad in law. The decision is open to challenge where it is shown that the responsible entity would have acted differently had it been properly advised. Similarly, where the responsible entity bases its decision on considerations which are irrelevant to the issue to be determined, or fails to consider relevant factors, resulting in a materially different outcome, the decision may also be bad in law. The responsible entity must address its mind to the correct question to be asked and must understand what exactly is required of it with respect to the statutory restraint.

(c) 'Adversely Affect Members' Rights'

The next issue is the proper construction of the question to be asked by the responsible entity in forming its opinion, which will also provide guidance as to the proper considerations which must be addressed in forming that opinion. As already discussed directly above, if the responsible entity misconstructs what is required of it, the action will be challengeable.

The restraint requires that the responsible entity reasonably considers the amendments 'will not' adversely affect members' rights. This is a lower threshold than in Eagle Star Trustees Ltd v Heine Management Ltd, where amendments were prohibited where the trustee considered the amendment may have an adverse affect. In that case, Phillips J interpreted the provision as requiring the trustee to be convinced that members' rights cannot be effected. The responsible entity is not imposed with such a high requirement.

Three issues arise with respect to the construction of the phrase 'adversely affect members' rights':

(i) The definition of rights.
(ii) Whether members' rights entails the rights of each individual member or the members as a whole.
(iii) The meaning of adversely affect.

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58 This approach is similar to the so called Wednesbury Test applied to administrative actions: Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223.
59 (1990) 3 ACSR 232.
60 Ibid, at 239.
Part B – Amendments by the Responsible Entity

(i) The Definition of ‘Rights’

The first issue to be determined is the definition of ‘rights’. No definition is offered by the legislation. Ascertaining the meaning of ‘rights’ is crucial, as it will directly determine the scope of the responsible entity’s unilateral amendment power. Hanrahan observes that in the extreme, ‘rights’ could be interpreted as being either of the following:*1

- Extending to a right to have the scheme operated in accordance with the constitution as in effect at the time the member joined the scheme, thereby precluding amendments without members’ consent.
- Limited to statutory rights, being incapable of modification by constitutional amendments.

She concludes that these interpretations are, as a practical matter, too extreme, the preferable view being that ‘rights’ encapsulates the following:

- Distribution rights.
- Withdrawal rights.
- Voting rights.
- Rights to receive information.
- Rights in respect of scheme property.

The specific rights identified above clearly constitute the primary or essential rights vested in scheme members. However, it is submitted that the definition of ‘rights’ can be extended one step further. As has already been discussed,*2 a member in a scheme derives a bundle of rights from the Act, the scheme constitution and equity. It is submitted that ‘rights’ in the context of s601GC(1) must be interpreted widely to encapsulate all rights which a member receives by virtue of their interest in the scheme.*3 These rights have been identified above.*4 Only if these rights are adversely affected will the provision not be complied with.

A further matter to note is that as the responsible entity must consider the rights of ‘members’, this will only extend to those who are members, being persons who hold an interest in the scheme, at the time the amendment is executed.*5 Therefore, past and future members need not be considered.*6

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*i Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 63.
*1 See Ch 3 above.
*2 In this sense, a distinction must be drawn between a right and an interest, the latter being wider and encapsulating commercial interests. In contrast, rights are limited to legal and equitable rights: See Hanrahan, op cit, at 63.
*3 See s9 definition of ‘members’ and ‘interest’.
*4 Compare Cowan v Scargill [1985] 1 Ch 270 at 286-287, where Megarry VC held that the trustee of an employment pension scheme was under a duty to act in the best interests of both present and future beneficiaries upon exercising its investment powers. See further 5.3.1 above.
A further issue is whether the definition of 'rights' encapsulates only accrued rights, or whether it extends to future rights which are yet to accrue. For instance, trust income which members are presently entitled to but which has not been distributed represents an accrued right. However, the right to future income which has yet to be generated is not accrued. The issue is whether such rights must not be adversely affected upon an amendment being executed.

Containing a similar requirement, the superannuation deed amendment clause in *Re UEB Industries Ltd Pension Plan* provided that the consent of members was required where the amendment would 'reduce or adversely affect that Member's interest in the Fund at the date of alteration'. Although the restraint related only to the interest accrued at the date of the amendment, Cooke P interpreted this requirement as encapsulating future benefits flowing from an interest. The consideration was not limited to benefits already accrued at the date of the amendment. His Honour stated:

> In superannuation schemes, clauses designed to prevent adverse effect on a member's 'interest' without consent should be construed in my opinion, in the light of the principle and evident purpose that, without the consent of the member, benefits which may flow from his or her past membership and contributions should not be altered to his or her disadvantage.

Section 601GC is different in its terminology to the amendment power in the above case. Rather than restricting amendments which affect a member’s *interest* at the date of the alteration, the Act prevents amendments from adversely affecting the *rights* of members. Whether this encapsulates future rights or alternatively only rights existing at the date of the alteration is not specified.

However, it is submitted that the scope of the restraint in this regard will be construed in a similar manner to the finding of Cooke P. The responsible entity must consider the effect an amendment will have on the *rights* arising from *interests* currently held by members in the scheme. Therefore, future rights cannot be adversely effected if those rights arise from a present interest. Following from this, the responsible entity could not, for example, adversely affect a current member’s rights to future distributions. Although this is a future right, it is derived from that member’s current interest in the scheme. However, amendments which adversely affect distribution rights arising from future contributions are valid.

This position would seem only just, as to alter the constitution retrospectively to affect rights correlating to contributions already made would seem unfair to members who contracted on the basis of the rights they were to receive, even where those rights were yet to accrue at the date of the purported amendment. Whilst such contributions are admittedly subject to the statutory amendment power, it would seem unlikely that the courts would view amendments favourably which retrospectively act to the detriment of members. Subsequent contributions, however, are made on the basis of the constitution as amended at the date of the contribution, and therefore with notice of the alteration to the rights.

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If the above is correct, it must further be queried whether the consideration is limited to the rights flowing from the actual quantum of interest currently held at the date of the purported amendment. For instance, assuming a member held \( x \) units at the time the amendment is to take affect, but after that date held \( x + y \) units, it must be determined whether the responsible entity need only consider the effect on the rights and benefits flowing from the first \( x \) units and not the later contributions.

This argument was presented to the New Zealand Court of Appeal in *Ritchie v Blakeley*[^69] in the context of a superannuation trust deed. The deed prevented amendments which adversely affected 'a member's interest in the Fund as established at the date of such amendment'. The trustee argued that this merely required an examination of the amount standing in the member's account at the relevant time, and would not include advantages and pecuniary sums which would flow from later contributions. The alternative argument was that the term 'Fund' referred to the scheme as a whole and not a specified accumulated sum of money. The submission by the trustee was accepted by Cooke J and Hardie Boys J who held that the phrase should be interpreted as referring to the credit in the member's account as at that date together with the rights arising from that credit.^[70]

Applying this decision to s601GC(1), amendments must not adversely affect the rights of members arising from their contributions *as at the date of the purported amendment*. Rights arising from future contributions by current members, however, may be affected. This is consistent with contractual principles as future contributions are made upon a new contract on the terms of the constitution as amended at that date.

**(ii) Whether ‘Members’ Rights’ Entails the Rights of Each Individual Member**

The second issue is whether amendments are restrained which adversely affect the rights of each individual member, or alternatively the rights of the members as a whole. It is submitted that the responsible entity may seek amendments to the constitution on the proviso that it reasonably considers such amendments will not adversely affect the rights of *members as a whole*.^[71] Three arguments can be offered in support of this construction.

*First*, as discussed above,^[72] a practical and purposive approach to construction is to be adopted, the amendment provision being considered in the light of the commercial context and the scheme a whole. A managed investment scheme is a form of collective investment in which a large number of members contribute to the fund in order to receive a return. In order to give effect to the commercial operation of the scheme, a collective approach must be adopted, which would entail the responsible entity considering the interests of the majority of members. If it were intended that the rights of each individual member was to be considered, the provision would have

[^69]: [1985] 1 NZLR 630.
[^70]: *Ibid,* at 639 per Hardie Boys J; *Ibid* at 637 per Cooke J (Woodhouse P in dissent).
[^71]: A contrary argument is that as s109R(b) states that words in the plural include the singular, 'members' includes a 'member', and therefore the rights of each individual member must be considered. See Hanrahan P, *Managed Investment Law*, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 63.
[^72]: See 4.2.2 above.
required the responsible entity to consider whether such amendment adversely affects a member’s rights.\textsuperscript{73}

Secondly, as also established above,\textsuperscript{74} a construction must be adopted which is most congruous with the balance of power between the scheme organs struck by the constitution and the MIA. In this regard the primary organs of a managed investment scheme are the responsible entity and a resolution of scheme members. The MIA attempts to balance the interests of the organs, vesting various powers and discretions in each. Therefore, it is a resolution of members, and not individual members, which are provided powers and discretions.\textsuperscript{75} In this regard, the doctrine of majority rule is ingrained into the Act. It is consistent with this position if the restraint were interpreted as requiring the responsible entity to consider the effect the amendment will have on the rights of members as a whole, being the majority of members constituting a resolution.

Finally, the scheme constitution provides a source of valuable rights for scheme members.\textsuperscript{76} Amendments to the constitution invariably involve some form of competing interest either between the rights of members and the responsible entity, or as between the rights of members \textit{inter se}. Preventing amendments which adversely effect the rights of individual scheme members will unduly fetter the power vested in the responsible entity, effectively resulting in the constitution being virtually unalterable except by virtue of a members’ resolution.

It is therefore only the rights of members as a whole which must be considered by the responsible entity. This proposition is supported by the \textit{obiter} comments of Phillips J in \textit{Eagle Star Trustees Ltd v Heine Management Ltd}.\textsuperscript{77} The case involved three unit trust deeds containing an amendment power drafted in similar terms to s601GC(1). The trustee purported to amend the governing deeds to extend the buy-back period. In response to the argument that if the trustee had merely considered the position of those members who had given withdrawal notices, it would not have formed the necessary consideration that their rights would not be adversely affected, his Honour stated:\textsuperscript{78}

\begin{quote}
...I do not decide that [the amendment power] requires the trustee to look only at such rights. It may well be (and it is unnecessary for present purposes to decide) that the trustee should look at the rights of unitholders generally, although recognising that some will be affected differently to others.
\end{quote}

These observations are consistent with the proposition that it is the rights of members as a whole, and not the rights of each individual member which the responsible entity must draw its mind to when forming the relevant consideration in accordance with s601GC(1).

\textsuperscript{73} For instance, see the amendment clause in \textit{Ritchie v Blakeley} [1985] 1 NZLR 630, which was required by reg 6(2) of the \textit{Superannuation Scheme Regulations} 1983 (NZ).
\textsuperscript{74} See 4.2.2 above.
\textsuperscript{75} For instance, see s601FL(1), s601FM(1), s601NE(1)(b).
\textsuperscript{76} See 3.3.2 above.
\textsuperscript{77} (1990) 3 ACSR 232.
\textsuperscript{78} \textit{Ibid}, at 240-241.
(iii) The Meaning of ‘Adversely Affect’

The third issue is the meaning of ‘adversely affect’. If a broad interpretation is adopted, the restraint would encapsulate any amendment which affects members in a manner contrary to their interests, irrespective of the extent of that effect. For instance, in Ritchie v Blakeley, Cooke J interpreted the phrase ‘adversely affect a Member’s interest’ as follows:

That interest will be adversely affected if an amendment diminishes or restricts the benefits – whether as of right or discretionary, and whether as to time, quantum or otherwise – that may in due course flow from that share.

However, a narrower interpretation must be given to s601GC(1)(b), as the restraint is limited to amendments which adversely affect rights rather than interests. In this regard, a distinction must be drawn between amendments which expressly diminish or restrict members’ rights, being contrary to s601GC(1)(b), and amendments which merely diminish the effectiveness of those rights. For instance, an amendment which purports to directly remove or limit voting rights is impermissible. In contrast, an amendment which does not alter the substantive right to vote, but has the effect of diluting the voting power of certain members may arguably be permissible under the provision. While the effectiveness of the right is altered, the legal right to vote itself remains intact. Only those amendments which remove or in some way alter or limit the extent of substantive legal and equitable rights are prohibited.

Whilst the statutory restraint requires an amendment to not adversely affect members’ rights, it does not require amendments to benefit members. Therefore, it would seem that provided the rights of members are not diminished, the responsible entity may seek to amend the constitution for its own benefit. On this point, cases dealing with variations of trusts on behalf of infants, unborn children and incompetent persons may provide assistance. In Queensland, Victoria and Tasmania, courts are provided a statutory power to approve arrangements varying or revoking trusts on behalf of such persons, provided the arrangement is for the benefit of that person. In Western Australia and New Zealand, on the other hand, an arrangement cannot be approved by the court where it is to the person’s detriment. In interpreting the latter requirement

79 Compare the ALRC/CSAC proposal which required the directors of the responsible entity to be satisfied that the amendment ‘does not affect the interests’ of scheme members: s183A(1)(a)(ii) Collective Investment Scheme Bill 1995 in ALRC/CSAC Vol 2 at 114-115.
80 [1985] 1 NZLR 630 at 637.
81 However, such an amendment may be found to be for an improper purpose, as discussed below at 5.1.3.
83 Trusts Act 1936 (Qld), s95.
84 Trustee Act 1958 (Vic), s63A.
85 Variation of Trusts Act 1994 (Tas), s13. The Tasmanian legislation requires the amendment to be ‘in the interests of’ the beneficiaries. This would seem to be analogous to ‘for the benefit of’: Dal Pont G E, Annotated Trustee and Trustee Companies Legislation, Butterworths, 1997 at 423. The Tasmanian legislation also requires the court to have regard to certain stated criteria in its determinations: Variation of Trusts Act 1994 (Tas), s14.
86 Trustees Act 1962 (WA), s90.
87 Trustee Act 1956 (NZ), s64A.
Part B – Amendments by the Responsible Entity

in the New Zealand legislation, McGregor J in *Re Aitken's Trust*,\(^8\) stated that the phrase ‘not to his or her detriment’ is not materially different to the phrase ‘for her or his benefit’.

As with the phrase ‘not to his or her detriment’, the statutory restraint in s601GC(1)(b) similarly places a negative criteria on amendments. Following from the above decision, it would seem that irrespective of the wording of the provision, it will be interpreted in the same manner as if it contained a positive criteria requiring amendments to benefit members. This would not seem to be a correct interpretation. On proper construction, the MIA provision clearly does not require the same standard as if it were drafted as a positive requirement. Provided that it does not adversely affect or diminish benefits that will reasonably flow to members by virtue of their current interest in the scheme, it is submitted that an amendment by the responsible entity which is for its own benefit is not prohibited by s601GC(1)(b). This, of course, is qualified by the application of trustee and fiduciary obligations, as well as correlating statutory duties, which are discussed below.\(^9\)

**ASX Listing Rules**

Where the scheme is listed with the ASX, a further restraint is placed on amendments. *ASX Listing Rule* 6.10 prevents the removal or change of a member’s right to vote or receive dividends except in certain stated circumstances, such as where the removal or change is required by legislation, the alteration is required in order to comply with legislation, it is under a court order, or the ASX has approved the change as being appropriate and equitable. Therefore, irrespective of the quantum or extent, amendments which alter voting or distribution rights are prohibited in listed schemes. This is the case irrespective of whether the change is actually for the benefit of members.\(^6\)

Where the scheme is not listed, this restraint does not apply. However, it would seem that amendments negatively affecting voting or distribution rights to the detriment of members would nonetheless be restricted by virtue of s601GC(1)(b).

**Summary**

By way of summary, the following conclusions can be offered with respect to the statutory restraint placed on the responsible entity in seeking amendments to the scheme constitution:

- The responsible entity, through its board of directors, must subjectively hold the opinion that the amendment will not adversely affect the rights of scheme members.
- The opinion must be reasonable, based on a proper construction of the requirement, and founded on proper considerations.

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\(^8\) [1964] NZLR 838 at 839. See also *Re Greenwood* [1988] 1 NZLR 197 at 210.

\(^9\) See Ch 5 below.

\(^6\) The *ASX Listing Rules* are enforceable by virtue of s777(3).
- The responsible entity must consider the effect the amendment will have on the rights of scheme members as a whole rather than individual scheme members.
- In reaching the opinion, the responsible entity must have regard to both present and future rights arising from current interests held by members.
- Where the scheme is listed, voting and distribution rights cannot be removed or changed except in certain stated circumstances.

4.3.2 Restraint Derived from Contract

Section 601GC(1) grants the responsible entity power to amend the scheme constitution unilaterally if certain conditions are met. The issue to be discussed in this section is whether a provision in the scheme constitution may impose further requirements which must be met before an amendment may be effected.\(^1\) For instance, it may be envisaged that a constitutional provision may require:

- the consent of members prior to an amendment becoming effective.
- the certification by the directors of the responsible entity that they are of the opinion that the amendment will not be detrimental to the interests of members.\(^2\)
- the responsible entity to only exercise its power of amendment in certain stipulated circumstances, for certain stipulated purposes, or to only exercise the power in a particular manner.\(^3\)

Upon a natural reading of the statutory power, constitutional provisions placing such conditions or otherwise making the ability to amend the constitution more onerous would be inconsistent with the Act. Section 601GC(1)(b) provides that the constitution may be modified where the statutory condition is met. This power exists, irrespective of whether further conditions are imposed by the scheme constitution.

This position may be contrasted with the former s1069A, which provided that a unit trust deed 'cannot be modified unless' certain conditions were met. It was held by Hodgson J in *Re Australia Wide Property Trust*\(^4\) that this section did not provide an exhaustive code in relation to the modification of trust deeds, and as such, was not intended to override further restrictive provisions to the amendment power in trust deeds.

It is submitted that this position does not hold under the current legislation. Section 1069A did not create a power of amendment, but merely restricted amendments exercised under a trust deed power in certain circumstances. In contrast, s601GC(1) is the actual source of the power. A constitutional provision purporting to limit or exclude that statutory power will be of no effect.

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\(^1\) Compare 4.1.2 above which discusses constitutional provisions which allow amendments by less onerous means.

\(^2\) As was proposed by the ALRC/CSAC draft Bill: s183A(1)(a)(ii) Collective Investment Scheme Bill 1995 in ALRC/CSAC Vol 2 at 114-115.

\(^3\) Such as the ALRC/CSAC proposal which only allowed minor amendments: *Ibid.*

\(^4\) (1992) 8 ACSR 611.
Duty not to Fetter a Discretion

The inability of the scheme constitution to place further restraints on the responsible entity’s amendment power may be further explained by a trustee’s duty not to fetter its discretion. As a trustee, the responsible entity is under a duty not to fetter its discretion by committing itself in advance to its future conduct.\(^95\) It cannot bind itself as to the manner in which it will exercise a discretion in the future, such as by virtue of an antecedent resolution, a contract or an undertaking to a third party or members.\(^96\) In particular, the responsible entity must not permit members to dictate the manner in which its discretion ought to be exercised.\(^97\) For instance, in *Osborne v Amalgamated Society of Railway Servants*,\(^98\) Moulton LJ discussed the situation of a trustee being contractually bound to exercise its discretion in a certain manner, stating:\(^99\)

Every such agreement is tainted with the vice of the trustee binding himself contractually for valuable consideration that he will exercise a trust in a specified manner to be decided by considerations other than his own conscientious judgement at the time as to what is best in the interests of those whom he is trustee.

The justification for the principle is that ongoing discretions must remain unencumbered and must be exercised from time to time and in accordance with the circumstances prevailing at the particular time the power is exercised.\(^100\) The court will not compel the trustee to complete the contract and breach its fiduciary duties.\(^101\)

The power vested in the responsible entity to amend the constitution by virtue of s601GC(1) is an ongoing discretion. The validity of a purported amendment must be judged at the time the amendment is to take effect and not at the time the scheme is constituted. A decision as to whether to exercise the discretion must be made in the context of the current circumstances and environment in which the scheme is operating. A contractual restraint on the power by virtue of a constitutional provision may be a fetter on the discretion vested by the Act, and therefore of no effect.

By way of counter-argument, as the contractual restraint is embodied in the constitution, being the trust instrument itself, it could be argued that it is not a fetter as such but rather a redefinition of the discretion itself, thus altering the nature and scope of the power rather than placing a fetter on its exercise. However, it is submitted that as the power of amendment is conferred by statute and not by the trust instrument, any restraint on that power derived from the constitution will not be a redefinition of

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\(^95\) See generally Dal Pont & Chalmers, *op cit*, at 462-463; Finn P D, *Fiduciary Obligations*, Law Book Company, 1977 at 25. However, note that some unit trust deeds expressly allow the trustee to fetter a future discretion.

\(^96\) *Oceanic Steam Navigation Co v Sutherberry* (1880) 16 Ch D 236.

\(^97\) *In re Brockbank; Ward v Bates* [1948] 1 Ch 206 at 209 per Vaisey J.

\(^98\) (1909) 1 Ch 163.

\(^99\) *Ibid* at 187. This decision was followed by the High Court in *The Watson’s Bay and South Shore Ferry Company Ltd v Whitfield* (1919) 27 CLR 268 at 277 per Isaacs J, which related to a fetter on a statutory discretion vested in a public officer. See also *Re Stephenson’s Settled Estate* (1906) 6 SR(NSW) 420 at 424-425 per Street CJ.

\(^100\) Finn, *op cit*, at 28.

\(^101\) *Moore v Clench* (1875) 1 ChD 447. However, an action for damages may be available: *In re Landers & Bagley’s Contract* [1892] 3 Ch 49.
the power but rather a contractual fetter on the exercise of that power. The constitutional restraint will be unenforceable.

Class Rights

There is one exception to the position that the scheme constitution cannot contain a restraint on the responsible entity's power of amendment. ASIC Class Order 98/60, issued on 10 July 1998, stipulates that s601GC(1) be read to include the following:

If the constitution of a scheme sets out a procedure for varying or cancelling rights of a class of members of the scheme, or rights attaching to a class of interests under the scheme, those rights may be varied or cancelled by a resolution under [s601GC(1)(a)] only if that procedure is complied with.

Therefore, whilst the class rights provisions of the Corporations Law do not directly apply to managed investment schemes, they may be incorporated by virtue of a provision in the constitution, thereby imposing the further requirement of a resolution or special resolution by any class of members specifically affected before an amendment can take effect.

4.3.3 Restraint Derived from Equity

As discussed above, s601GC(1) results in amendments by the responsible entity being conditional on it reasonably believing that the change will not adversely affect members' rights. The provision does not require that the amendment only be instigated for the sole benefit of members, nor does it require that the amendment not benefit the interests of the responsible entity. Depending on the judicial definition given to 'members' rights', the statutory restraint may be further limited in its scope, only preventing an actual removal of or limitation on substantive legal and equitable rights. Furthermore, where the criteria is satisfied, amendments may be made unilaterally with no veto by or reference to those who's rights may be most affected. When considered in the light of the ALRC/CSAC proposals, it would seem that the legislation as it stands offers little comparative protection for members upon amendments instigated by the responsible entity. However, further protection to members may be offered by equity as a result of the fiduciary relationship between the responsible entity and scheme members.

This section briefly discusses whether the power of amendment can be characterised as a fiduciary power, and so subject to the relevant equitable restraints imposed on fiduciary actions. This involves the identification of a fiduciary relationship and investigation as to whether the power of amendment is fiduciary in nature. The content of the fiduciary obligations imposed upon an exercise of the power will be the subject of Chapter 5. The following points will be briefly explored in turn:

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102 The Class Order is issued under s601QA(1)(b), which provides ASIC with a power to declare that Chapter 5C applies to a person as if specified provisions were omitted, modified or varied as provided for in the declaration.
103 Part 2F.2.
104 The statutory and equitable duties of impartiality, discussed below at 5.3.3, may provide further protection where the rights of members in a particular class are affected.
Part B – Amendments by the Responsible Entity

(a) The general nature of the fiduciary office.
(b) Whether the responsible entity is a fiduciary.
(c) Whether the amendment power is subject to fiduciary restraints.

(a) The Fiduciary Office

The central premise underlying the fiduciary office is the service of another’s interest. Equity attaches various duties and obligations to the office outside those derived from statute, contract and tort. A summation of the nature of the fiduciary office was offered by Mason J in the leading High Court decision of Hospital Products Ltd v United States Surgical Corporation:

The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.

Therefore, fiduciary law imposes standards of acceptable conduct on one party to a relationship for the benefit of others where the law decrees that that person has a responsibility for the preservation of the other’s interests. This is achieved by ensuring that the use of the powers and opportunities of the position by a fiduciary are prescribed with the requirement that it be exercised in a manner consistent with its responsibility.

(b) The Responsible Entity as a Fiduciary

The responsible entity is the trustee of the scheme assets for the benefit of scheme members. It is trite law that the position of trustee is an accepted category of fiduciary, the law viewing the legal relationship itself as existing for the benefit of the beneficiary as a matter of course. As such, the MIA is clear in its intention: the responsible entity is a trustee of the scheme assets and is thereby imposed with all the correlating duties and obligations attaching to that office.

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108 Section 601FC(2).
109 Letterstedt v Broers (1884) 9 App Cas 371 at 386 per Lord Blackburn. See also Hospital Products Ltd v US Surgical Corp (1984) 156 CLR 41 at 68 per Gibbs CJ; Elders Trustee and Executors Co Ltd v E G Reeves Pty Ltd (1987) 78 ALR 193. Note that even if an office is not within one of the stated categories, a fiduciary relationship may nonetheless be found to exist by virtue of the characteristics of the particular relationship. For instance, it has been argued that under the now repealed Part 7.12, the manager of a unit trust held a fiduciary office even though it was not in a trustee role: see Hughes at 117-125; Ford H A J & Hardingham I J, ‘Trading Trusts: Rights and Liabilities of Beneficiaries’, in Finn, P D, Equity and Commercial Relationships, Law Book Company, 1987 at 69-70; Stewart R, ‘Unit Trusts – Legal Relationships of Trustee, Manager and Unitholders’ (1988) 6 CSLJ 269; Brewster D, ‘Fiduciary Obligations of Trust Managers and the Takeover of Unit Trusts’ (1990) 8 CSLR 303.
However, these duties and obligations are not immune from the statutory and contractual aspects of the scheme. The MIA imposes various statutory duties on the responsible entity, being similar in nature to the general law requirements. In this sense, the equitable principles are subsumed by the legislation, it being possible to commence actions on the basis of a statutory cause of action rather than a claim for equitable compensation. Furthermore, the equitable rules may be modified by the scheme constitution and increased obligations may be imposed. The constitution may further modify or abrogate the duties of the responsible entity, with the proviso that the duties expressed in the legislation cannot be affected. In this sense, the MIA provides the minimum standard required of the responsible entity.

As the responsible entity and scheme members are parties to a commercial contract, one could argue that the nature of the responsible entity’s office is incongruous with the basis of the fiduciary office: being to solely serve the interests of the beneficiary. The scheme represents both the investment capital of members and the business of the responsible entity, thereby existing for the interests of all participants rather than solely for the benefit of members. It is the constitution, representing the contractual bargain struck between the parties, which should be the basis of regulating the legal relationships within the scheme. The following responses can be offered in reply to this proposition.

First, it has consistently been held that commercial contracts and fiduciary obligations may coexist. While the contract regulates the basic rights and liabilities of the parties, fiduciary duties may be imposed where it is appropriate to give effect to the expectations of the parties upon entering the arrangement.

Secondly, the responsible entity receives its reward for the management of the scheme by virtue of its contractual right to remuneration. The reward for members for contributing their resources, however, is contingent on the successful operation of the scheme, and therefore the actions of the responsible entity. While both parties profit from the exercise, the members place reliance on and are vulnerable to the actions and performance of the responsible entity. The position is no different to a traditional trustee company which, irrespective of the fact that it receives remuneration and thereby benefits from the successful operation of the trust fund, nonetheless owes obligations of a fiduciary nature to its beneficiaries.

Finally, irrespective of the above discussion, the legislature has deemed that fiduciary obligations are to be imposed. The legislation deems there to be a trust. One can only assume it is intended that trust and fiduciary obligations necessarily flow. The Act also explicitly provides that the best interests of members must be pursued and preferred over the interests of the responsible entity. Therefore, irrespective of the contractual and statutory nature of the scheme, a trust relationship is formed, the

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110 Section 601FC(1).
111 Section 601MA(1).
112 See for instance Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41 at 97 per Mason J.
114 Section 601FC(1)(c).
Part B - Amendments by the Responsible Entity

responsible entity thereby being imposed with all the duties and obligations attaching to the fiduciary office.\textsuperscript{115}

(c) The Power of Amendment as a Fiduciary Power

It has been established that the office of the responsible entity is fiduciary in nature. However, the identification of a fiduciary relationship is not the most important inquiry, as the content and scope of the obligations attaching to that office must also be established in the light of the particular relationship at hand.\textsuperscript{116} It is well established that a person may be a fiduciary for some purposes and not for others.\textsuperscript{117} Even a trustee, being the archetypal fiduciary, may be a fiduciary only in part, depending on the circumstances of the given relationship.\textsuperscript{118} In this sense it may be possible to draw a distinction between fiduciary powers, being those powers of which their exercise is subject to fiduciary obligations, and beneficial powers, being powers which may be exercised in the interests of the holder.\textsuperscript{119} It must therefore be queried whether the responsible entity is imposed with fiduciary obligations upon all actions and exercises of power, or merely those which exist for the sole benefit of member.

In support of the latter proposition, it may be argued that the trust is used as a holding device for scheme property and is merely one aspect of a larger contractual and statutory scheme for the investment and management of the collective investment. The trust relates to the scheme property and does not dictate or provide the primary source of substantive legal rights of the parties to matters not relating to the property-holding function. Powers not directly related to the property-holding function may therefore be exercised in the interest of the responsible entity, being analogous to an absolute power of appointment and therefore not restrained by those duties ascribed to persons acting in a fiduciary capacity.

If this argument is accepted, it must be determined whether the power of amendment falls within the category of powers which are fiduciary in nature. Two arguments may be offered in support of the proposition that the amendment power is a beneficial power, the responsible entity not being imposed with fiduciary obligations upon its

\textsuperscript{115} A further argument could be that there is no equality of bargaining power between the parties. Individual investors are likely to hold a small proportion of the scheme units, and are not represented by any collective body to negotiate the terms of the constitution in their interests, such as a union in the case of superannuation schemes.

\textsuperscript{116} Aas v Benham [1891] 2 Ch 244; Birchnell v Equity Trustees Executors and Agency Co Ltd (1929) 42 CLR 384; Miller v Miller (1995) 16 ACSR 73. See also SEC v Chenery Corp (1943) 318 US 80 at 85-86 per Frankfurter J: “To say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?”

\textsuperscript{117} NZ Netherlands Society v Kuys [1973] 2 All ER 1222 at 1225 per Lord Wilberforce; Hospital Products Ltd v US Surgical Corp (1984) 156 CLR 41 at 98 per Mason J.


\textsuperscript{119} Scott A W, The Law of Trusts, Little Brown and Company, 1939, Volume 2 at 1358. This distinction has been accepted by English courts: see Re Triffitt’s Settlement [1958] Ch 852. In Noranda Australia Ltd v Lachlan Resources NL (1988) 14 NSWLR 1 a joint venture agreement deemed the parties to be in a fiduciary relationship. Irrespective of this provision, however, it was held that the scope of the fiduciary obligations did not extend to contractual provisions which, upon proper construction, allowed the parties to pursue their own distinct interests.
exercise. First, s601GC provides for amendments by either a resolution of scheme members or unilaterally by the responsible entity. Given the fact that both organs of the scheme are vested with such a power, it is possible to infer an intention by the legislature that either party may seek amendments in pursuit of their own interest. Secondly, the statutory restraint on amendments by the responsible entity in s601GC(1)(b) prevents amendments which 'adversely affect' members' rights. This differs from the obligations placed on fiduciaries in exercising a fiduciary power which requires the exercise to be for the benefit of beneficiaries, being a higher standard of conduct. Following from this, the express statutory restraint would be redundant if the responsible entity was imposed with the higher equitable standard.

However, it is submitted that the responsible entity is imposed with fiduciary obligations in the exercise of all its powers and duties, including the constitutional amendment power. The statutory duties placed on the responsible entity by virtue of s601FC(1)(c) and (d) require it to act in the best interests of members and to act impartially 'in exercising its powers and carrying out its duties'. Therefore, the Act imposes fiduciary obligations on the responsible entity upon performing all its functions and exercising all of its powers, irrespective of whether those functions or powers are properly characterised as relating to the property-holding function of the scheme.

Following from this, the power of constitutional amendment is a fiduciary power. Judicial support may be offered for this proposition, the cases involving powers vested in superannuation trustees to consent to trust deed amendments. The High Court decision of Metropolitan Gas Company v FCT involved a claim for the deductibility of superannuation contributions by a company. The Commissioner disallowed the deduction on the ground that the rights of employees to receive the benefits had not been fully secured to them by the trust instrument within the meaning of s23(1)(j) of the Income Tax Assessment Act 1922-1929 (Cth). One provision relied on by the Commissioner granted a power to the directors of the company, with the approval of the trustees, to make and alter rules for the administration of the fund. In relation to the discretion vested in the trustee to consent to such amendments, Duffy CJ and Starke J stated:

> The trustees are, of course, in a fiduciary position under the trust instrument, and must exercise their powers honestly and reasonably in the interest of the contributors. Otherwise, we apprehend, they would be controlled by a Court of competent jurisdiction.

Therefore, the High Court acknowledged that a power vested in the trustee to veto amendments made by the scheme manager was subject to equitable restraints. A similar finding was made in relation to the power of consent vested in a trustee in Lock v Westpac Banking Corporation. Citing Metropolitan Gas Company v FCT, Waddell CJ stated:

> Clearly enough, in exercising their power to consent to the amendment to the deed the Trustees were obliged to act honestly and in good faith, to act in

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120 (1932) 47 CLR 621.
121 Ibid at 633.
122 (1991) 25 CLR 593 at 609 per Waddell CJ.
what they consider to be the interests of the members, and to act for proper purposes and upon relevant considerations.

These decisions relate to rights of veto vested in trustees upon amendments instigated by employer companies. In contrast, s601GC(1) provides the responsible entity with a power to effect amendments itself. Irrespective of this distinction, it necessarily follows from these decisions, as well as the arguments presented above, that the power vested in the responsible entity to instigate the amendments on its own behalf will be subject to those duties which attach themselves to the fiduciary office. Therefore, it is submitted that the power of amendment, as with all the powers vested in the responsible entity by virtue of the Act and the constitution, is fiduciary in nature and subject to obligations of a fiduciary character. The following chapter explores the nature and scope of these obligations.

Superannuation trust deeds commonly vest a trust deed amendment power in the employer company, with a right of veto vested in the trustee. In the New South Wales Court of Appeal decision of Wilson v Metro Goldwyn Mayer (1990) 18 NSWLR 730 at 736, Kearney J (by way of obiter) found that irrespective of the fact that the employer company was not in the position of trustee, it may still owe fiduciary obligations in the exercise of its amendment power. Compare Lock v Westpac Banking Corporation (1991) 25 NSWLR 593 at 607-608 where Waddell CJ found an employer company to not be subject to fiduciary obligations in the exercise of a constitutional amendment power in a superannuation trust deed. His honour did, however, find that the power was subject to an implied condition that it be exercised honestly and in good faith, based on the fact that superannuation is part of the members' contracts of employment.
5. Equitable Restraint on the Power

This chapter is concerned with the restraints placed on the responsible entity when amending the scheme constitution by virtue of equity, as well as its correlating statutory duties derived from those in equity.¹

During the course of this chapter, it must be borne in mind that while equity ascribes various rules and obligations, the specific content of those obligations is defined by the nature of the particular relationship between the fiduciary and its beneficiaries.² Without a doubt, the responsible entity is a fiduciary and the amendment power is a fiduciary power.³ However, the scope of what exactly is required from this office will be particular to it alone, based on the nature of the scheme as a commercial vehicle for collective investment, the provisions of the MIA, and the terms of the particular scheme constitution.

When reviewing the exercise of a discretion by a fiduciary, the courts adopt two distinct legal perspectives.⁴ First, the courts will treat the action as an exercise of a limited power of appointment. The exercise of the power will be judged by reference to the nature of the power and the purpose for which it was conferred, requiring the fiduciary to act within the power and for a proper purpose. Secondly, the courts will undertake an additional examination as to whether the fiduciary has acted in what it believes to be in the best interests of the beneficiaries.⁵

¹ Further duties may be imposed by the scheme constitution, and if so, will have statutory effect by virtue of s601FC(1)(m). However, as discussed above at 4.3.2, such further duties cannot place a direct restraint on the power of amendment, as to do so will be inconsistent with the statutory power vested in the responsible entity.


³ See 4.3.3 above.


⁵ Professors Finn and Austin argue that neither of these duties are fiduciary in nature upon proper analysis. The duty to act in the beneficiaries' interests is merely an aspect of the duty of good faith, while the duty to act for a proper purpose in exercising fiduciary discretions is a manifestation of fraud on the power, being an examination as to whether the purported action was within the scope of the power. It is applicable to the exercise of all powers, whether fiduciary or not. Finn and Austin further argue that the exhaustive content of fiduciary obligations is explained by the no-profit and no-conflict rules, discussed briefly below at 5.3.2. These two obligations imposed on fiduciaries are based on the requirement that the fiduciary have an undivided loyalty towards its beneficiaries: Finn P D, 'The Fiduciary Principle', in Youdan T G (ed), Equity, Fiduciaries and Trusts, Carswell & Law Book Company, 1989; Austin R P, 'Moulding the Content of Fiduciary Duties', in Oakley A J (ed), Trends in Contemporary Trust Law, Clarendon Press Oxford, 1996. This proposition has received recent judicial support by the High Court of Australia: Breen v Williams (1996) 138 ALR 259 at 274 per Dawson, Toohey J. See also Gaudron and McHugh JJ at 285. That given, the title to this chapter, being 'Equitable Restraint on the Power', is given a loose definition, as it can be argued that some duties discussed in this context are not derived from equity. In particularly, the duty to act for a proper purpose may merely concern whether a purported exercise of power is ultra vires. Irrespective of this, however, whether obligations placed on the responsible entity upon exercising its powers and discretions are properly described as fiduciary or non-fiduciary is of little bearing for current purposes. The issue is the applicability, requirements and extent of these duties. Furthermore, many of the obligations discussed have received statutory expression, their underlying source therefore being a mere moot point. Finally, many of the obligations discussed are applicable
The opening section of this chapter examines the first perspective, involving an analysis of fraud on the power and the duty to act for a proper purpose (5.1). This is followed by a discussion of the doctrine of failure of substratum, in which it is argued that the doctrine is merely an instance of fraud on the power (5.2). The third part analyses the second perspective adopted by courts in examining fiduciary actions, concerning the duty to act in the best interests of the beneficiaries (5.3). The final part briefly examines the issue of whether breaches of fiduciary obligations may be ratified or whether the duties themselves may be excluded (5.4).

5.1 Duty to Act for a Proper Purpose

In exercising their powers, fiduciaries are treated as donees of a limited power of appointment, thereby being under an obligation to ensure that their actions fall within the scope of the power. This restraint is not reliant on the exercise being of a fiduciary power. It is also applicable to powers vested in non-fiduciaries. It is concerned with ensuring that persons vested with limited powers do not exceed the scope of the power conferred.

The courts have adopted a distinct approach to controlling actions by company directors in exercising their fiduciary powers, being derived from the doctrine of fraud on the power, but developed in order to accommodate the particular position of a director in a commercial enterprise. This section first explores the doctrine of fraud on the power as originally formulated to control donees of limited powers of appointment. This is followed by a survey of the approach taken in the control of company directors. It is then argued that in controlling actions by the responsible entity in amending the scheme constitution, the latter approach is to be preferred.

5.1.1 Fraud on the Power

A limited power which is designed to achieve one particular purpose cannot be exercised to achieve a different purpose, as this would constitute the purported action being beyond the scope of the power. An action in excess of a power is referred to as fraud on the power.

The General Formulation

Fraud on the power is a device for the judicial control of appointments by trustees of discretionary trusts and donees of powers of appointments to ensure they act within the authorising terms of the conferring instrument. In the House of Lords decision of
Duke of Portland v Lady Topham,\(^9\) Lord Westbury LC described the formulae as follows:\(^10\)

…the donee, the appointer under the power, shall, at the time of the exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view to the real purpose and object of that power, and not for the purpose of accomplishing or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power.

In the later case of Vatcher v Paull,\(^11\) Lord Parker of Waddington provided the classic formulae for the doctrine:\(^12\)

The term fraud in connection with frauds on a power does not necessarily denote any conduct on the part of the appointer amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power…it is enough that the appointer’s purpose and intention is to secure a benefit for himself, or some other person not an object of the power.

In determining whether a fraud on the power has been committed, a two step inquiry is conducted by the courts.\(^13\) First, the nature and scope of the power is ascertained as a question of law in order to determine the range of purposes for which it may be validly exercised. The courts will look to the conferring document, as well as the surrounding circumstances of the conferring of the power. In this regard, the courts may investigate the purpose and intentions of the donor in granting the power.

Secondly, the object or purpose of the donee in exercising the power is established as a determination of fact. It is the subjective intention of the donee which is relevant in determining the validity of the appointment. It is not required that the improper intention be carried into effect, but merely that such a purpose exists upon the appointment being made and is causative of that appointment.\(^14\) Therefore, an appointment is not bad merely because it confers some benefit upon the donee, the issue being one of the purpose for which the appointment is made rather than the effect the appointment has on the financial position of the appointor. What is required is that the appointment be made with the intention of conferring a benefit on some

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\(^9\) (1864) XI HLC 32; 11 ER 1242.

\(^10\) Ibid, at 54. See also the judgement of Lord St Leonards at 55. Lord Westbury’s formulation was described by Vaisey J in Re Greaves [1954] Ch 434 at 439 as the classic pronouncement of the highest authority on the subject. See also In re Brook’s Settlement [1968] 1 WLR 1661 at 1664 per Stamp J.


\(^12\) Ibid, at 378.

\(^13\) Finn, op cit, at 39-40.

\(^14\) Re Wright [1920] 1 Ch 108; Re Crawshay [1948] Ch 123 at 135 per Cohen LJ. However, where the improper intention of the appointor is not known or proved, courts will be reluctant to find a fraud on the power: Re Dick [1953] 1 Ch 360.
non-object to the appointment. This distinction is crucial to what is argued below, and was explained by Stamp J in *Re Brook's Settlement* as follows:

It is, however, to be observed that the exercise of a fiduciary power of appointment does not become a fraud on the power because it in fact confers a benefit upon a person who is not an object of the power, but because the purpose, or one of the purposes, of the appointment is not to benefit the appointee who is an object of the power but is an ulterior purpose. The fact that a person who is not an object of the power does obtain a benefit is no doubt often evidence that that was the purpose or one of the purposes of the appointment. But that is not always so; and the distinction between the effect of the appointment and its purpose remains.

As there is a *prima facie* assumption that an exercise of power is bona fide, the onus is on the party alleging the fraud to prove the exercise is bad.

**Competing Purposes**

As stated by Lord Westbury LC in *Duke of Portland v Lady Topham*, the power must be exercised 'with an entire and single view to the real purpose and object of the power'. As such, any improper purpose, however minor, will render the appointment invalid, provided that purpose is causative of the appointment. Therefore, where there is a combinations of proper and improper purposes, the appointment will be bad, irrespective of whether the improper purpose is ancillary to the appointment. For an appointment to escape the doctrine, it is not enough that one of the purposes for which it was made was to benefit the beneficiaries, but rather that must be the only purpose. All that is required to invalidate the appointment is that the improper purpose is causative of the appointment, as otherwise the investigation will be of no relevance. As stated by Vaisey J in *Re Simpson*:

The doctrine can be summed up in the shortest possible way by saying that an appointment will be held to be fraudulent if it is executed with a view to furthering some object which the appointer had in view, and not with the sole object of benefiting the appointee who is the object of the power.

However, there are authorities which suggest that the improper purpose must be the real, dominant, or primary purpose before an appointment is rendered bad. In the New South Wales Supreme Court decision of *Hooke v Robson*, Jacobs J drew a distinction between primary and secondary purposes, stating:

It is necessary to determine the intention or purpose with which the power was exercised...A purpose or intention to benefit himself or a stranger makes

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15 *Re Robertson's Will Trusts* [1960] 1 WLR 1050.
16 [1968] 1 WLR 166 at 1666. See also *In Re Burton's Settlement* [1955] Ch 82 at 100 per Upjohn J.
17 *Gordon v Australian & New Zealand Theatres Ltd* (1940) 40 SR(NSW) 512 at 517 per Jordon CJ.
18 (1864) XI HLC 32; 11 ER 1242 at 1251.
20 [1952] 1 Ch 412 (emphasis added). See also *In Re Brook's Settlement, supra* at 1668 per Stamp J.
21 See for instance *Re Holland* [1914] 2 Ch 595 at 601; *Re Burton's Settlements* [1955] Ch 82 at 100-101.
23 Ibid, at 609.
Part B - Amendments by the Responsible Entity

a donee's exercise of a power fraudulent, but it is not, in my view, any intention or purpose to benefit himself or a stranger which has this effect. That intention or purpose must be a primary one, that is to say, an actuating purpose without which it cannot be said that the appointment would have been made.

If his Honour, by this statement, is merely stating that the improper purpose must be causative of the appointment, then it is consistent with the general doctrine. However, if the statement is suggesting that there exists a further requirement, being that the improper purpose must not only be causative but also primary, then this approach is inconsistent with the general principles established in *Duke of Portland v Topham* and *Vatcher v Paull*. The doctrine of *fraud on the power* is concerned with the appointor's purpose *per se*. It is of no consequence whether a purpose is primary or secondary. In this vein, Maclean has stated in relation to the general formulation of the doctrine:24

Those tests do not themselves require that an improper purpose should be the dominant, substantial, primary or sole purpose of an appointment for it to be bad as a fraud on the power. Further, it is clearly contemplated that a fraud on a power can be found in the case of an appointment that has been made for a combination of proper and improper purposes...It is thereby assumed that an appointment made for both proper and improper purposes is fraudulent in the present sense. There is no requirement that the improper purpose should satisfy any special test of substantiality or the like.

Therefore, where there is more than one purpose, each such purpose being causative of the appointment, the courts will not investigate whether the improper purpose is primary or secondary. The appointment will be bad.

5.1.2 Fraud on the Power and the Company Director

Before applying the doctrine of *fraud on the power* to actions by the responsible entity, it is necessary to survey decisions relating to exercises of power by company directors. Whilst based on the equitable doctrine discussed above, these decisions have resulted in the evolution of a unique and distinct formulation applicable to company directors.25

The Duty to Act for a Proper Purpose

In exercising powers conferred on them, company directors must act for a purpose for which the power was expressly or impliedly conferred.26 In this sense, the director is treated as a donee of a limited power. Therefore, the above principles of *fraud on the power* have been applied to fiduciary powers vested in the company director.

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25 It is not necessary to conduct a thorough analysis of the company law decisions, but merely to emphasis the way in which they diverge from the underlying equitable doctrine of *fraud on the power* and thereby apply them to a managed investment scheme context. As such, only the primary cases are considered.
There has been a tendency for courts to treat the duty to act for a proper purpose as merely one aspect of a director's fiduciary obligation to act *bona fide* in the interests of the company. The duty has been characterised as an objective element of the duty of good faith, being an otherwise subjective test. However, this view is a misclassification, the two obligations being both separate and distinct. The former is based on the doctrine of *fraud on the power* and relates to the restraint on directors to act within the scope of their power. This restraint is not reliant on the power being fiduciary in nature. The latter, on the other hand, is based on the directors' position as fiduciaries and their obligation to act in the interests of their beneficiaries. Therefore, as the two duties are distinct in both source and nature, an exercise of power which is made *bona fide* in the best interests of the company may nonetheless be invalid if exercised for an improper purpose.

The decisions applying the duty to act for a proper purpose predominantly involve directors exercising their power under the company articles to allot shares in order to manipulate the control structure of the general meeting or to frustrate a take-over bid. The following section surveys the more important of these cases, identifying where the principles have diverged from their equitable origins. It is argued that this approach, as applied to company directors, is applicable to exercises of power by the responsible entity rather than the more restricting requirements placed on donees of limited powers.

*The Law Prior to Howard Smith v Ampol Petroleum: The Single Formulation of the Duties*

The former approach adopted by courts in reviewing actions by directors is represented by the High Court decision of *Mills v Mills*. The litigation involved a resolution by directors in a family company to distribute the accumulated profits to ordinary shareholders in the form of shares, thereby increasing the voting power of ordinary shareholders as compared to preference shareholders. An action was commenced on behalf of shareholders on the basis that the resolution was not passed *bona fide* in the interests of the company but rather with the intention of securing continuing control in the defendant director. It was further argued that the resolution was *ultra vires*. The Court held that the motivation for the share issue was to give

27 See for example *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199 at 217 per Isaacs J; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483 at 493; *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288.

28 See for instance *Rogers N, 'When Can Target Directors Legitimately Frustrate a Takeover Bid?'


30 The duty to act *bona fide* is now reflected in a statutory duty to act honestly: ss232(2). For managed investment schemes, see s601FC(1)(a).

31 In relation to pension schemes, see *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, where Knox J held that an exercise of a power allowing the trustee to transfer the entire assets and liabilities of the scheme to another pension scheme constituted a *fraud on the power*, notwithstanding that the trustees had acted in what they considered to be the best interests of the members.

32 (1938) 60 CLR 150. See also *Ngurli v McCann* (1953) 90 CLR 425; *Hogg v Cramp horn* (1967) Ch 254; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483; *Teck Corporation Ltd v Millar* (1972) 33 DLR (3d) 288; *Pine Vale Investments Ltd v McDonnell and East Ltd* (1983) 1 ACLC 1294; *Cayne v Global Natural Resources PLC*, Chancery Division, 12 August 1998, unreported.
ordinary shareholders title to the profit reserves, the exercise being valid. Dixon J stated the relevant law as follows:  

[If] the substantial object the accomplishment of which formed the real ground of the board’s action...is within the scope of the power, then the power has been validly exercised. But if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power.

This approach is consistent with the fraud on the power doctrine, an examination as to the purpose or object of the directors in exercising their power being undertaken. In relation to share issues, a purpose of maintaining control over the affairs of the company or defeating the wishes of the majority of shareholders is not a proper purpose.  

Two observations may be offered with respect to this approach. First, this decision illustrate an instance where the courts have expressed a reluctance to interfere with the commercial decisions of the company. The inquiry is as to whether the decision by the board was made bona fide and in what the directors considered to be in the interests of the company, and no more. No examination as to the objective desirability of the decision is undertaken. Once the court is satisfied that the directors have fulfilled their duty to act bona fide, it will not replace its own decision for the decision made by the board exercising their management power. This approach is often referred to as the business judgement rule, described by the High Court as follows:  

Directors in whom are vested the right and the duty of deciding where the company’s interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgement, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.

Secondly, resulting from their reluctance to interfere with management decisions which are shown to be bona fide, the case illustrates an instance where the courts have considered the two duties placed on directors, the first being to act for a proper purpose, and the second relating to whether they considered their actions to be in the interests of the company, as one unified basis for judicial review. The directors must act for a proper purpose, being for the purpose of benefiting the company as a whole. This is most clearly illustrated by the observations of Berger J in Teck Corporation Ltd v Millar:  

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33 (1938) 60 CLR 150 at 150.
34 Ibid, at 175 per Starke J. See also Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co (1968) 121 CLR 483 at 493 per Barwick CJ, McTiernan J and Kitto J.
35 Harlowe’s Nominees Pty Ltd, supra, at 493.
36 See for instance Starke J at (1938) 60 CLR 150 at 175, who states: ‘Directors in the exercise of their powers are in a fiduciary position and must exercise those powers for the benefit of the company. So, directors are not entitled to exercise their powers merely for the purpose of maintaining control over the affairs of the company or merely for the purpose of defeating the wishes of the majority of shareholders’.
37 (1973) 33 DLR (3d) 288 at 315-316.
I think the Courts should apply the general rule in this way: The directors must act in good faith. Then there must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company’s interest, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose.

As already noted, this approach does not give adequate appreciation to the distinct nature of each test. Properly applied, it is open to the courts to find that although the directors did in fact act in what they considered to be the corporate interest, the power was nonetheless exercised beyond the scope conferred. Under the joint formulation applied in these decisions, where the two rules are reliant on each other, no such finding can be made. The formulation is therefore questionable.

The Current Position: The Dual Formulation

*Mills v Mills* was considered by the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd*, which similarly involved a share issue by directors which had the effect of diluting the holdings of a majority shareholder. The issue to be determined was whether the substantial object of the directors in exercising the power was to satisfy the company’s need for capital, or alternatively to destroy the majority shareholdings of the respondent. As a finding of fact at first instance, the Supreme Court of New South Wales held that the directors were not motivated by any purpose of personal gain or advantage, or in any way by a desire to retain their position on the board. Nonetheless, it was found that the primary purpose for the share issue was to reduce the shareholdings of the respondent and to induce a take-over bid from a friendly third party.

The Privy Council accepted the finding by the Supreme Court that the share issue was motivated by an intention to induce a friendly take-over bid. As to whether this purpose fell within the scope of the power, the Court stated:

> Just as it is established that directors, within their management powers, may take decisions against the wishes of majority shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office...so it must be unconstitutional for directors to use their fiduciary powers over shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company’s constitution which is separate from and set against their powers.

Therefore, the Court approached and determined the issue as follows: *first*, it was determined, as an issue of fact, that the power was exercised for the purpose of destroying the existing majority and facilitating the take-over bid; *secondly*, the Court

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38 [1974] AC 821. This decision has been cited as authority for the proposition that individual shareholders have standing to bring a personal action to challenge allotments made for an improper purpose, therefore providing an exception to the rule in *Foss v Harbottle: Re a Company* [1987] BCLC 82; *Eromanga Hydrocarbons NL v Australis Mining NL* (1988) 14 ACLR 486; *Residue Treatment & Trading Co Ltd v Southern Resources Ltd (No 4)* (1988) 51 SASR 196.

39 Ibid, at 837.
held, as a matter of law, that this purpose was outside the scope of the power and therefore improper. This approach is consistent with the doctrine of fraud on the power.\(^6\)

The decision of the Privy Council was considered by the High Court of Australia in *Whitehouse v Carlton Hotel Pty Ltd*.\(^4\) The litigation involved a company with three classes of shares. Class A, held by Mr Whitehouse, the governing director, carried unrestricted voting rights. Class B carried voting rights only after Mr Whitehouse's death, and was held by his wife, while class C contained no voting rights. Mr Whitehouse allotted new class B shares in order to ensure control of the company went to his son rather than his wife upon his death. It was accepted by the court that the action was intended to benefit the company by ensuring its efficient and profitable operation upon his death. The allotment was challenged on the ground that it was an improper exercise of power.

In their majority judgment, Mason, Deane and Dawson J held that the exercise was beyond the scope of the allotment power. Irrespective of whether the allotment was made with the interests of the company in mind, the power was exercised for an improper purpose:\(^5\)

...the directors of a company cannot ordinarily exercise a fiduciary power to allot shares for the purpose of defeating the voting power of existing shareholders by creating a new majority...The reason why, as a general rule, it is impermissible for a company to exercise a fiduciary power to allot shares for the purpose of destroying or creating a majority of voting power was identified by the Privy Council in *Howard Smith v Ampol Petroleum Ltd*. It lies essentially in the distinction between the indirect proprietorship and ultimate control of the shareholders on the one hand and the powers of management entrusted to the directors on the other. It is simply no part of the function of the directors as such to favour one shareholder or group of shareholders by exercising a fiduciary power to allot shares for the purpose of diluting the voting power attaching to the shares held by some other shareholder or group of shareholders.

As the allotment was made for an improper purpose, it was bad, irrespective of the "altruistic" motives of the director.\(^9\) Therefore, the High Court moved away from the approach of treating the two heads of duty placed on directors as a single formulation.\(^4\) Irrespective of whether the course of action adopted by the directors

\(^6\) See also *Hogg v Cramphorn Ltd* [1967] Ch 254 at 268-269 per Buckley J; *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109 at 137 per Ipp J (Malcolm CJ and Seaman J concurring); *Kokotovich Construction Pty Ltd v Wallington* (1995) 17 ACSR 478 at 490


\(^9\) *Ibid.*, at 293.

\(^4\) The approach of the majority in *Whitehouse v Carlton* can be compared with the minority judgments of Wilson J, *ibid.*, at 305. His Honour took the view that as the action was taken with a subjective intention to benefit the company, it was valid, irrespective of whether it had the effect of manipulating the voting power and control within the company. All that was required was that the director exercised his power for the purpose of serving the interests of the company, and not for some ulterior or impermissible purpose.
was considered to be in the company's interest, it could still be found improper and outside the power.\textsuperscript{45}

It must be queried whether the current approach adopted by the High Court and the Privy Council is consistent with the underlying doctrine of *fraud on the power*. It is submitted that the approach differs in respect to the manner in which the courts construe the relevant purpose in situations where there is more than one causative purpose for the purported action. In this regard, the approach diverges from its predecessor on two counts, each of which will be explored in turn:

(a) Courts have applied an objective determination of the purpose for the exercise of power.
(b) When there are mixed or competing purposes, a *dominant purpose* test is applied.

(a) Objective Determination of Purpose

The traditional approach, as applied in *fraud on the power* cases, is to determine the subjective purpose behind an exercise of power by the donee, as a question of fact. As discussed above,\textsuperscript{46} the courts are concerned with the *purpose* for which the donee exercised the power and not the *effect* of the exercise. This subjective determination is weighed against the objective determination of law as to the scope of permissible purposes.

However, objective considerations necessarily come into play in establishing the director's purpose for the action.\textsuperscript{47} This was expressly acknowledged by the Privy Council in the *Howard Smith v Ampol Petroleum* decision, where Lord Wilberforce stated that the Court:\textsuperscript{48}

...is entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial, or per contra, insubstantial an alleged requirement may have been. If it finds that a particular requirement, though real, was not urgent, or critical, at the relevant time, it may have reason to doubt, or discount, the assertion of individuals that they acted solely in order to deal with it, particularly when the action they took was unusual or even extreme.

It is submitted that the objective approach taken by the courts goes further than as described by Lord Wilberforce. The doctrinal basis of the investigation is the same as for *fraud on the power*. However, the determination of the purpose for which the power is exercised has shifted from a subjective to an objective inquiry, the courts concerning themselves with the *effect* the exercise has on the balance of power between the company directors and the shareholders rather than the subjective

\textsuperscript{45} See also *Advance Bank of Australia v FAI Insurance Ltd* (1987) 9 NSWLR 464 at 485-486 per Kirby P (with Glass JA concurring).

\textsuperscript{46} See 5.1.1 above.

\textsuperscript{47} Professor Sealy has attributed the willingness of the courts to objectively judge the purposes for which a power is exercised on the commercial awareness of judges in modern time as compared with their predecessors: Sealy L S, ‘Bona Fides and Proper Purpose in Corporate Decisions’ (1989) 15 Monash ULR 265.

\textsuperscript{48} [1974] AC 821 at 832.
Part B - Amendments by the Responsible Entity

The courts have held that certain ends are improper. In the cases at hand, an exercise of the power to allot shares cannot be exercised if this would result in a manipulation of the ownership or voting structure of the company, irrespective of whether the purpose of the action is to benefit the company. This restriction is justified on the basis of the balance of power within the company, the directors being prohibited from exercising their powers to interfere with the inherent rights of shareholders. Such actions are improper, irrespective of the subjective purpose for which the power was exercised. Put another way, rather than investigating the purpose held by a director in exercising his or her power, the court is restricting the company itself from following certain courses of conduct, irrespective of the underlying purpose.

This is most clearly illustrated by the disparity between the decision of the majority and the minority judgment of Wilson J in *Whitehouse v Carlton*. Both decisions applied a proper purpose test. However, their characterisation of the purpose of the share allotment diverged significantly. The majority characterised the purpose as manipulating the voting structure of the company. This being the case, the purpose was improper and the action therefore invalid. Wilson J, on the other hand, considered the purpose as ensuring the continued efficient and profitable operation of the company after the death of Mr Harlowe, the majority characterising this as a motive rather than a purpose, and therefore irrelevant to the investigation. This disparity is explained by the majority looking to the effect of the action, even though their Honours shrouded their investigation in terms of the purpose.

In some respects, this distinction would seem a matter of semantics. The immediate intention of the directors in *Whitehouse v Carlton* was to manipulate the voting structure of the company, while their ultimate intention was to ensure the future operation of the company. The former may be viewed as a purpose, the latter being a mere motive which led to the pursuit of that purpose. On the other hand, ensuring the future operation of the company may be construed as the real purpose for the action, while manipulating the share structure may be seen as a consequence or effect of pursuing that purpose, being necessary in order to realise the underlying purpose of the action. While the labels attached to the action may seem a matter of semantics, the

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50 *Whitehouse v Carlton*, ibid, at 289-290.
51 Another possible explanation for this objective approach may be that the courts are merely drawing inferences as to the subjective intention of the directors from the objective facts ascertained concerning their action. In criminal law, see *Cutter v R* (1997) 143 ALR 498. In that case, Kirby P at 510-511 (in a dissenting judgment) discussed the need for courts to draw inferences as to an accused's intention at the relevant time from the facts proved in evidence. However, the justification given by his Honour for this approach was that in criminal proceedings, the accused is entitled to remain silent while the prosecution is put to proof. This practical difficulty of obtaining evidence in criminal proceedings is not present in company law proceedings, where direct evidence can be obtained from the directors concerned. Moreover, in the company law cases discussed above, the courts are not merely drawing an inference as to subjective intention from the objective facts, but are actually categorising the objective consequence as the purpose or intention itself. Kirby P (at 511) also drew the distinction between a person's intention and their 'motives, desires, wishes, hopes, reasons or expectations', only the former being relevant in proving the necessary mens rea for a criminal offence.
ramifications of the construction in determining whether a purported action is within the power are real. As observed by one commentator:\(^{52}\)

The doctrine is perhaps inaptly described as the 'proper purpose' doctrine, for the rule postulated by the Privy Council above has nothing to do with an examination of the motives of the directors, but everything to do with a consideration of the shareholders' rights affected by the director's decisions.

The approach of construing the effect or immediate consequence of the action as the relevant purpose has not only altered the doctrinal investigation undertaken by the courts, but it also has had the effect of shifting the balance of power considerably in favour of shareholders, allowing for a greater level of judicial intervention.\(^{53}\) It provides a means for the courts to investigate the merit of a business decision by judging the ramifications the action has on the relevant stakeholders in the company.\(^{54}\)

This new found judicial activism further allows for value-laden determinations by the courts on what directors should be doing, as opposed to what they ought to intend to achieve by doing it.\(^{55}\)

(b) Competing Purposes

In the context of fraud on the power, an appointment will be held invalid if it is made with an impermissible purpose. Where there are several competing purposes to which the donee was motivated, the improper purpose need not be the substantial or dominant purpose, but merely causative of the appointment.\(^{56}\)

In the context of actions by directors, however, there would seem to be a deviation from this strict approach. It is the substantial object of the directors which the courts scrutinise in order to determine the validity of an action. In Mills v Mills, Dixon J stated:\(^{57}\)

\[\text{...it may be thought that a question arises whether there must be an entire exclusion of all reasons, motives or aims on the part of the directors, and all of them, which are not relevant to the purpose of a particular power. When the law makes the object, view or purpose of a man, or of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote,} \]

\(^{52}\) Rogers N, ‘When Can Target Directors Legitimately Frustrate a Takeover Bid?’ (1994) 12 CSLJ 207 at 218.

\(^{53}\) The objective nature of the investigation may be further apparent in future decisions given the High Court decision of Gambotto v WCP Ltd (1995) 182 CLR 432, discussed below at 8.1.2.

\(^{54}\) Compare this with the prior reluctance of courts to interfere in business judgments, discussed above in the context of Mills v Mills (1938) 60 CLR 150.

\(^{55}\) Under CLERB, the distinction between the duty to act for a proper purpose and the duty to act in the interests of the company will be made clear in the case of company directors: CLERB, s181(1). Note that it is further proposed that a statutory business judgement rule be implemented in order to provide a safe harbour for directors in the exercise of their powers. Directors will be assumed to have complied with their civil duty of care and diligence in respect of their judgements if certain conditions are complied with, one of those conditions being that the judgement be made for a proper purpose: CLERB, s180(2). Therefore, the introduction of the provision will not protect a director who acts outside the scope of the power conferred on him or her by acting for an improper purpose, and will therefore not effect the application of the general doctrine and case law discussed above.

\(^{56}\) See 5.1.1 above.

\(^{57}\) (1938) 60 CLR 150 at 185-186. See also Latham CJ at 161-162.
which, in turn, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within the power. The application of the general equitable principle to the acts of directors managing the affairs of a company can not be as nice as it is in the case of a trustee exercising a special power of appointment. It must, as it seems to me, take the substantial object the accomplishment of which formed the real ground of the board's action.

This approach was adopted by the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd*. However, in *Whitehouse v Carlton*, the majority stated (in *obiter*) that the substantial purpose test should be replaced by a single causative examination.\(^{58}\)

As a matter of logic and principle, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose is causative in the sense that, but for its presence, the power would not have been exercised.

This *dicta* sees a return to the investigation undertaken in determining if a fraud on the power has been committed. However, the single causation examination has not been consistently applied in later decisions. Professor Sealy has observed that subsequent cases have only paid 'lip-service' to the new formulae.\(^{59}\) For instance, in *Darvall v North Sydney Brick & Tile Co Ltd*,\(^{60}\) Mahoney JA drew a distinction between a transaction for the purpose of defeating a takeover offer and one merely prompted by the offer but, in the end, entered into for a legitimate purpose.\(^{61}\) Surely both scenarios involve a causative improper purpose. Although adopting the High Court *dicta* in form, his Honour applied a dominant purpose test, requiring the improper purpose to be more than merely causative.

Therefore, it would seem that irrespective of observations by the High Court to the contrary, a substantial purpose test is applied by the courts in determining whether a power by directors is exercised for a proper purpose. This approach sees a divergence from the strict principles applied to donees of limited powers of appointment. It is submitted that a substantial purpose test is appropriate in the case of company directors. Vested with a general power of management, powers will be exercised for myriad objects and purposes. It is consistent with the reluctance by the courts to review bona fide business decisions if such actions were only deemed bad where their

\(^{58}\) (1987) 162 CLR 285 at 294. Wilson J at 301 and Brennan J at 309 continued to apply a substantial purpose test.


\(^{60}\) (1989) 15 ACLR 230 at 248. See Kirby P (in a strong dissenting judgment) who described the causative examination as merely a 'rule of thumb' for determining the substantial purpose for the action. The judgment of Kirby P was adopted in *Haselhurst v Wright* (1991) 4 ACSR 527. See also *McGuire v Ralph McKay Ltd* (1987) 12 ACLR 107 where the Victorian Supreme Court accepted the *dicta* in *Whitehouse v Carlton*, but nonetheless found an exercise of power by the directors valid even though a causative factor in the action was to ensure the company was less susceptible to a take-over action. Although the improper purpose was causative, it was found not to be the dominant purpose. See also *Hannes v MJH Pty Ltd* (1992) 10 ACLC 400. Compare *Kokotovich Constructions Pty Ltd v Wallington* (1995) 13 ACLC 1113.

primary or substantial purpose was foreign to the power. The strict fraud on the power approach, rendering an exercise bad if it is made with an improper causative purpose, irrespective of whether that purpose was ancillary to the exercise, is too restrictive an approach for the commercial operations of a corporation.

5.1.3 Application to Managed Investment Schemes

Application of Fraud on the Power

Whilst the doctrine of fraud on the power is commonly discussed with respect to powers of appointment, it has developed into a wider doctrine of equitable fraud, being generally applicable to the exercise of all limited powers, whether entrusted to fiduciaries or not. Therefore, the doctrine is equally applicable to administrative powers vested in the responsible entity, including the statutory power of constitutional amendment. This is supported by the observations of Megarry VC in the pension scheme decision of Cowan v Scargill:

Powers must be exercised fairly and honestly for the purposes for which they are given and not so as to accomplish any ulterior purpose, whether for the benefit of the trustees or otherwise: see Duke of Portland v Topham...a case on a power of appointment that must apply a fortiori to a power given to trustees as such.

Therefore, as with purported exercises of powers vested in superannuation and pension trustees, amendments to the constitution by the responsible entity in a managed investment scheme is subject to the equitable doctrine of fraud on the power.

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62 Finn, op cit, at 39.
63 [1985] 1 Ch 270 at 288. See also Hillsdown Holdings plc v Pensions Ombudsman [1997] 1 All ER 862, where Knox J applied the principles enunciated in Vatcher v Paull to a purported transfer of the assets and liabilities of a pension scheme to another scheme by the trustees. In relation to amendments to pension trust deeds, in Metropolitan Gas Company v FCT (1932) 47 CLR 621 at 635, Rich J stated that amendments to a pension scheme which enabled the destruction of substantive rights held by pensioners was 'not unlike' a fraud on the power. Similarly in Re Courage Group's Pension Schemes [1987] 1 All ER 528 at 542, Millett J applied a proper purpose test to the exercise of an amendment power. His Honour stated that the power can only be exercised for the purpose for which it was conferred, concluding (at 537) after analysing the nature of the trust deed that the purported exercise of the power in removing a fund surplus was foreign to the purpose for which the power was conferred and therefore invalid. See also Lock v Westpac Banking Corporation (1991) 25 NSWLR 593 at 606-608, where Waddell CJ found an amendment purporting to return surplus funds to the employer company was within the scope of the power. His Honour dismissed a claim that the action was a fraud on the power, stating (at 608) that it was merely another way of expressing the same submission. However, see Re UEB Industries Ltd Pension Plan [1992] 1 NZLR 294 where Cooke P found the term fraud on the power to be inappropriate, stating at 301: 'It is a simple case of ultra vires or acting outside power. In some of the argument the expression 'fraud on the power' has been used but it need not be invoked and seems to me not altogether appropriate'. This would seem to be a point of semantics, as fraud on the power is essentially a control to ensure an action is not ultra vires or outside the power upon which it is exercised.
Application of the Restraint Placed on Company Directors

However, as discussed above,64 the approach taken by the courts in determining whether an exercise of power is for an improper purpose is different in respect of company directors. The issue is whether the divergent approach, both with respect to the objective analysis of the effect of an action as well as the approach to mixed purposes, is applicable to actions by the responsible entity. Hughes argues that it is not appropriate to import the company law decisions. He states:65

The issues revealed by a comparative analysis of the principles of trust law and company law in relation to exercise of powers pose a number of difficult and unaddressed problems for articulating the position of the trustee and the management company under a public unit trust. It has been argued throughout this work that the entity concerned must be considered as a trust rather than completely assimilated with a company. If this should involve the establishing of double standards for assessing the activities of the fiduciaries involved this can be attributed to the nature of the institution itself. There are, after all, different standards applicable to different functionaries. Therefore, in relation to the trustee, one could suggest that the trustee is subject to the same obligations in this context as those which persist in relation to trusts generally. For this reason it would be appropriate to suggest that the so-called 'substantial object doctrine' cannot apply in respect of the exercise of powers by the trustee.

While there is need to maintain distinct levels of accountability in terms of the level of prudence required by both a trustee and a company director, it is submitted that the approach, as established in company law cases relating to the exercise of a share issue power, is applicable to the responsible entity in exercising its powers generally, and in particular when seeking to amend the scheme constitution. The following arguments can be offered in support of this proposition.

First, the divergence from the strict approach of the traditional equitable doctrine when applied to company directors is a recognition of the commercial realities of corporate governance. As is clear from the comments of Dixon J in Mills v Mills,66 extracted above,67 it is not realistic to expect 'an entire exclusion of all reasons, motives or aims on the part of the directors, and all of them, which are not relevant to the purpose of a particular power'. As such, the dominant or substantial object of the action is examined.

Unlike the traditional trustee of a private trust who is concerned primarily with the passive preservation of assets, the responsible entity is responsible to members for the generation of wealth.68 The scheme constitution represents a contract for the provision of financial services through a form of collective investment. As with the board of company directors, the responsible entity is 'judged not only in terms of honesty and loyalty but also in terms of skill and performance'.69 In this regard, the responsible

64 See 5.1.2.
66 (1938) 60 CLR 150 at 185-186.
67 See 5.1.2.
68 However, compare ASC v AS Nominees (1995) 62 FCR 504 at 517 per Finn J, discussed below.
entity is more analogous to a board of directors than it is to a traditional private trustee of a family settlement. Both the responsible entity and the board of directors are equivalent organs in their respective commercial entities. Both are vested with the power of management and are solely responsible for the operation of the entity, and both are accountable to the members of the entity in the proper exercise of their powers and discretions. As such, the strict approach adopted with regard to donees of limited powers, such as the requirement that all causative purposes for an action must be permissible, is not appropriate to the entrepreneurial and commercial nature of the responsible entity’s office. An equivalent standard should be applied, where possible, as is applied in the supervision of actions by the board of directors and the responsible entity.

Secondly, the less stringent company law approach in relation to mixed purposes has further been attributed to the fact that the power is exercised by a group of persons, making up the board of directors, and not one individual appointor, as is the case with the fraud on the power cases. As such, the approach to supervision of actions cannot be as ‘neat’ as it is with donees of special powers of appointment. The powers of the responsible entity are exercised by the responsible entity as a company, requiring an examination of the purposes of a group of people making up the board of directors of the responsible entity. Therefore, these concerns are similarly applicable to managed investment schemes.

As well as the mixed purpose doctrine, the fact that a decision by the responsible entity is actually taken by a group of people provides a justification for the importation of the objective approach adopted in the company decisions. In its strictest form, fraud on the power requires an examination of the subjective purpose of those persons exercising the power. To determine such matters creates evidentiary difficulties given it is the subjective intentions of more than one person which is analysed. For practicality, the courts simply deem certain actions to be prima facie for an improper purpose, attributing subjective intention to the persons exercising the power based on the objective outcome of the action. In this sense, the onus is shifted to the defendant to rebut the presumption that actions achieving a certain end are improper. This approach is adopted with respect to actions by company boards and, it is submitted, is equally applicable to actions by the responsible entity, as exercised by its own board.

The third point also relates to the reluctance of courts to allow exercises of power which have the effect of altering the ownership and voting structure of the company. The underlying policy behind this broad restriction is that to allow such actions would be contrary to the constitutional allocation of power within the organisation. The board of directors is vested with a broad power of management, allowing it to exercise all the powers of the company, except where otherwise stated in the Act or the company constitution. Shareholders are unable to interfere with or direct actions by the board, as to do so would be to usurp the powers and functions properly vested

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70 Mills v Mills (1938) 60 CLR 150 at 185-186 per Dixon J, extracted above at 5.1.2.
71 However, compare Re Southern Resources Ltd (1989) 15 ACLR 770 per Perry J.
73 Section 226A. Note that this section operates as a replaceable rule and may therefore be displaced or modified by the company constitution.
Recourse by shareholders is limited to their powers to alter the constitution or replace the board. As shareholders have no ability to control the actions of directors, the courts have held that it would be equally unconstitutional for the powers vested in directors to be exercised in order to interfere with the ownership rights of the shareholders.

This argument is once again equally applicable to the division of beneficial ownership and control within a managed investment scheme. The ultimate and beneficial ownership of the scheme is held by the members. However, both legal ownership and an unfettered power of management is placed in the responsible entity, members having no direct ability to interfere with the operation of the scheme. Given this structure, as is the case with directors, it would be inconsistent to allow the responsible entity to attain certain ends which would have a detrimental effect on the ownership and voting rights of members. As such, a similar approach, adopting an objective examination of the ends an exercise of power will achieve, should be adopted by the courts in controlling the power of amendment vested in the responsible entity.

Finally, in the Federal Court decision of Elders Trustee Co Ltd v E G Reeves Pty Ltd, Gummow J applied company law principles relating to company promoters to the manager of a unit trust. In doing so, his Honour outlined the historical derivation of the company, and the role the trust played in that development. His Honour emphasised the explanation for the development of the registered company as a means of giving directors more flexibility in the exercise of their powers rather than being imposed with the ‘unreasonably stringent’ fiduciary principles developed in the nineteenth century for trustees of family settlements. Following from this, the fiduciary obligations placed on company promoters were held to equally apply to the manager of a unit trust in promoting and establishing the scheme.

It is submitted that it is consistent with the approach of Gummow J that in determining the appropriate equitable restraint on the exercise of powers by the responsible entity, that an examination be conducted which is drawn by analogy from the law as developed in the context of company directors. In this regard, one commentator states:

\[\text{To bring the Unit Trust within the concept of a ‘joint stock company’ (which includes corporations) and generally impose similar obligations on the}\]
Manager as would be imposed on a company director would be consistent with Gummow J's approach...for these reasons there is a strong argument that it would be most appropriate given the Manager's commercial role, to impose on the Manager duties analogous to duties of company directors rather than duties analogous to those of trustees.

The Distinction between Trust and Company

The counter argument is that the responsible entity is a trustee, while the company director is a mere fiduciary. Elders Trustee Co Ltd v E G Reeves Pty Ltd related to a unit trust manager rather than a responsible entity, only the latter being a trustee. Following from this, the court must be more stringent in its supervision of the former.

The distinction between trustees and other fiduciaries such as company directors was discussed by Finn J in *ASC v AS Nominees Ltd* in the context of the standard of care required of a trustee company in the conduct of its business. His Honour emphasised the distinction between the two functionaries, conceding that 'the need to view what are essentially trust law problems through the prism of corporations law is itself a complicating factor'. Unlike the company director, who may display 'entrepreneurial flair' and accept commercial risk to maximise return, trustees must exercise a more constrained and conservative approach.

...underlying the distinction today is, probably, not merely an historical assumption about the separate purposes of companies and of trusts, but also a generalisation about the different risks that persons who invest their assets in companies on the one hand and in trusts on the other are considered likely to have assumed.

As such, the trust and the company do not provide functionally interchangeable investments, the former ascribing a more protective role to the trustees than that which is required of company directors. This distinction between the level of prudence required of company directors and trustees is not disputed in the context of either the general management of the trust business or the care and diligence required upon investing the trust property. As it hold the legal title to the scheme assets, the responsible entity must be imposed with a higher standard of care than a board of directors who have no such legal interest in the company property.

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85 Ibid, at 508.
86 See *Daniels v Anderson* (1995) 37 NSWLR 438 at 494 per Clarke and Sheller JJA.
88 See Hanrahan P, 'Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law' (1999) 17 CSLJ 67 at 73 who states: 'It may be possible, in the case of a managed investment scheme, to distinguish *ASC v AS Nominees* on the basis that it dealt with a superannuation scheme. It could be argued that investors in superannuation schemes have different expectations about the preservation of capital from those in managed funds. However, such a distinction is not readily apparent on the face of the judgment in *ASC v AS Nominees*'.
89 Note that both company directors and the responsible entity are imposed with identical statutory duties of care and diligence: s232(4), s601FC(1)(b). However, irrespective of the similar wording of these provisions, it is likely that courts will interpret the latter more strictly by imposing a higher standard of care on the responsible entity, based on the factors considered by Finn J above.
However, it is submitted that this distinction is only applicable to the required level of care and diligence, and has no relevance when considering the issue of whether a purported exercise of power by a trustee falls within the scope of the power conferred. The control by the courts of an exercise of power is not reliant on the donee of the power being a trustee, nor is it reliant on there being a fiduciary relationship between the parties. It is based merely on a necessity to ensure persons vested with a limited power act within the scope of that power. The distinction between a trustee and a fiduciary in this regard is of no relevance. Therefore, while the actions of the responsible entity, as trustee of the scheme assets, are subject to various equitable obligations in relation to dealings with that property which are more onerous than those duties imposed on mere fiduciaries, this has no bearing on the existence and extent of equitable controls imposed on the exercise of its administrative discretions. Whether a person is a trustee, fiduciary or otherwise, a limited power vested in that person can only be exercised for a purpose which is within the scope of that power.

Furthermore, it may be possible to isolate those actions by the responsible entity which relate to the trust, and those which relate to the management of the scheme. In this regard, reference should be made to the prior two-party structure under Part 7.12. Before the enactment of the MIA, trusteeship and management of unit trusts was divided. The trustee was responsible for those functions and duties relating to the trust property such as the custody of the property and obtaining the income which forms part of the trust property. The trustee further was obliged to oversee the management of the trust and ensure compliance by the management company, as well as taking enforcement and other remedial action on behalf of unitholders upon non-compliance. The manager, on the other hand, had the function of managing the scheme in accordance with the trust deed and the law.

Under the MIA, a single management structure has been adopted, placing responsibility both for the management and the trust-related aspects of the scheme with the responsible entity. However, the two aspects are still quite distinct. It is submitted that merely because the responsible entity is a trustee, thereby imposed with corollary trust obligations in the performance of that function, this does not alter the level of obligation in respect of the management of the scheme. When executing its operational function, therefore, the responsible entity is analogous to both the management company under the former prescribed interests regime, as well as a board of company directors. Whilst it is true that unlike either of these bodies, the responsible entity holds legal title to the scheme assets, this does not alter the level of obligations attached to exercises of power relating to the management and administration of the scheme. Therefore, an analogous approach must be adopted.

Conclusion

The result of the above is twofold. First, where exercises of power by the responsible entity have the effect of disturbing the balance of power within the scheme, they will

be *prima facie* invalid, irrespective of the subjective intention of the responsible entity in taking the action.

In relation to amendments to the scheme constitution, an example would be an amendment which *dilutes* the voting power attached to units such that certain groups or classes of members will be disadvantaged, such as an amendment to the constitutional division of the scheme into units which results in some members holding a smaller proportionate interest in the scheme. It could be argued that such an amendment would be detrimental to members’ voting rights, and therefore outside s601GC(1)(b). As such, it would be necessary to obtain a special resolution of scheme members under s601GC(1)(a) before the amendment can be passed. However, depending on the construction placed on ‘members’ rights’, the alternative (and preferable) argument would be that the amendment does not in fact disturb a member’s right to vote as such, that right remaining in tact. While the relative weight of a vote may be diluted by the amendment, the right itself is not effected. If this is the case, a complainant would need to resort to there being a breach of the responsible entity’s duty to act for a proper purpose, or some other equitable obligation discussed below.

The *second* result of applying the company law cases is that where an improper purpose is identified, the action will only be deemed invalid where that purpose is the dominant purpose for which the power was exercised. It is not sufficient that the improper purpose is causative of the action, but rather it must be shown to be the real or substantial cause.

Where the constitutional amendment power is exercised for an impermissible purpose, the action will be beyond the power and therefore void. The responsible entity may be liable to compensate members for any loss resulting. Statutory damages may also be available if the statutory duty of honesty is interpreted as encapsulating the duty to act for a proper purpose, as is the case with the correlating duty imposed on company directors.

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93 See Part C below.
94 See 4.3.1(c)(iii) above.
95 The duty will similarly extend to other powers vested in the responsible entity, such as the power to issue new units where the issue will frustrate a takeover bid or otherwise disturb the voting power of certain members.
96 In relation to compensation by directors who act for an improper purpose, see *Re Lands Allotment Co Ltd* [1894] 1 Ch 616 at 631, 638; *FAI Insurances Ltd v Urquhart (No 2)* (1986) 11 CLLR 464.
97 Section 601FC(1)(a) requires the responsible entity to act ‘honestly’ in exercising its powers and carrying out its duties. In relation to the duty of honesty placed on directors in s232(2), the requirement has been interpreted as requiring directors to act *bona fide* in the interests of the company, and to exercise their powers for a proper purpose: *Marchesi v Barnes* [1970] VR 434. Hanrahan argues that s601FC(1)(a) will be construed in a similar manner: Hanrahan P, *Managed Investment Law*, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 76. The result will be that exercises of power for impermissible purposes will breach s601FC(1)(a), thereby allowing members to seek compensation under either s601MA(1) or s1325.
5.2 Failure of Substratum

Unlike the ALRC/CSAC proposal, the power of amendment derived from the MIA is not explicitly restricted to minor alterations.98 This raises the issue of whether the power may be utilised by the responsible entity in order to effect amendments which fundamentally alter the nature of the scheme.

There may be a situation where although the substantive rights of members are not affected, s601GC(1)(b) thereby not providing protection, the underlying nature of the scheme is nonetheless disturbed. For instance, a constitutional amendment fundamentally altering the investment powers vested in the responsible entity, while having no ramifications in terms of the substantive legal and equitable rights available to scheme members, may result in a scheme being fundamentally different from when members first deposited their contributions.99

The following section analyses the concept of failure of substratum as it applies to constitutional amendments in managed investment schemes. The first part explores the doctrine as it is applied in trust law. This is followed by an analysis of how the doctrine may be applied to schemes. It is argued that failure of substratum is merely an instance of fraud on the power. Finally, the doctrine of contractual frustration is briefly discussed as an alternative recourse for members upon the responsible entity effecting amendments which fundamentally alter the nature of and rights derived from the scheme.

5.2.1 Failure of Substratum in Trust Law

An early line of authorities, commencing in 1836, illustrates the jurisdiction of courts to limit the scope of powers to amend trust deeds granted in apparently unrestricted terms such that the power cannot be exercised in a manner which fundamentally alters the nature of the trust. However, since the New South Wales Court of Appeal decision of Keams v Hill,100 it would seem that this jurisdiction has been substantially limited. It is therefore necessary, after surveying the earlier line of authorities, to analyse whether this restraint on trust deed amendments still remains in light of that decision.

Early decisions

The first decision, Duke of Bedford v Marquess of Abercorn,101 involved a marriage settlement in favour of the intended children of the marriage. A power of amendment was granted to the husband and wife to make alterations in such a manner as to them seemed fit. An amendment purported to jointure any future wives of the husband and to charge younger children of any future marriage. The Court examined evidence of the scope and intended purpose of the amendment clause, concluding that the only reasonable construction of the power was that it only permitted variations of the charges created as amongst those who were intended to benefit by them, and not to introduce new interests in favour of strangers.102

99 See 6.1 below.
100 (1990) 21 NSWLR 107.
101 (1836) 1 My & CR 311; 40 ER 394.
102 Ibid, at 403 per Lord Cottenham.
Similarly, *Re Dyer* involved a trust settled in order to assist in the establishment and maintenance of a metropolitan permanent orchestra. The deed provided that the settlor, his executors or administrators, may ‘from time to time and at any time or times by deed vary all or any part of the trust and powers hereinbefore declared and created’. The settlor executed a deed varying the objects of the trust to include various music societies and associations not originally entitled under the deed, directing the income of the fund to be applied to those organisations in specified amounts. It was held that the alteration was inconsistent with the underlying nature of the trust, Martin J stating:

> It would be strange if the donor who desired to help in founding a fund for a particular purpose, and who expected others to contribute to that fund, attempted to reserve to himself a power to change the whole substratum of the gift, not only as regards his own donation, but also the donations of others who subscribed money for the particular purpose. A power to revoke is common in deeds of this nature, and I cannot believe that the draftsman would not have included such a power had it been intended that the donor was to be entitled to benefit an object other than the one nominated in the deed. What are the limits of the power to vary is a very difficult question, which does not call for determination here, but I consider none of the draft deeds submitted falls within those limits...

Therefore, these decisions dictate that unless a power of revocation is reserved by the donee, a power to amend a trust deed cannot be exercised in a manner which will alter the *substratum* of the trust, such as by allowing for benefits to be directed to non-objects.

**Keams v Hill**

The above authorities were considered more recently by the New South Wales Court of Appeal in *Keams v Hill*. The case involved the construction of a clause authorising the trustee to revoke any powers conferred on it or to ‘vary or amend’ any provision of the trust deed other than the declaration of trust or the vesting date. The trustees purported to amend the definition of ‘beneficiaries’ contained in the deed so as to include a new class of beneficiaries constituted by the children of the existing beneficiaries.

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104 Ibid, at 290-291.
105 Similar principles can be drawn from cases considering the *Variation of Trusts Act 1958* (UK). The Act grants the court jurisdiction to approve arrangements ‘varying’ or ‘revoking’ trusts, but not the resettlement of a new trust. It has been held that if an arrangement changes the whole *substratum* of the trust, then it cannot be regarded as varying the trust: *Re Ball’s Settlement Trust* [1968] 1 WLR 899; *In Re T’s Settlement Trusts* [1964] Ch 158; *Re Holt’s Settlement* [1969] 1 Ch 100; *Allen v Distillers Co (Biochemicals) Ltd* (1974) 2 All ER 365, *Re Smith* [1975] 1 NZLR 495. See Harris J W, *Variation of Trusts*, Sweet & Maxwell, 1975, at 66-68, who questions the correctness of these decisions. Harris argues that the preferable view upon construction of the *Variation of Trusts Act 1958* is that it allows courts to approve any arrangement which benefits the beneficiaries.
107 However, the amendment power provided the following restriction: ‘...PROVIDED However that no such release revocation variation or amendment shall be valid if such release revocation or amendment would have the effect of infringing any rule against perpetuities or directing or requiring any excessive accumulation of income or would entitle the settlor or the trustee or any person who has been a trustee of the settled fund to receive any of the income or corpus of the settled fund.’
Meagher JA\(^\text{108}\) held that on a proper construction of the clause, the power of variation extended to \textit{any provision} in the deed. His Honour noted that while each deed must be considered in its own particular context, so that no other deed executed in different circumstances and in different language can decide the fate of a given deed, it was impossible to discern from the deed in question any intention that the list of beneficiaries should remain perpetually inviolate.\(^\text{109}\)

Counsel for the respondent relied on the decisions discussed above. Meagher JA characterised the \textit{ratio} of \textit{Duke of Bedford v Marquess of Abercorn} as being that the court must consider the scope and evident purpose of a variation clause when determining the validity of a given amendment. However, given that the evident purpose of the clause in question was to ensure maximum flexibility, it was found that such a consideration was of little assistance.\(^\text{110}\) Furthermore, in relation to \textit{Re Dyer}, his Honour stated that the restriction on amendments destroying the \textit{substratum} is similarly of little help in the case at hand, given the relevant \textit{substratum} was to benefit the descendants of the beneficiaries, and that purpose was achieved rather than destroyed by the purported amendment.\(^\text{111}\) Mahoney JA was more explicit in his disapproval of the above authorities, stating:\(^\text{112}\)

\begin{quote}
In earlier times, the view was taken in some cases that...the intention of the settlor was that the alterations to be made should not alter the main structure of the trust or the beneficial entitlements under it. I doubt that would be seen as the intention of such a clause at the present time. As the precedent books show, discretionary trusts have in more recent times been used to provide to the settlor or the person having the benefit of the power of variation the power to make fundamental changes in the structure of the trust document and the entitlements under it. In England, the desire of settlors to retain such flexibility as would allow them to meet the changes resulting from war, taxes and depression is, I think, clear. And these are reasons why, in Australia, a power of variation of greater rather than lesser extent has been seen as desirable. Therefore I do not think that any limitation should be placed upon the generality of the power of variation by reason of the factors referred to in the cases cited.
\end{quote}

Does this decision result in the doctrine of failure of \textit{substratum} not being available in trust law? It is submitted not. Five points are worth noting in relation to this judgment. \textit{First}, Meagher JA stated that it was impossible to locate a \textit{substratum} in the trust at hand. This observation seems odd in the context of his Honour's decision. He acknowledged that the trust was designed to deal with the disposal of family assets to the descendants of the settlor.\(^\text{113}\) This in itself is the relevant \textit{substratum}, being the underlying intention or purpose for which the trust was formed.

\textit{Secondly}, the issue would seem to be one of characterisation of the \textit{substratum}. In this decision, Meagher JA determined the purpose to be to benefit the descendants of the

\(^{108}\) With whom Mahoney JA and Clarke JA agreed.

\(^{109}\) (1990) 21 NSWLR 107 at 111.

\(^{110}\) \textit{Ibid.}, at 110.

\(^{111}\) \textit{Ibid.}, at 110.

\(^{112}\) \textit{Ibid.}, at 108. In a similar vein, Meagher JA stated at 111: 'I also put to one side the equally obvious consideration that the conditions which existed in England in 1850 are not necessarily the same as those which existed in New South Wales in 1970'.

\(^{113}\) \textit{Ibid.}, at 109.
settlor. The purported amendment sought to add further descendants as objects of the trust, and was therefore within the ambit of the substratum. This may be contrasted with Re Dyer, where the substratum was narrowly characterised as providing a benefit to the immediate objects of the trust as originally settled. In that case, if the Court had characterised the substratum broadly so as to benefit the promotion of music generally, the purported amendment would have been within its scope and therefore valid. Therefore, the divergence in findings in these two decisions is one of characterisation of the relevant arrangement rather than a doctrinal divergence. It is submitted that if the trustees in Keams v Hill purported to include third persons as beneficiaries who were in no way concerned with the family and therefore not within the scope of the class of intended beneficiaries, a different finding would result.

Thirdly, Mahoney JA stated that while the earlier decisions promoted the view that the settlor intended amendments not to alter the main structure or beneficial entitlements under the trust, no such intention is evident in modern times. This is a misinterpretation of the early authorities. The intention of the settlor is not that the structure and beneficial entitlements are to remain intact, but rather that the underlying purpose is to remain intact. If, as is shown by the facts of Keams v Hill, the underlying purpose can be maintained upon a change to the constituent objects of the trust, the amendment is valid. If the amendment fundamentally changes the nature of the trust such that it no longer achieves or is no longer likely to achieve the objects for which it was originally settled, the amendment is invalid.

Fourthly, Meagher JA stated that there is little utility in investigating the scope and evident purpose of an amendment clause when the purpose is merely to ensure maximum flexibility. This is once again in conflict with the substance of his Honour’s decision, as an investigation of the terms of the deed was undertaken in order to determine the intended scope of the amendment power.114 It is submitted that the scope and evident purpose of the amendment power the subject of Keams v Hill was to ensure maximum flexibility in the management and administration of the trust, provided that such amendments did not depart from the underlying substratum upon which the trust was created, being to benefit the descendants of the settlor.

Finally, the restraint on trust deed amendments which result in a failure of substratum was accepted in Re Courage Group’s Pension Schemes115 and by the Supreme Court of New South Wales in Lock v Westpac Banking Corporation,116 the latter decision of which was handed down after Keams v Hill and cited Re Dyer to support the proposition.

Therefore, Keams v Hill does not overturn the doctrine of failure of substratum as applied to amendments to trust deeds. The case does, however, provide authority for the proposition that a power to vary a trust will be construed according to its natural

114 At first instance, Young J examined the terms of the deed, finding the repeated reference to persons who are ‘capable’ of becoming beneficiaries as consistent with giving the variation power the width which the appellant contended. The analysis was accepted by Meagher JA on appeal: ibid, at 110.
115 [1987] 1 All ER 528 at 537 per Millett J.
116 (1991) 25 NSWLR 593 at 601 per Waddell CJ. See also at 603 where his Honour states: ‘It is true that in some cases a power to vary a trust deed may be held not to extend to a variation which would alter the substratum of the trust’.
meaning and in such a way so as to give it the most ample operation. The judgments in *Kearns v Hill* clearly promulgate a wider and more literal construction of trust deed amendment clauses than did the earlier courts. The judgments also promulgate a wider characterisation of the underlying purpose or *substratum* of the trust. However, the decision does not negate the underlying principle that a power of amendment cannot be exercised in a manner which disturbs the *substratum* of the trust.

**An Instance of Fraud on the Power?**

The *substratum* cases may be explained as an instance of a fraud on the power being committed. The amendment power in trust deeds can only be exercised for a permissible purpose. Amendments which seek to divert benefits to non-objects or otherwise fundamentally alter the nature or underlying purpose of the trust may be found to be improper under general equitable principles. This explanation is supported by *Lock v Westpac Banking Corporation*, where Waddell J stated:

> In my opinion, what is the substratum is to be determined as a matter of construction of the deed and having regard to the circumstances. If the amendment is as a matter of construction within the power, it cannot be an infringement of the substratum.

Therefore, his Honour combined the examination of whether the power was exercised for a proper purpose and whether it infringed the *substratum* of the superannuation scheme. An action for the purpose of disturbing the *substratum* is an impermissible purpose.

Similarly, *Re Courage Group’s Pension Schemes* involved pension trust deeds containing a power of amendment vested in the employer trustee which expressly prevented amendments which would alter the main purpose of the schemes, being the provision of pensions on the retirement of scheme members. Millett J found the restraint on fundamental alterations to exist irrespective of the express restraint, stating:

> This is a restriction that cannot be deleted by amendment, since it would be implicit anyway. It is trite law that a power can be exercised only for the purpose for which it is conferred, and not for any extraneous or ulterior purpose. The rule amending power is given for the purpose of promoting the purposes of the scheme, not altering them.

Therefore, where an amendment is instigated which results in a divergence from the underlying purpose of the scheme, resulting in a failure of *substratum*, the power has been exercised for an impermissible purpose, a fraud on the power thereby being committed.

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119 [1987] 1 All ER 528 per Millett J.
120 Ibid, at 537.
5.2.2 Application to Managed Investment Schemes

The responsible entity's constitutional amendment power is not restricted to minor changes.\(^{121}\) If an amendment changes the inherent nature of a managed investment scheme, members have several options. If a right to withdraw is provided in the constitution, a member may redeem their units. However, such a provision need not be included in the constitution.\(^{122}\) Furthermore, where the scheme is not liquid, a member may only withdraw from it in accordance with the statutory regime for redemption offers.\(^{123}\) If the scheme is listed, members who do not agree with the change can sell their unit holdings on the stock exchange. If a majority of members disagrees with the changes, they may either seek to have the scheme wound up under s601NB, resolve to re-amend the constitution,\(^{124}\) or remove the responsible entity.\(^{125}\)

Where the scheme is not listed, there is no right to withdraw or the scheme is not liquid, and only a minority of members disagree with the changes, the dissenting members must rely on there being a failure of substratum and seek to have the amendment set aside. Alternatively, as is the case in company law, a failure of substratum may provide grounds for a member to apply for the winding up of the scheme on just and equitable grounds in accordance with s601ND(1). Winding up may, however, seem a harsh remedy where the scheme is a going concern and the member would prefer simply to have the amendment set aside.

It must therefore be queried whether constitutional amendments in managed investment schemes are subject to the failure of substratum limitation. In this regard, Phillips J offered a reserved comment relating to the inherent limitation to amendments to unit trust deeds in *Eagle Star Trustees Ltd v Heine Management Ltd*:\(^{126}\)

> It is unnecessary to decide how far the [amendment power] extends; it may not authorise a change in the very essence of the trust which is established by the governing deeds.

It is submitted that the restraint on fundamental amendment disturbing the substratum of the scheme is equally applicable to managed investment schemes as it is to private trusts. However, two arguments can be offered in the negative. Each argument will be canvassed and rebutted in turn, being namely that:

(a) Failure of substratum only applies to closely-held organisations and therefore not to large entities such as managed investment schemes.

(b) As the constitutional amendment power allows for the repeal and replacement of the constitution, the substratum doctrine has no application.

\(^{121}\) Unlike the ALRC/CSAC proposals: Section 183A(1)(a)(ii) *Collective Investment Scheme Bill 1995* in ALRC/CSAC Vol 2 at 115. See 4.1.1 above.

\(^{122}\) Section 601KA(1).

\(^{123}\) Section 601KB.

\(^{124}\) This latter course of action may lead to a dead-lock situation and ultimately result in the scheme being wound up.

\(^{125}\) Section 601FM.

\(^{126}\) (1990) 3 ACSR 232 at 238.
(a) **Application to Large Entities**

From the company law decisions, it would seem that the doctrine of failure of *substratum* is only applicable to small quasi-partnerships in which it is possible to ascertain some explicit objective upon formation of the company.\(^\text{127}\) This would result in the doctrine having limited application to large managed investment schemes, being more analogous in economic terms to public rather than private companies. However, in *Re Tivoli Freeholds Ltd*, Menhennitt J stated that failure of *substratum*:\(^\text{128}\)

> ...is not, it appears to me, confined to cases of ‘partnership’ companies or ‘main object’ companies. Whilst it may be easier to find the general intention and common understanding in those cases I can see no reason in principle why it should be confined to such cases and I am not aware of any decision that it is so confined.

Therefore, as a matter of law, a failure of *substratum* can be found to have occurred in a large public company, and thus also in a managed investment scheme. However, as an evidentiary issue, establishing a common understanding between all the members may be difficult. Nonetheless, where there is a stated objective which is publicised to members generally in the prospectus, or some other means of establishing a common understanding between members, such a finding may be possible.

(b) **The Repeal and Replacement of the Constitution**

The amendment power conferred by s601GC is not limited to modifications to the scheme constitution, but also extends to the repeal and replacement of the constitution. From this, it could be argued that the statutory provision reserves a power of revocation in the responsible entity, allowing fundamental amendments which result in a failure of *substratum* being permissible, even to the extent of a resettlement. Two responses can be made to this argument.

*First*, the repeal and replacement of the scheme constitution does not in itself result in a resettlement of the trust, as would be the case with the revocation of a traditional trust deed, as both the trust settlement and various core powers and duties of the trustee are contained in the MIA, thereby remaining intact upon revocation of the deed. Furthermore, revocation and replacement of the constitution by virtue of s601GC(1) does not result in a new *scheme* as such, as there is no need to re-register the scheme with ASIC but merely to lodge a copy of the new constitution.\(^\text{129}\)

Following from this, the mere fact that the amendment power extends to the repeal and replacement of the scheme’s constitutive document does not necessarily result in fundamental amendments which amount to a resettlement of the trust being permitted.

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\(^\text{127}\) Furthermore, as discussed above, the policy basis of the doctrine is that shareholders should not be forced to maintain their investment in a company where the underlying nature of that investment has substantially altered. However, in public companies, this logic does not hold, as members who are not content with the manner in which the business of the company is being carried out have the option of exiting the company through the secondary markets.

\(^\text{128}\) [1972] VR 445 at 469 per Menhennitt J.

\(^\text{129}\) Section 601GC(2).
The question is one of the extent to which the amendment effectively varies the nature of the trust.\textsuperscript{130}

Secondly, as has already been discussed,\textsuperscript{131} where there is a competing interpretation to a provision of the constitution, the courts are likely to give effect to the interpretation which best reflects the commercial nature and balance of power within the scheme. It is submitted that allowing the responsible entity to change the fundamental nature of the scheme without referring the change to members is inconsistent with the intricate balance intended by the legislature between investor protection and the commercial freedom of the responsible entity.

Therefore, an amendment which purports to change the substratum of the scheme will be invalid. The invalidity will be under the guise of an examination as to whether the amendment was made for a proper purpose, thereby implicitly restricting amendments which disturb the underlying purpose of the scheme.\textsuperscript{132} However, this proposition is tempered by one proviso: the evidentiary burden in establishing a failure of substratum will be difficult due to both the flexible and large nature of managed investment schemes, as well as the fact that members may have other means of avoiding an oppressive outcome, such as withdrawal or exiting through the secondary market.

Identifying the Substratum in Managed Investment Schemes

As it has been established that an amendment to a scheme constitution which results in a total failure of substratum may be grounds for the invalidity of the amendment, it is necessary to explore the scope of the substratum concept.

In this regard, assistance may be sought from company law cases relating to the just and equitable ground for winding up a corporation.\textsuperscript{133} A common basis upon which a winding up order under the provision is sought is where the company engages in acts which are entirely outside what can fairly be regarded as having been within the general intention and common understanding of the members when they became members.\textsuperscript{134} What is required is that the conduct of business within the objects of

\textsuperscript{130} Furthermore, the Variation of Trusts Act 1958 (UK), discussed above at n105, similarly extends beyond variations and encapsulates the revocation of a trust. Irrespective of this provision, the courts still found that they did not have jurisdiction to approve resettlements.

\textsuperscript{131} See 4.2.2 above.

\textsuperscript{132} Further restraints may exist in relation to listed schemes, as it may be necessary to disclose details of the proposed amendment to the ASX where there is a proposed change to the general character or nature of the scheme: ASX Listing Rule 3.1; ASX Listing Rule 11.1. Furthermore, the ASX may require the approval of members by way of an ordinary resolution before the change may be effected: ASX Listing Rule 11.1.2.

\textsuperscript{133} Section 461(1)(k). A similar remedy is available to members of a managed investment scheme: s601ND(1).

\textsuperscript{134} Re National Portland Cement Co Ltd [1930] NZLR 564; H.A.Stephenson & Sons Ltd (In Liq) v Gillanders, Arbuthnot & Co (1931) 45 CLR 476 at 487; Re Kitson & Co Ltd [1946] 1 All ER 435; Re Taldue Rubber Co Ltd [1946] 2 All ER 763; Re Eastern Telegraph Co Ltd [1947] 2 All ER 104; Galbraith v Merito Shipping Co [1947] SC 446; Re Wondoflex Textiles Pty Ltd [1951] VLR 458 at 468; Re Tivoli Freeholds Ltd [1972] VR 445. The doctrine of failure of substratum is different to the doctrine of ultra vires which has been abandoned by virtue of s125(2): see Re Tivoli Freeholds Ltd, supra at 470 per Menhennitt J.
incorporation has become impossible, at least in a practical sense. There must be an abandonment of the primary objects of the company, such that the shareholders who have taken up contributing shares are being asked to leave their money in a venture which is different altogether from what they originally subscribed to.

The main source for obtaining the common understanding of members upon incorporation is the company constitution, particularly if the constitution contains the stated objects of the company. The courts may also look at the prospectus, the company's name and any circulars issued to shareholders. The company's course of conduct may also be relevant.

In relation to commercial trusts such as superannuation schemes or managed investment schemes, the investigation as to the underlying substratum may differ from the company law approach. The basis of the divergence may be extracted from the Re Courage Group's Pension Schemes decision. Millett J noted that in determining whether an amendment results in a disturbance of the substratum, that amendment must be judged at the time it is intended to take effect rather than when the trust is first created. A fluid approach to the purpose of the trust is adopted, allowing for the main purpose of the scheme to be changed by degrees. This diverges from the company law cases which require an analysis of the common understanding of the corporators at the time of incorporation. In accordance with Millett J's observations, while a change may be unacceptable if introduced all at once, the change may be introduced over a long period of time.

Applying these principles to managed investment schemes, in the widest sense, the substratum of a scheme may be characterised as the operation of a collective investment vehicle in order to return financial benefit to members. However, depending on the particular scheme in question, a narrower substratum may be found. To do so, it would need to be shown that the scheme was established for a defined and limited objective, and that that objective will be undermined by the purported amendment. In this regard, the scheme constitution, the scheme name and the prospectus may be relevant.

Furthermore, it is explicitly clear from the provisions of the MIA that a scheme may have a defined purpose. Section 601NC provides that where the responsible entity considers that the purpose of a scheme either has been accomplished or cannot be accomplished, it may take steps to have the scheme wound up. This provision does

135 Galbraith v Merito Shipping Co, ibid, at 456 per Lord Moncrieff.
136 Re National Portland Cement Co Ltd, supra, at 572 per Myers CJ; Re Eastern Telegraph Co Ltd, supra, at 109 per Jenkins J.
137 Re Tivoli Freehold, supra, at 471 per Menhennitt J.
138 Re Crown Bank Ltd (1890) 44 Ch D 634 at 643.
139 (1987) 1 All ER 528 per Millett J.
140 Ibid, at 537. His Honour used as an illustration the case of Thellusson v Viscount Valentia [1907] 2 Ch 1. That case involved a club formed for the purpose of providing a ground for pigeon-shooting. From time to time, other activities were introduced without objection from members. The club committee resolved to discontinue pigeon-shooting, and the decision was upheld by the Court of Appeal. The Court observed that although the club was originally formed for the encouragement of pigeon-shooting, it now provided several objects, none being more fundamental than the other.
141 Millett J justified the approach on the basis of a pension scheme being an institution of long duration and gradually changing membership. As such, it is arguably equally applicable to companies: Ibid, at 537.
not assist an aggrieved minority scheme member, as the power is vested in the responsible entity. However, it does provide express acknowledgment by the legislature that a scheme may be established for a defined purpose or objective, and that the accomplishment of that purpose or objective may be undermined.

Therefore, the constitutional amendment power cannot be exercised in a manner which fundamentally alters the nature of the scheme, as to do so would amount to an action for an improper purpose. The example of a fundamental alteration to the investment powers vested in the responsible entity has already been offered. As an example in relation to other powers, where the scheme is reliant on the skill and reputation of a particular operator, the retirement of the responsible entity may similarly result in a total failure of *substratum*, the characteristics and qualities of that particular company being the foundation of the scheme itself.

5.2.3 Contractual Frustration

If a managed investment scheme is contractual in nature by virtue of the scheme constitution, the contractual doctrine of *frustration* will be applicable. This may provide a further means by which members can seek relief upon constitutional amendments which alter the underlying purpose of the scheme.142

The Doctrine of Frustration

Frustration occurs where an event changes the circumstances under which a contract is performed to such an extent that it can be said that the parties did not intend to be bound by performance in the changed circumstances. In *Davis Contractors Ltd v Fareham Urban District Council*,143 Lord Radcliffe described the doctrine as follows:

...frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract...It was not this that I promised to do.

As with failure of *substratum*, frustration requires there to be a common assumption between the parties that a particular state of affairs will exist.144 Whilst the common assumption must be found in the contract itself, the court may look to extrinsic evidence in the form of the surrounding circumstances to assist in the interpretation of the contract, unless the language of the contract is so plain that recourse to extrinsic evidence would result in a contradiction of the contractual terms.145

142 See Sin K F, *The Legal Nature of the Unit Trust*, Clarendon Press Oxford, 1997 at 120-122 who argues that frustration applies to unit trusts. Sin proposes that the following events may be examples of where frustration may be relevant: the enactment of a law prohibiting investment in a particular country to which the trust is targeting; changes in taxation law where the trust is tax driven; specialised funds exploiting opportunities in new technologies where the technologies cease to be viable; the winding up of the manager where the qualities of the manager are crucial to the trust.

143 [1956] AC 696 at 723. This formulation has been adopted by the High Court of Australian: *Brisbane City Council v Group Projects Pty Ltd* (1979) 145 CLR 143 at 159-163 per Stephen J; *Codelfa Construction Pty Ltd v State Rail Authorities of New South Wales* (1982) 149 CLR 337 at 357 per Mason J.

144 *Codelfa Construction Pty Ltd v State Rail Authorities of New South Wales*, *ibid*, at 357 per Mason J

145 *Ibid*, at 357-358 per Mason J. See also *Krell v Henry* [1903] 2 KB 740.
Frustration in Managed Investment Schemes

The doctrine of frustration is foreign to trusts. However, it has been applied to the association contract of an unincorporated association formed under a trust structure. *Re Unley Democratic Association* involved an unincorporated association which had ceased operation but had not been dissolved. The South Australian Supreme Court found that a basis of the continuation of the association relationship was that there should be a minimum number of members in order to carry out the affairs of the association. As the purpose for which the association was formed became impossible, there only being five remaining members, the contract of association was frustrated.

As is the case with unincorporated association, the doctrine may be equally applicable to managed investment schemes based on the inherent contractual relationship between the parties. If the scheme constitution is frustrated, it is immediately terminated and the parties are discharged from their relevant obligations under the constitution. As a result, s601GB will not be complied with, as the constitution will no longer be legally enforceable. The responsible entity will thereby be in breach of its statutory obligations, and ASIC will be granted the power to deregister the scheme and apply to the court to have it wound up.

However, under the general formulation of the doctrine, neither party must be at fault, as the frustrating act cannot be self-induced but must be caused by something for which neither party was responsible. In managed investment schemes, as the constitutional amendment is instigated at the will of the responsible entity and is not an outside event as such, the contract is arguably not frustrated. This would seem an odd outcome, as in effect the responsible entity is answering a claim by members that the contract is frustrated by pointing to its own fault.

*FC Shepherd & Co Ltd v Jerrom* involved a similar situation. An employer contended that an employment contract was frustrated as a result of the employee being convicted of various criminal offences. The employee argued that as the purported frustrating event resulted from the fault of a party, the contract was still enforceable and he was thereby able to establish a claim for compensation under unfair dismissal laws. Lawton LJ rejected the employee’s argument, holding that a

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146 Sin describes the automatic resulting trust as the ‘nearest analogy’ in trust law to the contractual doctrine of frustration: Sin, *op cit,* at 120. In trust law, where the settlor fails to exhaustively dispose of the beneficial interest in the property, an automatic resulting trust operates for the benefit of the settlor: *Re Vandervell’s Trusts* [1974] Ch 269 at 289. See for instance *Braithwaite v Attorney-General* [1909] 1 Ch 510 which involved a charitable trust established for the benefit of a friendly society which subsequently ceased to exist.

147 [1936] SASR 473.

148 Section 601FC(1)(f).

149 Section 601PB(1)(b).

150 Section 601EE(1).

151 Hirji Mulji v Cheong Yue SS Co [1926] AC 447 at 507 per Lord Blackburn; *Maritime National Fish Ltd v Ocean Trawlers Ltd* [1935] AC 524 at 529 per Lord Wright. In order to be at fault, a party need not be in breach of the contract but merely have acted deliberately: *Denmark Productions Ltd v Boscobel Productions Ltd* [1969] 1 QB 699.

152 [1987] QB 301.
party cannot plead their own default in such circumstances. Applying this decision to a constitutional amendment in a managed investment scheme, it would be no answer by the responsible entity to a claim for frustration that the alleged frustrating event was self-induced. Frustration may therefore be pleaded by a member as a result of an amendment by the responsible entity.

However, although technically available, the doctrine of frustration is of little utility to aggrieved members upon a constitutional amendment. In many situations, the winding up of the scheme would be viewed as an extreme remedy. In such cases, it would be preferable to seek to have the amendment set aside under the doctrine of failure of substratum. Furthermore, there would seem little benefit in pursuing the frustration option given a member could simply seek a winding up order on just and equitable grounds.

5.3 Duty to Act in the Best Interests of Members

As well as reviewing an action by a fiduciary on the basis of the nature and purpose of the power conferred on it, the courts must determine whether, in exercising its power, the fiduciary has discharged its obligations owed to the beneficiaries by virtue of the fiduciary office: namely whether it has acted in the interests of its beneficiaries. Therefore, even where a power has been exercised in conformity with the scope and evident purpose of that power, a fiduciary may nonetheless have breached its equitable obligations based on the substance of the decision itself.

The following section analyses the nature and scope of a trustee’s duty to act in the interests of its beneficiary as it applies to constitutional amendments by the responsible entity. This further entails an examination of the correlating duty of impartiality (5.3.2), the duty to avoid a conflict of duty and interest (5.3.3), and the duty to consider whether a discretionary power should be exercised (5.3.4).

5.3.1 Duty to Act in the Best Interests of Members

The trustee office exists for the benefit of its beneficiaries. Therefore, in exercising its powers and discretions, a trustee is under a duty not to act for its own benefit or for the benefit of third persons. The cardinal nature of the obligation is enforced by the

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5.15 Ibid, at 319. See also The Super Servant Two [1990] 1 Lloyd’s Rep 1 at 8 where the rule against self-inducement was interpreted as only referring to lack of default by the person relying on the frustration.

5.15 Once again, it may be incorrect to refer to this obligation as a fiduciary duty, as it is merely part of the duty of good faith and loyalty: see fn 5 above. In Breen v Williams (1996) 138 ALR 259 at 289, Gaudron and McHugh JJ stated: "...the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed". See also Gommow J at 308. Whether such a positive duty is imposed will depend on the nature of the relationship at hand. Given that the responsible entity is a trustee of the scheme assets, it is submitted that the obligation will apply. Furthermore, as will be discussed, the obligation is reinforced by the imposition of statutory duties by the MIA. The obligation will therefore be discussed as a trustee duty.
MIA, which places a statutory duty on the responsible entity based on its fiduciary obligations. Section 601FC(1)(c) states:\textsuperscript{156}

In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must...act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests.

The nature of the underlying equitable duty is illustrated by the case of Cowan v Scargill,\textsuperscript{157} which involved the exercise of the investment power by the trustees of an employee pension scheme. The trustees refused to approve an investment plan except under certain conditions placed on the scope of investments made by the investment managers. Giving the decision of the Court, Megarry VC stated that the same principles with respect to the obligations of trustees applied to pension schemes as they do to traditional trusts. The large size of pensions funds and the fact that members commonly contribute to the fund only enforces the underlying principle that the interests of the beneficiaries are paramount.\textsuperscript{158} His Honour stated:\textsuperscript{159}

The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests.

Certain issues arise with respect to this statutory requirement and the trustee obligation underlying it, each of which will be dealt with in turn:

(a) Is the requirement subjective or objective?
(b) What does 'best interests of the members' mean?
(c) Can the responsible entity also consider its own interests?

\paragraph{(a) An Objective Examination?}

A trustee must act in what it considers to be the interests of its beneficiaries. It is a subjective examination, being what the trustee and not what the court considers to be in the beneficiaries' interests.\textsuperscript{160} The beneficiaries cannot direct the trustee in its exercise of a power, as this would amount to dictation as to how a fiduciary power or discretion is to be exercised.\textsuperscript{161} Therefore, provided the exercise of a power by the

\textsuperscript{156} Breach of the statutory duty will give standing to members to seek damages under s601MA(1) while breach of the underlying fiduciary duty will provide a right for equitable damages: Nocton v Ashburton [1914] AC 932; Catt v Marac Australia Ltd (1986) 9 NSWLR 639; Hill v Rose [1990] VR 129.

\textsuperscript{157} [1985] 1 Ch 270.

\textsuperscript{158} Ibid, at 290.

\textsuperscript{159} Ibid, at 286-287.

\textsuperscript{160} See for instance Hindle v John Cotton Ltd (1919) 56 ScLR 625 at 630-631 per Finlay VC.

\textsuperscript{161} Re Brockbank [1948] Ch 206; Re Whitchelow [1954] 1 WLR 5. A similar position exists with respect to shareholders and company directors: Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame [1906] 2 Ch 34.
trustee is made honestly in what it believe to be in the beneficiary's interests, the decision will not be disturbed. This is similarly the case in the company law context, where a director's duty of good faith is limited to subjective considerations, the courts being reluctant to intervene in legitimate and bona fide business decisions.\(^{162}\) It is said that directors must act 'bona fide in what they consider – not what the court may consider – is in the interests of the company'.\(^{163}\) So, in Marchesi v Barnes, it was said that:

A breach of the obligation to act bona fide in the interests of the company involves a consciousness that what is being done is not in the interests of the company, and deliberate conduct in disregard of that knowledge.

However, there have been instances where an objective examination of the conduct of the trustee has been conducted. For instance, where a trustee has acted bona fide and with a view to benefit the beneficiaries, an action may nonetheless be challenged where the trustee has failed to recognise that it is acting unjustly towards those whose interests it is bound to protect,\(^{165}\) or where the action is not founded on grounds upon which a reasonable person could come to the same decision.\(^{166}\) For instance, with regard to company directors, it has been found upon the facts that:\(^{167}\)

\(^{162}\) The comparison with company directors in this context must be qualified. First, unlike the responsible entity, a company director is not a trustee. Secondly, unlike the responsible entity who owes its fiduciary and trust duties directly to the members, company directors owe their fiduciary duties to the company: Percival v Wright [1902] 2 Ch 421; Winthrop Investments v Winns [1975] 2 NSWLR 666 at 680. This divergence is a recognition of the separate legal nature of the corporate entity as opposed to the body of shareholders. Only in limited circumstances will a direct fiduciary relationship between director and shareholder be found, based on the characteristics of the particular relationship in question: Coleman v Myers [1977] 2 NZLR 225. However, courts have treated the phrase 'the company as a whole' as meaning the corporators as a general body rather than the company as a commercial entity: Greenhalgh v Arderne Cinemas [1951] Ch 286 at 291 per Evershed MR; Provident International v International Leasing (1969) 89 WN(Pt1)(NSW) 370. See Finn, op cit, at 64-70 who considers this failure to recognise a fiduciary relationship between directors and shareholders while still requiring directors to act as such as 'mystifying'. With this distinction in mind, the cases will nonetheless provide guidance in determining how courts will approach the issue at hand.

\(^{163}\) Re Smith & Fawcett Ltd [1942] Ch 304 at 306 per Lord Greene MR. See also Odessa Tramways v Mendel (1877) 8 ChD 235; Anglo-Universal Bank v Baragnon (1881) 45 LT 362; Richard Brady Franks Ltd v Price (1937) 58 CLR 112 at 136 per Latham CJ; CAC v Papoulas (1990) 20 NSWLR 503; Southern Resources Ltd v Resides Treatment & Trading Co Ltd (1990) 56 SASR 455; Feil v Corporate Affairs Commission (1991) 9 ACLC 811.

\(^{164}\) [1970] VR 434 at 438 per Gnows J. Note that this case was based on the statutory duty to act honestly, currently found in s232(2). However, that duty was interpreted in the same manner as the general fiduciary obligation to act bona fide.

\(^{165}\) See Hampden v Earl of Buckinghamshire [1893] 2 Ch 531 at 544 per Lindley J, which involved a statutory power of mortgage to a tenant for life.

\(^{166}\) See Ex parte Lloyd (1882) 47 LT 64 at 65 per Jessel MR, which involved a power of sale vested in a trustee in bankruptcy. See also Leon v York-O-Matic [1966] 1 WLR 1450; Re Teller Home Furnishers (in liq) [1967] VR 313 at 318; Re Mineral Securities Australia (in liq) [1973] 2 NSWLR 207. With regard to amendments to the company articles by shareholder resolution, see Shuttleworth v Cox Bros & Co (Maidenhead) (1927) 2 KB 9 at 23 per Scrutton LJ; Hutton v West Cork Railway Co (1883) 23 ChD 654 at 671 per Bowen LJ; Australian Metropolitan Life Assurance Company Ltd v Ure (1923) 33 CLR 199 at 206 per Knox J; Peters' American Delicacy v Heath (1939) 61 CLR 457 at 482 per Latham CJ, discussed at 8.1 below.

\(^{167}\) Australian Growth Resources Corp Pty Ltd v Van Reesema per King CJ (Cox J concurring) (1988) 6 ACLC 529 at 537-538.
It is inconceivable, to my mind, that directors with an appreciation of their fiduciary responsibilities could cause a company to enter into [the particular] transaction. It could not possibly be regarded as for the benefit of the company. It is not the point that a director genuinely considers his purposes to be honest if those purposes are not in the interests of the company.

Professor Finn refers to this corrective jurisdiction as 'the duty to not act capriciously or totally unreasonably', observing that it applies to.\textsuperscript{168}

\ldots the situations where a fiduciary in taking a decision has not attempted to exercise his power to benefit his beneficiary, or where it cannot possibly be said on any view that his action was in their interests. And in these situations the court has felt compelled to intervene even though, as a general rule the fiduciary \textendash; and not the courts \textendash; is left to judge how his beneficiaries' interests are to be served.

Therefore, whilst the courts are generally non-interventionist, only requiring the trustee to act \textit{bona fide} in what it considers to be in the interests of the beneficiaries, decisions may be challenged where they are found to be totally unreasonable.\textsuperscript{169} In this regard, the objective consequences of the action may be considered.

Given this position with respect to trustees and other fiduciaries such as directors, it must be queried whether the same approach must be adopted with respect to the responsible entity upon exercises of power such as an amendment to the scheme constitution. Following from above, the responsible entity would only be required to act in what it considers to be the interests of members, unless that belief is found to be unreasonable. However, it is submitted that in the case of the responsible entity, the courts will review actions by the responsible entity on an \textit{objective} basis, that is, whether the action \textit{is in fact} in the best interests of scheme members. This proposition is supportable on four grounds.

\textit{First,} upon a natural reading of the statutory duty in s601FC(1)(c), it would seem that a responsible entity will be in breach of its obligations by failing to act in the best interests of the members, irrespective of whether it held the subjective belief that it was so acting. The responsible entity is required to act in the members' \textit{best interests}, and not in what it personally considers to be their interests. A positive, objective requirement is therefore imposed.\textsuperscript{170}

The objective nature of s601FC(1)(c) will be accentuated upon the enactment of CLERB. The Bill proposes to amend the statutory duty of good faith placed on company directors such that they must exercise their powers \textit{in good faith in what they believe to be in the best interests of the corporation},\textsuperscript{171} thereby emphasising the subjective nature of the investigation. No such amendment will be made to the correlating duty placed on the responsible entity, resulting in a clear distinction

\textsuperscript{168} Finn P D, \textit{Fiduciary Obligations}, Law Book Company, 1977 at 75.

\textsuperscript{169} Compare this with the \textit{Wednesbury unreasonableness} test in administrative law: \textit{Associated Provincial Picture Houses v Wednesbury Corporation} [1948] 1 KB 223.


\textsuperscript{171} CLERB, s181(a).
between the terminology used with respect to company directors and the responsible entity.

Secondly, both company directors and the responsible entity are imposed with a statutory duty of honesty. In the company law context, the duty of honesty has been interpreted as encapsulating the fiduciary duty of good faith, requiring directors to act in what they consider to be the corporate interest. However, the duty placed on the responsible entity to act in the best interests of members is additional to the duty of honesty. From this it can be inferred that the additional duty is intended to impose some further obligation on the responsible entity in the exercise of its duties, namely that its actions must be in the best interests of members, objectively determined.

Thirdly, s601FC(1)(c) diverges significantly from the statutory duties imposed by the ALRC/CSAC proposals. The proposed s260AE stated:

1. The operator of a collective investment scheme must not knowingly, intentionally or recklessly exercise its powers, or perform its duties, as scheme operator in the interest of itself or of anyone else if that interest is not identical to the interests of the scheme investors generally.

2. The operator of a collective investment scheme must not exercise its powers, or perform its duties, as scheme operator in the interest of itself or of anyone else if that interest is not identical to the interests of the scheme investors generally.

Defence: The defendant did not know, and could not reasonably have known, that the interests of the person in whose interests it was acting were not identical to the interests of the investors in the scheme.

It was therefore proposed that there be both a subjective and an objective duty. Section 260AE(1) was subjective, requiring the breach to be committed either "knowingly, intentionally or recklessly". Section 260AE(2), on the other hand, required no such knowledge, with the proviso that the defence could be pleaded where the breach was unknowing and could not reasonably have been known. These proposed provisions can be compared to s601FC(1)(c) which provides neither a subjective element to the duty, nor does it provide a defence where a breach of the duty was unintentional or unknown to the responsible entity. From this it can be inferred that in drafting the legislation as enacted it was intended that the investigation shift to an objective one.

Finally, in relation to the statutory duty imposed on directors to act honestly, which has been interpreted in the same manner as the general fiduciary obligation of directors to act in good faith, the requirement for actual subjective knowledge of the breach has been attributed to the fact that a breach of the duty formerly attached a criminal offence. This is no longer the case. Neither the duty placed on directors or s601FC(1) in relation to the responsible entity attract criminal sanctions per se, but

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172 Sections 232(2) and 601FC(1)(a) respectively.
175 Section 232(2).
176 Marchesi v Barnes [1970] VR 434-at 438 per Gowans J.
merely a civil penalty. In order for a contravention to amount to a criminal offence, a further statutory \textit{mens rea} component must be present, requiring the duties to be breached ‘knowingly, intentionally or recklessly’. It necessarily follows from this that the statutory duties \textit{can} be breached without the requisite \textit{mens rea}, thereby attracting a civil penalty rather than being a criminal contravention. As there is no immediate criminal sanction upon infringement of the statutory duties the courts will be more willing to issue a sanction in the absence of subjective intent. 

Therefore, the responsible entity is under a duty to act in the best interests of members, the investigation diverging from its equitable origins. This duty will be breached if an action is not in the members’ best interests, irrespective of the subjective intent of the responsible entity. With respect to an exercise of the constitutional amendment power, this duty goes further than the statutory restraint in s601GC(1)(b) which merely requires the responsible entity to hold a reasonable consideration that the amendment will not be adverse to members’ rights.

(b) ‘Best Interests of the Members’

The first issue to be determined is whether ‘members’ refers to only present members or whether it includes past and future members. In company law, when directors are acting in the best interests of the company, they are obliged to consider both the interests of present and future members. Similarly, in discussing a trustee’s duty to act in the best interests of beneficiaries in exercising the investment power, Megarry VC stated in \textit{Cowan v Scargill} that the trustee in a pension trust scheme must consider the interests of future as well as present members. However, this formulation is not applicable under the MIA. Section 601FC(1)(c) requires the responsible entity to act in the best interests of ‘members’, which is defined in the legislation to mean persons holding an interest in the scheme. Therefore, only those persons who currently hold such an interest, being present members, need be considered.

For the reasons given above in the context of the statutory restraint, it is submitted that ‘members’ means \textit{members as a whole}. This construction is consistent with the company law approach where the obligation to act in the interests of the company requires consideration of the \textit{company as a whole}. In relation to amendments by a resolution of unitholders in a unit trust, it has been held that such amendments must

177 Section 1317DA.
178 Section 1317FA.
179 See 4.3.1 above.
181 [1985] 1 Ch 270 at 286-287, extracted above at 5.3.1.
182 Section 9.
183 Discussed at 4.3.1(c) above.
be made in *good faith* for the *benefit of unitholders as a whole*.\(^{186}\) A similar construction should be adopted with respect to amendments by the responsible entity.

Furthermore, as is discussed below,\(^{187}\) where there are competing interests between members, the responsible entity has both an equitable and a statutory obligation to treat members in the same class equally and members in different classes fairly.\(^{188}\) This duty acknowledges that it is unrealistic to require actions by the responsible entity to be in the best interests of *all* scheme members. Actions must be in the best interests of members as a whole, as well as being fair as between members.

A final issue relates to the meaning of ‘best interests’. In *Cowan v Scargill*\(^{189}\) it was held that when the purpose of the trust is to provide financial benefits to members, the best interests of the beneficiaries requires consideration of their best *financial* interests. However, in the context of a purported amendment to the scheme constitution, the focus is unlikely to be so restrictive. *Cowan v Scargill* related to the fiduciary duties imposed on a trustee in the exercise of its investment power. As such, the power related directly to the generation of income from the underlying scheme assets. In that case, the primary consideration was to maximise financial benefits to members. However, the amendment power does not relate solely to financial interests, as it may affect the various rights vested in members by virtue of the scheme constitution and equity. Therefore, a wide scope of considerations must be taken into account when considering the best interests of members, including their financial interests, proprietary interest in the scheme, and the various rights and powers afforded to them.

(c) Can the Responsible Entity also Consider its Own Interests?

Being the operator of the scheme and legal proprietor of the scheme assets, an issue arises as to whether, in exercising its power of amendment, the responsible entity can consider its own interests as well as the interests of the members.

Where a contract allows a fiduciary to act in its own interests in certain matters, the contractual provisions are not necessarily inconsistent with the nature of the fiduciary office.\(^{190}\) A contractual entitlement to act in one’s own interest may coexist with a fiduciary relationship where there is also an obligation to act in the interests of another. Provided such obligation exists, a fiduciary relationship is present, irrespective of whether it is subject to qualifications.\(^{191}\) Therefore, in certain circumstances, a relationship may allow for the fiduciary to act in the joint interest of both itself and its fiduciaries.\(^{192}\) In this respect, the content of the fiduciary obligation must accommodate itself to the provisions of the underlying contractual relationship.

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\(^{186}\) *Graham Australia Pty Ltd v Perpetual Trustees WA Ltd* [1989] 1 WAR 65 at 81 per Malcolm J, discussed below at 8.2.3.

\(^{187}\) See 5.3.3 below.

\(^{188}\) *Birchnell v Equity Trustees, Executors and Agency Co Ltd* (1929) 42 CLR 384 at 408.

\(^{189}\) *Hospital Products Ltd v United States Surgical Corporation* (1983) 2 NSWLR 157. However, with the exception of Mason J, the issue was not addressed by the judgments in the High Court. Professor Austin suggests that as it would have been pertinent for the High Court judges to note any
With regard to the above observations, the position with respect to the responsible entity is that it is entitled to consider its own interests in exercising its powers and carrying out its duties, as the Act does not require that it abstain from considering its own interests. However, in all cases where the interests of members are inconsistent with its own interests, the former must be preferred. Furthermore, where an action is taken in the interest of the responsible entity which does not diminish the interests of members, the responsible entity may nonetheless be in breach of its duties where it has failed to advance the members' interests, the obligation being to act in the best interests of members, being a positive requirement rather than a mere negative criterion that their interests not be diminished. Actions will also be subject to the no-profit and no-conflict rules, discussed immediately below. Therefore, while in a strict sense the responsible entity may also consider its own interest in exercising its powers, the scope for such consideration is limited to where those interests are consistent with the interests of members and where no opportunity to advance the interests of members is foregone upon exercising the power. In this sense, the ability is somewhat illusory.

A further issue relates to whether the responsible entity can consider its own interests in its capacity as a scheme member when it holds an interest in the scheme. The company law decision of Mills v Mills provides a discussion of the duty imposed on a director to act in the best interests of the company where that director is also a shareholder of the company. Latham CJ observed that in such circumstances, by promoting the interests of the company, directors may also be promoting their own interests. Requiring otherwise would be to ignore reality and create impossibilities in the administration of companies. If the directors truly and reasonably believed what they did was in the interests of the company, the action is not invalid merely because they were also promoting their own interests in their capacity as shareholders.

The same can be said of the responsible entity. Section 601FC(1)(c) requires the responsible entity to act in the best interest of 'members', which includes all persons holding an interest in the scheme, therefore including itself where it is a member. It can therefore act in its own interest, provided it is also promoting the best interests of scheme members as a whole. The statutory duty further requires that the responsible entity give priority to the members' interests when it is in conflict with its own interests. It is submitted that in this context, 'its own interests' only encapsulates interests in a personal capacity rather than in its capacity as a scheme member.

5.3.2 Conflict of Duty and Interest

It has been established that the responsible entity can have regard to its own interests in amending the scheme constitution, provided the interests of members are treated as paramount. However, as well as the positive duty to act in the interest of its

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beneficiaries, self-interested actions by fiduciaries are further regulated by the requirement that a person in a fiduciary capacity must not profit from the relationship of trust by placing itself in a position where its duty and interest may conflict. The rule is often expressed as two distinct negative duties, although essentially intricately connected:

Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict exists between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it. Any such benefit or gain is held by the fiduciary as constructive trustee.

These negative duties, referred to as the no-conflict rule and the no-profit rule, result in actions which in some way confer a benefit on the fiduciary resulting either in the benefit being vested in the beneficiaries on constructive trust or an account of profits being ordered. This is so irrespective of an absence of good faith or injury to the beneficiaries.

With respect to the no-conflict rule, equity prohibits any profit being made by a fiduciary where that fiduciary holds an undisclosed personal interest which may in any way conflict with its duties and obligations to its beneficiaries. The prohibition has been stated as follows:

It is a rule of universal application that no one having [fiduciary] duties to discharge shall be allowed to enter into an engagement in which he has or can have a personal interest conflicting or which possibly may conflict with interests of those to whom he is bound to protect.

Therefore, a situation which creates the possibility of conflict will suffice. Irrespective of whether an action is in the interests of the beneficiaries, it will be challenged if an undisclosed personal interest is in existence and a profit is derived. It is the opportunity for conflict itself, and not the intentions of the fiduciary or the fairness of

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200 Many of the cases in which fiduciaries have been held to account for profit or gain involve situations where the fiduciary has obtained undisclosed remuneration over and above that which was authorised for its services, where the beneficiary holds an interest in a transaction in a private capacity, such as the purchase or sale of property to itself while acting in its fiduciary capacity, or where the fiduciary has otherwise made a profit by virtue of a misuse of its representative capacity. In this respect, the rules are of only marginal relevance to the current discussion, being predominantly instigated upon fiduciaries transacting and generally dealing with trust property rather than in the exercise of specific fiduciary powers vested in them. Therefore, only a cursory analysis of the application of the rules is required for present purposes.

201 Aberdeen Railway Co v Blaikie (1854) 1 Macq 462 at 471; [1843-60] All ER Rep 249.
the actions, which is examined. The rule aims to preclude a fiduciary from being swayed in its service to its beneficiaries by considerations of personal or third party interests. With regard to company directors, the rule is somewhat more relaxed, requiring there to be a significant, real or substantial possibility of conflict.

Under the no-profit rule, a fiduciary is precluded from using its position to advantage interests other than those of the beneficiaries. A fiduciary must account for all gains obtained by reason of its position, or of opportunity or knowledge resulting from that position. The strict approach to the rule has been described as follows:

The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his actions. The liability arises from the mere fact of a profit having, in the stated circumstances, been made.

The rules are applied strictly by the courts. However, where the power vested in the fiduciary authorises it to maintain a personal interest, the rule will have no application. In Chan v Zacharia, Deane J stated:

The principle is not however completely unqualified. The liability to account as a constructive trustee will not arise where the person under the fiduciary duty has been duly authorised, either by the instrument or agreement creating the fiduciary duty or by the circumstances of his appointment or by informed and effective assent of the person to whom the obligation is owed, to act in the manner to which he has acted.

Application to Managed Investment Schemes

The no-conflict and no-profit rules apply to the responsible entity in dealings in its fiduciary capacity. The restrictions can, however, be excluded by the terms of the constitution, which may permit certain profits to be derived irrespective of potential

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203 Phipps v Boardman [1967] 2 AC 46 at 124 per Lord UpJohn; Chan v Zacharia (1984) 154 CLR 178 at 199 per Deane J; Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41 at 103 per Mason J.


205 Chan v Zacharia (1984) 154 CLR 178 at 198-199 per Deane J.

206 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 at 386 per Lord Russell of Killowen.

207 Keech v Sandford (1726) Sel Cas T King 61; 25 ER 223 at 223 per Lord King LC. However, see Teele R, 'The Necessary Reformulation of the Classic Fiduciary Duty to Avoid a Conflict of Interest or Duties' (1994) 22 ABLR 99, where it is argued that modern commerce is requiring a less stringent application of the rules.

208 (1984) 154 CLR 178 at 204.

209 With respect to advantage gained from the use of information, the no-profit rule has obtained statutory expression: s601FC(1)(e).
or actual conflicts of interest and duty. In the absence of such an exclusion, the Act acknowledges that there is a scope for conflict to arise. Section 601FC(1)(c) provides that where there is a conflict between the interests of the members and the responsible entity, the former must prevail. If no conflict were permissible, this provision would be redundant. This was further acknowledged in the ALRC/CSAC:^\textsuperscript{210}

Investors in collective investment schemes rely heavily on the operator to act in their interests. Nevertheless, there will often be a potential for conflict between their interests and those of the operator...Conflicts of interest between scheme operators and investors are inevitable. The Review has concluded that the appropriate formulation of the test is that operators must prefer the interests of investors over their own interests where any conflicts arise.

Irrespective of this acknowledgment, however, the legislation does not in itself authorise the responsible entity to derive a profit where such a conflict or potential conflict is in existence. Therefore, where the responsible entity has a private undisclosed interest in a proposed action and derives some profit or benefit from its actions, that profit or benefit will be held on constructive trust for scheme members. For instance, purchasing from or selling property to the scheme, either by the responsible entity itself or an associate of the responsible entity, would result in a profit being derived where a possibility of conflict exists.^\textsuperscript{211} Taking advantage of corporate opportunities which are also available to the scheme, or which the responsible entity obtained information of in its capacity as trustee for the scheme may also result in a breach of its fiduciary obligations.

In relation to constitutional amendments, any profits obtained by the responsible entity resulting from its position as trustee, or which are derived where a possible conflict of interests may exist, are similarly subject to the duties. An example may be an amendment purporting to increase the quantum of remuneration payable to the responsible entity under the charging clause. Alternatively, an amendment seeking to reduce the ratification requirements for self-dealing transactions may also result in a profit being derived in a situation where a potential for conflict is in existence.

The Responsible Entity as a Scheme Member

A particular situation in which the responsible entity may have a conflict of interest and duty upon an amendment to the constitution is where it holds an interest in the scheme in the capacity of member. For instance, where the responsible entity holds an interest in the scheme, an amendment which purports to increase distributions payable to members will result in a profit flowing to the responsible entity. Under strict equitable principles, such a profit will be held on constructive trust.

*Edge v Pensions Ombudsman,*^\textsuperscript{212} a recent decision by the English Chancery Division, involved an amendment to the rules of a pension scheme. The scheme contained a large surplus which attracted adverse taxation consequences. The trustees purported to

^\textsuperscript{210} ALRC/CSAC Vol 1 at 92.

^\textsuperscript{211} See further at 6.3 below in relation to self-dealing transactions.

^\textsuperscript{212} [1998] 3 WLR 466. Note that an appeal from this decision has recently commenced in the English Court of Appeal.
amend the rules in order to reduce the surplus by reducing contributions made by both the employer and employees, as well as increasing pension benefits to members in service at the date of the amendment. Nine of the twenty trustees were current employees, and therefore received the benefit of the amendment. The Pension Ombudsman held that the trustees who were members in service were accountable for any benefit to which they had already or might in the future become entitled to under the deed of amendment.

Sir Richard Scott VC disagreed with this contention. The rules of the scheme required certain trustees to be current employees. As such, it was contemplated by the rules that, as trustees, the employee members may from time to time be required to exercise a discretion in which such a conflict may arise. The employee trustees were therefore not accountable for the increased benefits received. His Honour stated:

The notion that, when the discretionary power of amendment is exercised so as to increase an existing benefit or add a new benefit, the member trustees must be excluded from benefit is, in my opinion, quite simply ridiculous. The rules could not be taken to have intended so absurd a result. So why should equity intervene? Rules of equity were devised in order to produce fair and sensible results.

Unlike the rules in the above pension scheme, the MIA does not require the responsible entity to be a member of the scheme. It does, however, expressly permit the responsible entity to acquire an interest in the scheme, provided that such acquisitions are at market price and would not disadvantage other members. Therefore, as the MIA authorises the responsible entity to hold an interest in the scheme, irrespective of the inherent conflict in such a situation, profits derived by the responsible entity in that capacity will not be subject to a constructive trust. However, where the purported amendment seeks to increase the benefits conferred on the responsible entity in its capacity as a member to the exclusion of other members, the amendment will be in breach of the responsible entity’s duty to act in the best interests of the members and to prefer their interest when a conflict arises.

5.3.3 Duty of Impartiality

A trustee must serve the interests of all its beneficiaries. Therefore, it cannot act in a way which favours some beneficiaries at the expense of others. This has fostered two distinct rules imposed on a trustee in exercising its powers and discretions. First, the trustee is under a duty to treat beneficiaries of the same class equally, and

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213 See Pensions Act 1995 (UK), s39, which excludes the application of the conflict of interest rule to employee member trustees in pension schemes.


215 Section 601FG.

216 Section 601FC(1)(c).

217 Issues relating to the duty of impartiality ordinarily arise with respect to successive beneficiaries, where some beneficiaries are entitled to income and others are entitled to the capital of the trust in remainder: see Dal Pont G E & Chalmers D R C, Equity and Trusts in Australia and New Zealand, Law Book Company, 1996 at 471.

218 Re Tempest (1866) LR 1 Ch App 485 at 487-488; Simpson v Bathurst (1869) LR 5 Ch App 193; Knox v MacKinnon (1888) 13 App Cas 753 at 768; Tanti v Carlson [1948] VLR 401; Hyman v Perpetual Trustee Co of NSW (1914) 14 SR (NSW) 348.
secondly, it must treat beneficiaries of different classes fairly.219 These duties have also been given statutory form by virtue of the MIA. Section 601FC(1)(d) states:

In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must treat the members who hold interests of the same class equally and members who hold interests of different classes fairly.

Therefore, it is not sufficient that an action benefit the interests of the members as a whole. Where the issue is one of competing interests as between members, the duty of impartiality must be complied with. The principles as applied in company law are most succinctly stated by Latham CJ in Mills v Mills as follows:220

Directors are required to act not only in matters which affect the relations of the company to persons who are not members of the company, but also in relation to matters which affect the rights of shareholders inter se. Where there are preference and ordinary shares a particular decision may be of such a character that it must necessarily affect adversely the interests of one class of shareholders and benefit the interests of another class. In such a case it is difficult to apply the test of acting in the interests of the company. The question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair as between different classes of shareholders.

An Objective Examination?

Where an action by a trustee is conducted with subjective intent to discriminate between beneficiaries in the same class or treat beneficiaries in different classes unfairly, there is a clear case of the trustee being in breach of its duties. However, it is arguable whether it is not only the reasons underlying the decision, but also the consequences occasioned by the action which may be tested as to their fairness. For instance, Professor Finn states:221

The courts have not yet committed themselves completely to the view that any inequality of treatment will of itself be a breach of duty even though the fiduciary himself, quite honestly and with good intentions, believes his decision to be in the interests of his beneficiaries as a whole. But save for the case where some beneficiaries agree to be burdened so that all may ultimately be advantaged, it seems unlikely that courts will ever approve of a decision which does not on its face treat all the same classes equally.

Therefore, irrespective of if the trustee is acting in all honesty and good intent, with the subjective intention of serving the interests of its beneficiary, the court may

220 (1937-38) 60 CLR 150 at 164. For directors, see also British & American Trustee & Finance Corporation v Couper [1894] AC 399 at 417; Galloway v Halle Concerts Society [1915] 2 Ch 233. The fact that such a duty exists in relation to company directors would seem odd considering that directors only owes fiduciary duties towards the company and not individual members: see Finn P D, Fiduciary Obligations, Law Book Company, 1977 at 65-70.
221 Finn, op cit, at 57.
interfere where its actions are unjust towards some of those persons whom it is bound to protect.222

However, the decision of Edge v Pensions Ombudsman223 illustrates the reluctance shown by courts in subjecting trustees in pension schemes to an objective examination of their conduct. This poses the question as to whether such a non-interventionist approach will similarly be adopted in reviewing the actions of the responsible entity.

In Edge v Pensions Ombudsman, the purported amendment to the pension scheme rules had the effect that employees currently in service at the date of the amendment were both benefited with reduced contributions and increased pension benefits. Current pensioners under the scheme filed a complaint with the Pensions Ombudsman, as they were not to receive the benefit of the amendment. The Ombudsman determined that the trustees had acted in breach of trust in making the amendments in question since they had failed to act impartially as between different classes of beneficiaries. On appeal, Scott VC overruled the decision of the Ombudsman, stating:224

In relation to a discretionary power of that character it is, in my opinion, meaningless to speak of a duty on the trustee to act impartially. Trustees, when exercising a discretionary power to choose, must of course not take into account irrelevant, irrational or improper factors. But, provided they avoid doing so, they are entitled to choose and to prefer some beneficiaries over others...The trustees are entitled to be partial. They are entitled to exclude some beneficiaries from particular benefits and to prefer others. If what is meant by ‘undue partiality’ is that the trustees have taken into account irrelevant or improper or irrational factors, their exercise of discretion may well be flawed. But it is not flawed simply because someone else, whether or not a judge, regards their partiality as 'undue'. It is the trustee’s discretion that is to be exercised. Except in a case in which the discretion has been surrendered to the court, it is not for a judge to exercise the discretion. The judge may disagree with the manner in which trustees have exercised their discretion but, unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one that no reasonable body of trustees properly directing themselves could have reached, the judge cannot interfere. In particular he cannot interfere simply on the grounds that the partiality shown to the preferred beneficiaries was in his opinion undue.

Following this decision, it would seem that the courts will be reluctant to assess the fairness of a trustee’s decision, nor will they replace decisions with that of their own. Only if it is found that the decision was based on irrelevant, irrational or improper considerations will a decision be disturbed. However, this case does not go so far as excluding the duty of impartiality from exercises of the amendment power in pension schemes. The following arguments are offered in support of this proposition.

222 Hampden v Earl of Buckinghamshire [1893] 2 Ch 531 at 544 per Lindley LJ; Galloway v Halle Concerts Society [1915] 2 Ch 233.
224 Ibid, at 486-487.
First, the Vice-Chancellor characterised the rule amending power as 'a discretionary power to choose which beneficiaries, or which class of beneficiaries, should be the recipients of trust benefits'. On this basis, the Vice-Chancellor found the nature of the power itself to authorise actions which were unduly impartial between classes of beneficiaries. In this respect, the amendment power was characterised as a power of appointment rather than a broader power to amend the pension scheme rules. It is submitted that excluding the duty of impartiality on this basis is unfounded. There was nothing inherent in the amendment power in the given trust deed which permitted the trustee to act impartially or unfairly between beneficiaries.

Secondly, the Vice-Chancellor seemed to characterise the duty of impartiality as a duty to treat all beneficiaries equally and not to prefer the interests of one class over another. Given this understanding of the duty, it is understandable that it was held to be too restrictive to apply to the pension scheme. However, the duty of impartiality is not so strict such that actions cannot be taken which prefer one class of beneficiary over another. Decisions may be discriminatory. All that is required is that the action be fair as between different classes.

Thirdly, although he discarded the duty of impartiality, the Vice-Chancellor did in fact conduct an investigation and come to a determination that the action was in fact fair and justifiable. It was found that taking action to reduce the fund surplus was necessary given possible adverse taxation consequences. It was further found that diverting the benefit of the amendment to current employers rather than pensioners was justified on employment relations grounds. The exercise of power was therefore justified as fair in the circumstances.

On these bases, it is submitted that the decision would more appropriately have been dealt with by determining that although the action by the employer company was discriminatory against pensioners, it was in fact in the best interests of the beneficiaries as a whole and was fair given the surrounding circumstances. The pensioners did not suffer undue hardship as a result of the amendment. If, for instance, the amendment sought to increase benefits payable to current employees by diverting funds from pensioners, a different decision would have eventuated. There was no need to discard the duty of impartiality as being 'meaningless' in the context at hand, as the facts in question fell outside the duty. The decision therefore does not exclude the duty from applying to pension trust deed amendments.

Application to Managed Investment Schemes

In regard to managed investment schemes, the duty of impartiality applies to exercises of the constitutional amendment power. Moreover, the statutory duty of impartiality will increase the ability and the willingness of courts to review the objective effect of a fiduciary action by the responsible entity. Section 601FC(1)(d) requires that in exercising its powers, the responsible entity must treat members in the same class equally and members in different classes fairly. If these duties are not complied with, the courts will intervene in the action, even where the action is made within the scope of the power, for a proper purpose and with the bona fide intention of benefiting the

222 Ibid, at 486.
226 Ibid, at 489.
227 Ibid, at 490.
members as a whole. Therefore, the MIA makes it clear that, firstly, the duty of impartiality does apply, and secondly, the courts may intervene where the duty is breached, irrespective of the subjective knowledge or intent of the responsible entity.

This leaves the issue of the definition of a ‘class’. A class is signified by a category of units which are sufficiently distinguishable from other categories of units in terms of the rights attached to them. Therefore, where the scheme constitution ascribes different rights to particular units in the scheme, those units will constitute a separate class. For instance, the constitution may ascribe different voting rights or a different proportion of the fund to a particular class. In the case of listed schemes, only one class of ordinary units is permissible. Preference units may, however, be divided into different classes. Furthermore, the Act stipulates that where the scheme is not divided into two or more classes, the interests in the scheme represent a single class.

The duty of impartiality requires that the responsible entity treat members of the same class equally. This requires merely that the action not formally and explicitly discriminate between members rather than mandating that the impact of the action on members be equal. For instance, the duty will be breached if a constitutional amendment seeks to increase distributions to some members and not to other members in the same class. However, an amendment which increases distributions to all members in the class in proportion to their scheme interest, but which benefits some members greater than others due to taxation consequences, will nonetheless be treating members equally.

Where the scheme is constituted by more than one class, members in different classes need not be treated equally, provided they are treated fairly. It is submitted that fairness must be interpreted as fair given the surrounding circumstances. The responsible entity can discriminate between members in different classes, provided the action is in the best interests of the members as a whole and the action is justified in the circumstances. Where it is not justified, the action will be deemed unfair.

Finally, where the scheme constitution provides for requirements with respect to the alteration of class rights, those requirements must also be complied with where an amendment seeks to alter rights of a particular class of member.

5.3.4 Duty to Consider Whether a Discretion Should be Exercised

The final aspect of the responsible entity’s statutory and general law duties to act in the best interests of scheme members is the requirement that it considers from time to time whether a power must be exercised. The responsible entity is clearly in breach of its duties where it exercises a power in a manner which is inconsistent with the best interests of members (breach by commission). However, a breach will also occur where the responsible entity has failed to exercise a power when the best interests of members would only be properly served by the power being exercised (breach by omission).

228 In relation to classes of shares, see Clements Marshall Consolidated Ltd v ENT Ltd (1988) 13 ACLR 90 at 93 per Neasey J.
229 ASX Listing Rule 6.2.
230 Section 57(2).
231 ASIC Class Order 98/60. See above at 4.3.2.
This obligation may alternatively be explained as an application of the duty imposed on trustees of mere powers of appointment to consider whether to exercise their discretion. The duty requires the trustee to consider from time to time the merits of persons whom may be objects of the power. The trustee must apply its mind to the exercise of the discretion. There must be a real and genuine consideration of the exercise based on proper considerations and information. Professor Finn appropriately described the state of the law as follows:

A fiduciary must discharge the duties attached to its office. But what of his powers? While it is the essence of a power that its exercise is not mandatory a fiduciary is, nonetheless, prohibited from sleeping on those powers given him by virtue of his office. He cannot content himself with doing the absolute minimum his office positively requires of him by only discharging its duties while ignoring its powers. Through his powers he is given the means not only to facilitate the discharge of his duties but also to protect and to advance his beneficiaries’ interests as and when he considers that those powers can be exercised for these purposes. Not surprisingly his fiduciary obligations require him to consider their possible exercise - and this is a continuing duty. So it is settled that trustees, for example, cannot just push aside any power held by them in their fiduciary capacity and refuse to consider whether it ought in their judgement be exercised. Such a consideration must be given, and given from time to time.

This duty extends beyond powers of appointment, and is applicable to the exercise of administrative powers such as the responsible entity's constitutional amendment power. Therefore, the responsible entity will be under a duty to consider from time to time whether it will exercise its power to amend the constitution. If it fails to make such a consideration, and the circumstances require an amendment to be instigated in order to serve the interests of members, the responsible entity will be in breach of its fiduciary obligations and correlating statutory duties. An example may be where there is a change in the applicable taxation laws resulting in a greater tax burden unless the constitution is appropriately amended. A failure by the responsible entity to consider whether it is appropriate in this circumstance to exercise its power of amendment will result in a breach of its fiduciary obligations to members.

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232 A mere power is a power which need not be exercised but in respect of which consideration must be given to whether or not to exercise the relevant power each time a call for it arises. This may be compared with a trust power, being a power conferred where the trustee is obliged to exercise that power. Therefore, while a trustee vested with a trust power must decide how to exercise the power, in the case of a mere power they must also decide whether to exercise the power at all. In relation to trust powers, the court will execute the power if the trustee fails: Brown v Higgs (1803) 8 Ves Jr 561 at 570-571; 32 ER 473 at 476-478 per Lord Eldon; Re Gulbenkian’s Settlement [1970] AC 508; McPhail v Doulton [1971] AC 424.


235 Finn P D, Fiduciary Obligations, Law Book Company, 1977 at 34.

236 For instance, the duty has been applied to decisions by company directors: Scottish Co-operative Wholesale Society v Meyer [1959] AC 324 at 363; Bond v Barrow Haematite Steel Co [1902] 1 Ch 353 at 368.
5.4 Ratification and Exclusion

Two incidental issues remains with respect to equitable duties imposed on the responsible entity upon amending the scheme constitution: whether members can ratify a breach of duty by the responsible entity, and whether the scheme constitution can exclude the operation of the duties. Each are discussed in turn.

5.4.1 Ratification

It is a defence to a claim of breach of fiduciary duty that the breach occurred with the informed consent of the beneficiaries. As such, a ratification may be effected, involving a release by the members of any rights of action against the responsible entity as a result of its actions. The ratification may either be retrospective as to past breaches or in relation to a prospective breach. Effective ratification will require fully informed disclosure of the breach to members.

In relation to breaches by company directors, it is usually sufficient that the breach be ratified by a majority of members in a general meeting, subject to certain exceptions. As the company is the proper plaintiff to take action against the director, it is the company, through the general meeting, which can ratify the breach. In effect, actions by minority shareholders are blocked.

This may be contrasted with the position of the responsible entity. As a trustee, the responsible entity owes its duties directly to scheme members. As there is no interposed legal entity, each individual member has standing, both under the general law and the legislation, to seek redress for a breach. Therefore, ratification must be unanimous, as any dissenting member would have an action against the responsible entity. Given the likely size of a managed investment scheme, it would seem unlikely in a practical sense that unanimity could be obtained from scheme members, particularly if the issue relates to a profit made by the operator of the scheme, possibly at the financial expense of members. Of course, this is subject to contrary provisions in the constitution which may allow for ratification by special resolution or some other means.

Alternatively, a ratification of a constitutional amendment may be effected in substance by a special resolution rather than unanimous consent where members instigate the amendment themselves under s601GC(1)(a). The power vested in scheme members to amend the constitution will thereby act as a form of veto to

237 Birtchnell v Equity Trustees Executors and Agency Co Ltd (1929) 42 CLR 384 at 398 per Isaacs J
238 For disclosure requirements, see New Zealand Netherlands Society 'Orange' Inc v Keys [1973] 2 All ER 1222 at 1227 per Lord Wilberforce; Winthrop Investments v Winns Ltd [1975] 2 NSWLR 666 at 674; Grantwell Pty Ltd v Franks (1993) 61 SASR 390.
239 Furs Ltd v Tomkies (1936) 54 CLR 583 at 592; Regal (Hastings) Ltd v Gulliver, supra; Miller v Miller (1995) 16 ACSR 73. In limited situations, ratification may be effected by the board of directors: Queensland Mines Ltd v Hudson (1978) 18 ALR 1.
240 Such as where the ratification would be a fraud on the minority: Ngurli Ltd v McCann (1953) 90 CLR 4251, a misappropriation of company property would result: Hurley v BGH Nominees Pty Ltd (1982) 31 SASR 250, or where the ratification is oppressive or for an improper purpose: Residue Treatment & Trading Co Ltd v Southern Resources Ltd (1988) 14 ACLR 375.
241 Miller v Miller (1995) 16 ACSR 73 at 87 per Santow J.
242 Section 601MA(1), s1324, s1325.
amendments proposed by the responsible entity. However, the resolution will be subject to equitable restraints such as where it is found to constitute a fraud on the minority, explored in Part C below.

It must further be queried whether there are any breaches of duties and obligations which cannot be ratified by scheme members. Exercises of power by the responsible entity may be ratified where the action is beyond the power or for an improper purpose. However, breaches of duties which are given statutory force are arguably not ratifiable. In this regard, Santow J in Miller v Miller stated:

"It is also clear enough that a ratification cannot cure a breach of statutory duty, especially one imposing criminal liability. The most it can do is remove from the scope of technical dishonesty such actions as issuing shares for a purpose which is not a proper one, in the sense of not being for the benefit of the company as a whole."

The statutory duties prescribed by the MIA are not criminal offences per se. However, following from Santow J's observations, it would follow that scheme members cannot ratify a breach by the responsible entity of any duties stipulated in s601FC(1), and members will not be precluded from subsequently claiming under their statutory right to damages by virtue of s601MA. Furthermore, this would extend to breaches of any duties found in the scheme constitution which are not inconsistent with the statutory duties, as they are also given legislative status as a result of s601FC(1)(m). Therefore, only breaches of those duties and obligations which are not reflected in the legislation, such as the requirement to act for a proper purpose and the obligation to account for undisclosed profits, can be ratified.

5.4.2 Exclusion and Exemption Clauses

It was established above that the scheme constitution cannot exclude or circumvent the statutory restraint on amendments found in s601GC(1)(b). The final issue is whether the scheme constitution can exclude or dilute the operation of the various general duties and obligations imposed on the responsible entity upon exercises of power. As well as excluding trustee duties from operating, it may alternatively be possible to exempt the trustee from liability upon breach of those duties.

It is a fundamental principle of equity that fiduciary obligations must mould themselves to the particular relationship at hand. As such, the parties can alter the incidences of the fiduciary relationship by virtue of the constitution. However, as a trust relationship presupposes correlating rights and obligations, there is a limit to the extent to which fiduciary obligations may be excluded. This limit is represented by those obligations which are at the core of the trust relationship. To exclude these core duties would be repugnant to and 'make a nonsense of' the fundamental nature of the


244 (1995) 16 ACSR 73 at 89.

245 A breach may amount to a criminal offence if the requisite mens rea is proved: s1317FA.

246 Above at 4.1.7.

trust.\textsuperscript{248} As such, fundamental duties such as the duty to act in the interests of members cannot be excluded from operation. Similarly, it is unlikely that an exemption clause can effectively excuse a trustee from liability for either a deliberate breach of trust or a breach of trust involving bad faith.\textsuperscript{239} Liability for gross negligence may, however, be excluded.\textsuperscript{230}

With respect to managed investment schemes, the identification of the core duties is easily determined, as it is represented by the statutory duties. Those duties which have statutory force by virtue of s601FC(1) cannot be excluded, as to hold otherwise would be inconsistent with the provisions of the Act.\textsuperscript{251} So much is clear from the ALRC/CSAC proposal, in which one of the justifications for imposing general statutory obligations on the responsible entity was to ensure the duties were incapable of variation through the scheme constitution.\textsuperscript{252} It would be equally inconsistent with the legislation if the responsible entity were exempted from liability upon breach of those statutory duties.\textsuperscript{253} Therefore, the Act effectively increases the core duties of the responsible entity. Only those duties and obligations which are not reflected in the statutory provisions, such as the rule against conflicts between interest and duty and the making of undisclosed profits, may be excluded.

By way of summary, the responsible entity is vested with a statutory right to unilaterally amend the scheme constitution. As well as the statutory requirement found in s601GC(1)(b) and any class rights provisions contained in the scheme constitution, the responsible entity is imposed with a plethora of duties, obligations and restraints upon exercising the constitutional amendment power. Although derived from characteristics of trust and general fiduciary relationships, many of these duties have been given statutory form. These restraints are wider than the s601GC(1)(b) restriction, not merely being limited to amendments which affect members’ rights.

The responsible entity must not commit a fraud on the power by acting for an impermissible purpose. A purported amendment cannot undermine the substratum of


\textsuperscript{230} Ford & Hardingham, ibid, at 57.

\textsuperscript{251} In relation to pension funds, see Lee W A, ‘Can Trustee Law Protect Pension Funds? Pt I’ (1993) 5(1) Superannuation Law Bulletin 1 at 3. In relation to unit trusts under the prescribed interest regime, see former s1069(7) which deems trust deeds to include the covenants required by the Act. As such, the duties ascribed by the legislation could not be excluded, as they were deemed applicable irrespective of whether they were actually incorporated into the deed or not.

\textsuperscript{252} ALRC/CSAC Vol I at 91.

\textsuperscript{253} Similarly, a constitutional right of indemnity for liability cannot be obtained by the responsible entity except upon the proper performance of its duties: s601GA(2). As such, no right of indemnity can be granted by the scheme constitution upon a breach by the responsible entity of its duties.
the scheme. The action, or non-action, must be in the best interests of members as a whole, and must not result in an undisclosed profit being obtained by the responsible entity. Finally, the action must be fair as between classes of members and treat members within the same class equally. The following chapter discusses the application of these restraints in the context of selected amendments.
6. Selected Amendments to the Scheme Constitution

This Part has so far considered the power and various restraints placed on the responsible entity upon seeking to amend the scheme constitution. This chapter applies those restraints to selected amendments. The objective is to ascertain whether the restraints placed on the constitutional amendment power provide adequate protection to members upon such amendments. The discussion also provides a medium by which particular legal issues generally concerning managed investment schemes are canvassed. Three amendments will be considered in turn:

1. A change to the responsible entity's investment powers (6.1).
2. The removal or limitation of withdrawal rights (6.2).
3. The exclusion of the prohibition against trustee self-dealings (6.3).

6.1 Changing the Investment Powers

As a trustee, the responsible entity is under a duty to invest the trust fund in a manner in accordance with the trust instrument and legislation. The responsible entity may invest in any kind of investments, subject to both the prudent person test and the provisions of the scheme constitution.

With respect to the prudent person test, the responsible entity is required to exercise the care, diligence and skill that a prudent person in its profession would exercise in managing the affairs of other persons. The trustee legislation further provides an inclusive list of matters which the trustee must take into account in exercising its investment power. These include the purposes of the trust and the needs and circumstances of the beneficiaries, the desirability of diversification, the nature of and risk associated with the investments, potential for income return and capital appreciation, etc. The scheme constitution may, and commonly does exclude the operation of the prudent person requirement.

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1 Three further amendments will be considered in Ch 9 below in the context of amendments by scheme members. Note that the assignment of amendments to either Ch 9 or this Chapter is somewhat arbitrary, as the amendments could be sought by either the responsible entity or scheme members, or alternatively proposed by the responsible entity and vetoed by a special resolution of members.

2 *Adamson v Reid* (1880) 6 VLR (E) 164. For the duty to invest generally, see Dal Pont G E & Chalmers D R C, *Equity and Trusts in Australia and New Zealand*, Law Book Company, 1996 at 476.

3 *Trustee Act 1925* (NSW), s14-14A; *Trustee Act 1893* (NT), s5; *Trustee Act 1936* (SA), s6; *Trustee Act 1898* (Tas), ss6; *Trustee Act 1958* (Vic), ss5. *Trustees Act 1962* (WA), s17-18. However, trustee legislation in Queensland and the ACT contains a list of authorised investments in which the trustee may invest, unless otherwise specified in the trust instrument: *Trust Act 1973* (Qld), s21; *Trustee Act 1925* (NSW) as applied and modified by the *Trustee Act 1957* (ACT). See *Riddle v Riddle* (1952) 85 CLR 202 at 214 per Dixon J. Note that listed schemes are imposed with requirements regarding the net tangible assets of the scheme as well as various other investment obligations: ASX Listing Rule 1.5.

4 The responsible entity is subject to a similar care and diligence requirement with respect to the exercise of all its powers: s601FC(1)(b).

5 *Trustee Act 1925* (NSW), s14C(1); *Trustee Act 1893* (NT), ss8; *Trustee Act 1936* (SA), ss9; *Trustee Act 1898* (Tas), ss8; *Trustee Act 1958* (Vic), ss8; *Trustees Act 1962* (WA), s20.
With regard to the scheme constitution, adequate provision must be made for the powers of the responsible entity in relation to investments. This requirement may be satisfied by the constitution vesting in the responsible entity all the powers of a natural person in investing the scheme property. The responsible entity would thereby have a broad power to invest in any form of investments and securities, subject to the prudent person test. The constitution may further permit investments in assets which would otherwise result in a breach of trust, such as high risk or speculative securities and derivatives. At the other extreme, the constitution may limit the scope and nature of investments, expressly prescribing the types of investments which may be made in accordance with the purpose of the trust. For instance, the scheme may be specified as a property trust, the responsible entity only being able to invest in real property, or alternatively an equity trust, where investments are limited to company shares. Similarly, the constitution may prohibit certain investments, such as a mandate against shares in companies which are deemed environmentally unfriendly, or restrict investments to equity in companies operating in a specified industry.

This poses the question of whether, after the formation of the trust, the responsible entity can seek to amend the constitution in order to either create, alter or remove restrictions on its investment power. For illustrative purposes, two specific examples will be explored:

(a) An amendment changing the scheme from a property to an equity trust.
(b) An amendment vesting or removing a power to pursue social investments.

(a) Changing from a property to an equity trust

It is common for schemes to be formed and marketed as being constituted by investments in certain specified categories of assets such as real property or equity. Alternatively, a scheme may be sectorial specific, acquiring interests in a narrow class of securities such as industrial equities. This will be reflected in the name of the scheme, the prospectus and the terms of the constitution. However, upon members contributing to a scheme on this basis, it must be queried whether the responsible entity can subsequently amend the constitution to change the scope of its investment

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6 Section 601GA(1)(b).
7 ASIC Policy Statement 134.22.
8 Assuming, of course, that the prudent person test is not excluded by the constitution.
10 Note that a constitutional amendments would ordinarily not be required in order to alter the investment policy of the scheme, as the scheme constitution would vest the responsible entity with a broad power of investment. However, it is assumed that with more fundamental alterations to the investment policy, such as the two amendments discussed, alterations to the constitution may be required in order to either restrict or remove restrictions from the responsible entity's constitutional investment powers. See former reg 7.12.15(5)(bb)(d) which required the manager to inform the trustee of proposed variations to the investment policy of a prescribed interest scheme where a member would not reasonably expect such an amendment having regard to the prospectus.
powers, thereby changing the nature of the underlying scheme assets into which it has
invested.  

Such a change may be justified in terms of the interests of scheme members. For instance, where the property market is suppressed, it may be financially beneficial for members that the investment focus be shifted to shares or other forms of more liquid investments. This will satisfy the requirement that the amendment be in the best interests of members. Furthermore, assuming the narrow interpretation of members' rights discussed above is adopted, the statutory requirement that the responsible entity reasonably considers the change will not adversely affect members' rights may be satisfied, there being no change to the rights vested in scheme members by virtue of equity or the scheme constitution. 

The more difficult issue in relation to such amendments is the determination of the purpose for which the amendment is sought. The relevant purpose may be characterised as benefiting scheme members by ensuring their contributions are invested in the most liquid or financially beneficial assets. Alternatively, however, the amendment may be characterised as being for the purpose of undermining the underlying nature of the scheme, being the investment into real property for instance. In this sense, it may be argued that the amendment will result in a failure of substratum. Members contribute their capital upon the common understanding that their contributions will be invested in a specified form of property, in this case being real estate. This common understanding is founded by the name of the scheme, advertising, the scheme prospectus, and the terms of the scheme constitution as at the date of their membership contracts. An amendment to the nature of the assets undermines this understanding.

It may be that courts will construe the substratum of a scheme broadly in such a case. It was established above that the doctrine of failure of substratum remains applicable to trusts, irrespective of the decision of Kearns v Hill. That decision, however, does illustrate a tendency for courts to construe trust deeds in a manner which allows for their most ample operation, as well as the promulgation of a wider characterisation of the relevant purpose or substratum of the trust. In the current scenario, if the substratum of the scheme is characterised as the provision of a collective investment vehicle investing exclusively in real property, the amendment will infringe this purpose. This is likely in schemes in which the nature of assets invested into are particularly narrow, such as sectorial specific schemes. However, it is possible (and likely) that the substratum will be given a wider interpretation, being simply the

11 An illustration is the purported amendment in Heine Management Ltd v ASC (1993) 12 ACSR 578, being part of the Aust-Wide litigation. A unit trust was established for the purpose of investing solely in a particular property, being the Grosvenor Place Complex in Sydney. An amendment to the trust deed purported to allow investments in other properties with the purpose of allowing the acquisition of interests in 120 Collins Street Melbourne. Restraints on the amendment power was not in issue in the litigation.

12 Section 601FC(1)(c). See 5.3.1 above.
13 See 4.3.1(c)(i) above.
14 Section 601GC(1)(b).
15 See 5.1 above.
16 See 5.2 above.
17 (1990) 21 NSWLR 107. See 5.2.1 above.
provision of a collective investment scheme for the purpose of financial reward to members. If this is the case, the amendment will be valid.

(b) Social Investments

Generally speaking, managed investment schemes are created for the purpose of providing financial benefits to members. As such, in exercising its power of investment, the responsible entity must act in the best financial interests of scheme members by ensuring their financial return is maximised, given the level of risk and capital appreciation of the investment. The responsible entity cannot base investment decisions on non-financial factors such as moral, ethical, social or political concerns. For instance, the responsible entity cannot pursue a policy that it will not invest in companies which engage in activities considered to be socially or politically undesirable where investment in such companies will not be in the best financial interests of members. In this respect, Megarry VC stated in Cowan v Scargill:

In considering what investments to make trustees must put on one side their personal interests and views. Trustees may have strongly held social or political views. They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views they hold.

However, the right of a trustee to consider non-financial matters in conducting investments may be provided by a direction in the trust instrument. This poses the question of whether the responsible entity can amend the scheme constitution in a manner which provides it with a power to consider non-financial matters in its investment activity, ie, the inclusion of a social investment provision.

The insertion of a social investment provision will not adversely affect members’ rights, therefore not infringing the statutory restraint in s601GC(1)(b). Constitutional

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19 However, where all the beneficiaries of the trust hold strict views on a certain issues, it may be in their interest for the trustee to pursue those views in its investment policy: Cowan v Scargill [1985] 1 Ch 270 at 288. This may occur where, for instance, the scheme constitution specifies that a social investment strategy will be conducted by the responsible entity. In the absence of such a specification, it would be difficult to show that a social investment policy is in the members’ interests given the number and fluid nature of members.

20 [1985] 1 Ch 270 at 287-288. Note that where a decision to invest on social or political grounds where the investment is equally beneficial to members as an investment not based on those grounds, a breach of duty by the trustee will be difficult to maintain. It is only where the investment decision is less financially beneficial to the beneficiaries that the decision may be open to criticism: Cowan v Scargill, supra, at 287 per Megarry VC.

21 Harries v Church Commissioners for England, supra at 305 per Nicholls VC; Dal Pont G E, ‘Conflicting Signals for the Trustees’ Duty to Invest’ (1996) 24 ABLR 140 at 144.
rights to distributions, surplus upon winding up, etc, remain intact. However, the amendment may be in breach of the equitable and statutory duty on the responsible entity to act in the best interests of members. In relation to the constitutional amendment power, the best interests of members relates to members' financial interests, proprietary interests in the scheme, as well as the various rights afforded to them by virtue of the Act, the constitution, and equity. Where the social investment clause allows the responsible entity to consider non-financial issues when faced with competing investments which derive the same financial benefit, the best interests requirement may be satisfied, as investments will be equally beneficial to members in financial terms. However, where the provision allows the responsible entity to place non-financial issues above the financial interests of members in its investment decisions, the amendment will clearly be against members' best interests, therefore being invalid and the responsible entity being liable for breach of its fiduciary and statutory obligations. Although it may be argued that the amendment will benefit members incidentally on the basis of social arguments, it is inconceivable that such an argument will be accepted in the current context.

The amendment may also be deemed to be for an improper purpose, as it may be characterised as being for the purpose of promoting the interests of the responsible entity by allowing it to pursue its own social or political agenda. Similarly, a failure of substratum may result, the underlying purpose of the trust changing from a collective investment for the purpose of promoting the financial interests of members to a scheme in which social or political issues may be promoted through investments at the expense of the financial return to members.

The reverse situation may also be conceived, being where members contribute to a scheme on the basis of its social investment policy, the constitution subsequently being amended in order to remove the ability of the responsible entity to consider such matters. In such a case, the investment policy of the scheme upon formation may constitute its substratum. Members contribute their capital on the common understanding that certain non-financial objectives will be pursued, contracting to forgo the maximisation of financial return in certain situations where it conflicts with non-financial factors. An amendment which alters this fundamental characteristic of the scheme will result in a total failure of substratum, members no longer participating in a scheme with the same purpose for which it was first formed and for which they contributed their capital.

Therefore, amendments which either allow for or remove the ability of the responsible entity to pursue social objectives in its investment policy are unlikely to be valid. The distinction between the scenario explored above in respect of changing from a property to an equity trust and the amendments relating to social investments is that in the latter, the fundamental purpose for which the scheme was commenced has been changed. In the former, irrespective of whether the investments are in real property or company shares, the underlying purpose of promoting the financial interests of members remains intact.

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22 See 5.3.1(b) above.
23 See Cowan v Scargill (1985) 1 Ch 270 at 287 per Megarry VC.
6.2 Removal of Withdrawal Rights

The ASX Listing Rules prohibit listed schemes from providing a withdrawal facility. As such, this section is only concerned with non-listed schemes, where withdrawal provisions are the only means open to members to liquidate their investments.

The Right to Withdraw from the Scheme

Under the former Part 7.12, approved unit trust deeds were required to contain a buy-back covenant, being a provision binding the management company to either buy back, or cause to be bought back, any interests in the trust at a price specified in the trust deed upon request by a unitholder. The provision acted as a put option, requiring the manager to purchase the units upon request. This right to withdraw from the trust resulted in the unit trust being considered a liquid investment, being the primary commercial characteristic distinguishing it from direct investment in company shares. This characteristic has been referred to judicially as the 'essence' of the unit trust.

In contrast, the MIA does not require the scheme constitution to provide for a right of withdrawal for members. Section 601KA(1) merely states that the scheme constitution may make provision for members to withdraw from the scheme. Furthermore, where the scheme is not liquid, any right to withdraw must be in accordance with the statutory regime of periodic offers. Therefore, the constitution can either provide for withdrawals only when the scheme is liquid, withdrawals at any time with the proviso that when the scheme is not liquid withdrawals can only be effected by the scheme of offers, or provide no right of withdrawal at all. Alternatively, unlike under the prescribed interest provisions, it is possible for the constitution to provide for withdrawals subject to the absolute discretion of the responsible entity to refuse to redeem or purchase interests, or provide the responsible entity with the power to suspend redemptions at its own discretion.

Removing the Right to Withdraw

This poses the question of whether the responsible entity in a non-listed scheme may seek to remove or qualify the withdrawal provisions by virtue of a constitutional

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24 ASX Listing Rule 1.1, condition 5(b).
25 Former s1069(1)(c). Although the covenant only required the manager to buy-back the units upon request, it was more common in practice that withdrawal requests be satisfied by a redemption of the units, resulting in a cancellation of the units and a payment out of the trust fund. This practice was based on stamp duty considerations.
26 Graham Australia Pty Ltd v Corporate West Management Ltd (1990) 1 ACSR 682 at 689 per Brooking J.
27 Eagle Star Trustees Ltd v Heine Management Ltd (1990) 3 ACSR 232 at 237 per Phillips J.
28 Where withdrawal rights are provided, they must be ‘fair to all members’: s601GA(4). The Act does not provide a definition of ‘withdrawal’. As such, the provision may allow for either a unit buy-back by the responsible entity or the redemption of units from the trust fund, or both. In the former, the units continue to exist and may be re-issued by the responsible entity, while in the latter the units are cancelled.
29 Section 601KA(2). The definition of ‘liquid scheme’ is found in s601(4),(5). The statutory regime for offers is in s601KB.
30 However, although withdrawal rights are not required in order to comply with the Act, one would assume that the market would still demand withdrawal facilities in large unlisted schemes.
amendment. If so, a member may contribute to the scheme on the basis of its liquidity, subsequently being subject to the removal of his or her right of withdrawal, or having that right subject to some qualification such as the discretion of the responsible entity or a change to the terms of withdrawal. As there may be no ready market for units in non-listed schemes, this may result in a lock-in situation in which members are unable to withdraw from their investments.

The amendment may be justified in terms of the interests of members. As was the case with many unlisted property trusts in the late 1980s, non-liquid scheme assets may be inadequate to support the liquidity of units. Where redemption requests are greater than applications for new units and the scheme assets are not sufficiently liquid to meet the requests, the scheme will collapse. As such, while it would not be in the best interests of those members wishing to withdraw, the amendment would be in the interests of members as a whole, as it would ensure the scheme continues as a going concern.

Furthermore, the duty of impartiality will be satisfied provided the right is removed from all members and not merely one class or group of members. Members who have already provided withdrawal requests or who are intending on withdrawing are not in a different class by that virtue alone. They must therefore be treated equally with those members who have no immediate intention to withdraw. This requirement is satisfied by the amendment applying indiscriminately to all members of the scheme, as it is irrelevant whether the amendment has a harsher consequence on a certain group of members. Therefore, the amendment will be duly binding on those members awaiting or intending withdrawal.

The fact that there is no secondary market for units, the amendment resulting in a lock-in situation, provides no ground in itself for seeking redress. However, the validity of the amendment may be challenged on three grounds. First, with respect to the statutory restraint on amendments, it is unlikely that such an amendment could have been seen to not adversely affect members' rights. The right to withdraw from the scheme is a valuable right attaching to a member's interest. The removal of the right is clearly adverse.

31 Similar issues arise with respect to a purported constitutional amendment which seeks to either remove members' right to transfer units or makes transfers subject to the discretion of the responsible entity.

32 For instance, in *Eagle Star Trustees Ltd v Heine Management Ltd* (1990) 3 ACSR 232, the buy-back period in a unit trust was extended from 7 to 90 days by an amendment to the deed. Similarly, in *Gra-ham Australia Pty Ltd v Perpetual Trustees WA Ltd* (1989) 1 WAR 65, an amendment altered the valuation method upon withdrawal.

33 Even where units are transferable, an effective lock-in may occur where the market price for units on secondary markets is suppressed and not representative of the value of the underlying assets. Note that where there is a right of transfer but that right is subject to the discretion of the responsible entity, a member may seek recourse to the court where a refusal by the responsible entity to consent to the transfer is without just cause: s1094.

34 Section 601FC(1)(d). See 5.3.3 above.

35 *Gra-ham Australia Pty Ltd v Perpetual Trustees WA Ltd* (1989) 1 WAR 65.

36 With respect to companies, shareholders cannot seek recourse under the statutory oppression remedy merely on the basis that they cannot dispose of their interest in the company: *Re G Jeffrey (Mens Store) Pty Ltd* (1984) 9 ACLR 199; *McWilliam v L J R McWilliam Estate Pty Ltd* (1990) 2 ACSR 757.
Secondly, it could be argued that the amendment was made for an impermissible purpose. In the strictest terms, the purpose for which the amendment is sought may be characterised as being for the benefit of scheme members by ensuring the continuing existence of the scheme. However, as discussed above, in reviewing actions by the responsible entity, an approach analogous to the review of company directors is to be preferred. One ramification of this approach is that certain ends to which actions may be directed, being their objective effect rather than subjective purpose, may be deemed improper, irrespective of the power being exercised in the members’ interests. For instance, in company law, an exercise of the share allotment power which has the effect of manipulating the voting structure of the company will be improper, as this would be interfering with the inherent rights vested in shareholders. Following this approach with respect to an amendment seeking to remove or limit members’ right of withdrawal from a managed investment scheme, the amendment may be deemed improper due to its effect on the ownership rights of members, irrespective of the permissible subjective purpose for which it was sought.

Thirdly, it could further be argued that members in a managed investment scheme have a legitimate expectation to have their units redeemed upon request where the scheme provided for withdrawal rights at the time they entered the membership contract. This legitimate expectation forms the basis upon which membership was attained, the removal or substantial limitation of the right therefore amounting to a fundamental failure in the common understanding of the parties upon formation of the contract. The constitution is thereby either frustrated or is subject to a failure of substratum. In support of this argument, the comments by McHugh J in Gambotto v WCP Ltd in relation to expropriation of company shares from minority members are of assistance:

In the absence of an article authorising the expropriation of a member’s shares, members have a legitimate expectation that, unless some exceptional circumstance should arise, they will be able to retain their shares until they wish to sell or until the company is wound up.

If legitimate expectations are a relevant consideration, then just as shareholders have a legitimate expectation to maintain their status as members of the company, scheme members arguably have a legitimate expectation that their investment will remain liquid. The ability to withdraw from the scheme is a primary basis upon which members contribute capital. This may be contrasted with companies, where the principle of maintenance of capital prevents a company from repurchasing or

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37 Note that where the purpose of an amendment to a unit trust deed removing a buy-back provision is in order to register the trust under the MIA, the amendment may arguably be permissible under the transitional power vested in the proposed responsible entity by virtue of s1460(3)(b), as the amendment would be seeking to merely remove a covenant formerly required under Part 7.12.

38 See above at 5.1.3.


40 See Finn P D, ‘Controlling the Exercise of Power’ (1996) 7 Public LR 86 at 93 in relation to reasonable or legitimate expectations as a basis for controlling exercises of power generally.

redeeming its own shares. While shareholders expect their membership to be perpetual, scheme members have the expectation that they can withdraw from their investment by demand at any point in time. Furthermore, being based on a trust structure, schemes are subject to the rule against perpetuities. In this respect, the expectation of members in managed investment schemes and members in companies is converse. As a purported amendment removing a scheme member’s right to withdraw defeats his or her legitimate expectations, it will be found improper and therefore invalid.

Given the above arguments, it is unlikely that an amendment removing or limiting the right of withdrawal will be upheld.

6.3 Exclusion of Self-Dealing Rule

The final amendment to be considered involves the addition of a provision which permits the responsible entity to transact in scheme property in a personal capacity.

The Rule Against Self-Dealing

A trustee must not put itself in a position where its duty and interest may conflict. Following from this, a trustee cannot purchase or sell trust property by acting as a fiduciary on one side and an undisclosed principal on the other. This prohibition

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42 Chapter 2J. The principle of maintenance of capital was first established in Trevor v Whitworth (1887) 12 App Cas 409 and applied by the Victorian Supreme Court in Re Federal Bank of Australia Ltd (1894) 20 VLR 199.
43 See Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 at 106-111 who argues that the rule does not apply to unit trusts, there being no legal restriction on the duration of a unit trust scheme.
44 However, the assumption upon which these expectations are based, being that companies are perpetual while schemes have a finite life, loses persuasiveness when recent legislative reform is considered. First, unlike the prior Part 7.12, there is no longer a requirement for schemes to contain a redemption provision. Secondly, the company law doctrine of capital maintenance has lost favour, being open to criticism in relation to its effectiveness in protecting the interests of creditors. Companies have been granted the ability to effect capital reductions, share buy-backs and self-acquisitions with increasing ease: Chapter 2J. See also Ford H A J, Austin R P & Ramsay I M, Ford’s Principles of Corporations Law, 9th Edition, Butterworths, 1999 at 836-837; Magner E S, ‘Repurchase, Redemption, and the Maintenance of Capital’, in Austin R P & Vann R, The Law of Public Company Finance, Law Book Company, 1986. Thirdly, the Company Law Review Act 1998 (Cth) continued this trend, eliminating the requirement for nominal share capital in the company constitution, being a significant basis upon which the capital maintenance doctrine was conceived: s254C. Therefore, the distinction between companies and managed investment schemes in this regard is diminishing.
45 See 5.3.2 above.
46 In Tito v Waddell (No 2) [1977] 1 Ch 106 at 224-225, Megarry VC discussed the principles by way of two rules, the self-dealing rule and the fair-dealing rule. The former was described as follows: ‘...if a trustee purchases trust property from himself, any beneficiary may have the sale set aside ex debito justitiae, however fair the transaction’. The fair-dealing rule states that where a trustee purchases the beneficial interest in trust property, the beneficiaries may set the sale aside unless the trustee can establish that the beneficiaries were ‘fully informed and received full value’. See also Gillett v Peppercorne (1840) 3 Beav 79; 49 ER 31; Nugent v Nugent [1908] 1 Ch 546; Re Sykes [1909] 2 Ch 241; Re Salmen [1912] 107 LT 108; Armstrong v Jackson [1917] 2 KB 822; Wright v Morgan [1926] AC 788; Kuhlirz v Lambert Brothers (1913) 108 LT 565; Glennon v FCT 72 ATC 4181; Finn

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against self-dealing is independent of the transaction being for an adequate price and on fair and reasonable terms, whether the beneficiaries have suffered any loss, or whether a profit was derived by the trustee. As well as transactions in its personal capacity, the responsible entity is also prohibited from dealing with scheme property in its capacity as the responsible entity for another scheme. Unless there is full informed consent from the beneficiaries, the transaction is voidable at their option.

The Related Party Provisions

With regard to managed investment schemes, self-dealing transactions are prohibited by the related party provisions of the Act. It is an exception to the prohibition, however, where the transaction is on terms which are no more favourable to the responsible entity than if the transaction were conducted at arm's length. Alternatively, the transaction may proceed where it has been permitted by a resolution of scheme members in accordance with the procedure stipulated in Part 2E.5.

However, satisfying the related party provisions does not relieve the responsible entity from obligations derived from its fiduciary office. The rule against self-dealing will still apply, preventing the responsible entity from holding a private interest in a transaction in scheme property, either as vendor or purchaser. Even where the transaction is at market price and on fair terms, it will be voidable unless full


Campbell v Walker (1800) 5 Ves Jr 678; 31 ER 801; Lacey (1802) 6 Ves Jr 625; 31 ER 1128; Movitex Lid v Bulfield [1988] BCLC 104. For directors, see s231 and s232A; Gemstone Corporation of Australia v Grasso (1994) 13 ACSR 695.

Such a transaction would result in a conflict of duty and duty, where the responsible entity owes conflicting duties to two separate bodies of beneficiaries: see Fullwood v Hurley [1928] 1 KB 498; North & South Trust Co v Berkeley [1971] 1 WLR 470; Haywood v Roadknight [1927] VLR 512.

Re Sherman [1954] Ch 653. Note that trustee legislation in both the Northern Territory and South Australia vests a power in the courts to authorise self-dealing transactions: Trustee Act 1936 (SA), s49; Trustee Act 1893 (NT), s50.

Part 2E.7 applies the related party provisions in Chapter 2E to managed investment schemes, with modifications. Section 243H prohibits the responsible entity from giving a 'financial benefit' to itself or related parties, including the buying or selling of assets: s243G(4)(c). Self-dealing is prohibited, irrespective of whether consideration is full or adequate: s243G(2)(b). A self-dealing transaction is a breach of s243ZE(2), being a civil penalty provision. Furthermore, reg 5C.7.01 prevents the responsible entity from conferring a financial benefit on itself where it could diminish or endanger the scheme property. Hanrahan has identified various problems with the application of Part 3.2A to managed investment schemes: Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 87-92.

Chapter 2E does not relieve a person from other duties imposed by 'law': s243ZI(3). The definition of 'law' includes the rules of both common law and equity: s243ZI(5).

Similarly, the responsible entity will be in breach of s601FC(1)(e) where it uses information acquired in its capacity as the responsible entity in order to derive a personal profit, such as confidential information concerning the value of scheme property.
Part B – Amendments by the Responsible Entity

disclosure is given and consent obtained from all members. Where a self-dealing transaction is proposed, bringing it to a members’ meeting is clearly both impractical as well as difficult in terms of obtaining full consent. Where there is a large turnover of scheme property, referring matters concerning the day-to-day operation of the scheme such as transactions in scheme property may not be feasible.

Self-dealing transactions may be expressly permitted by the trust instrument. Therefore, a constitutional provision may provide that any contract entered into by the scheme in which the responsible entity is a party or has an interest, either in a private capacity or as trustee for another scheme, cannot be avoided due to the existence of that interest. The provision may further provide that the responsible entity will not be liable to account for any profits on the basis of its interest in the transaction. As a result of such a clause, no members’ assent would be required, although the transaction would still need to be on arm’s length terms in order to satisfy the related party prohibition.

Excluding the Rule Against Self-Dealing

The issue at hand is whether, after the commencement of the scheme, the responsible entity can amend the scheme constitution in order to insert a provision excluding the general law prohibition against self-dealing. The statutory related party prohibition cannot be excluded. As such, the constitutional exclusion of the general law rule would necessarily have to only allow self-dealing transactions made upon arm’s length terms, as otherwise Chapter 2E would require a members’ resolution to approve the transaction.

In relation to the statutory restraint on constitutional amendments, the amendment would arguably not adversely affect members’ rights, the price received or paid for scheme property being the same as if it were transacted at arm’s length. However, it may be argued that the amendment is removing members’ equitable right to take action in respect of self-dealing transactions. In relation to the responsible entity’s fiduciary duties, as discussed above, the responsible entity is able to consider its own interests in exercising its powers, provided its interests are subordinated to those of the members. An amendment which permits self-dealing on arm’s length terms is neither to the benefit nor detriment of members. As such, the responsible entity will not be in breach of its duty to act in the best interests of members by pursuing the amendment.

With regard to the purpose of the amendment, it could be argued that it is for the purpose of promoting the efficiency of the day-to-day management of the scheme, relinquishing the need for each transaction to be brought before a members’ meeting. Members receive sufficient protection by virtue of the related party provisions. The alternative purpose for which the amendment is sought would be for the financial benefit of the responsible entity. While the former purpose would be proper, the latter would be deemed improper, therefore rendering the amendment invalid. Where there

55 Where the responsible entity or its associates are also a scheme member, they will not be able to vote on the resolution: s253E.
57 See 5.3.1(c) above.
are competing purposes, the *substantial* or *dominant* purpose is to be scrutinised by the court. The determination of which purpose is dominant is a determination of fact and as such not open to speculation in this context.

Therefore, depending on whether the dominant purpose for the amendment is found to be proper, an amendment excluding the self-dealing prohibition may be valid, allowing the responsible entity to transact in scheme property, provided the terms of the transactions are no less beneficial to members than if they were conducted at arm’s length.

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58 See 5.1.3 above.
Part C - Amendments by Scheme Members

Part B was concerned with the manner in which members can intervene in actions by the responsible entity upon an abuse of power. This Part is concerned with the power to amend the scheme constitution by a special resolution of scheme members. Rather than addressing the balance of power between the two organs of the scheme, the discussion is concerned with the ability of minority and individual scheme members to intervene in actions by majority members where the majority exercises a power, such as the constitutional amendment power, which applies a majority rule basis for its exercise.

The methodology applied to amendments by the responsible entity in Part B is followed. Chapter 7 discusses the power granted to scheme members to effect amendments and the restrictions placed on their ability to exercise that power. Chapter 8 focuses on equitable restraints on the power, applying company case law concerning fraud on the minority to managed investment schemes. Chapter 9 analyses the restraints in the context of various selected amendments which may be sought by members, whilst Chapter 10 compares the protection provided to scheme members to the position of shareholders in a registered company.

7. The Power to Amend the Scheme Constitution

7.1 The Source of the Power

7.1.1 Power Derived from the Legislation

The MIA provides that the scheme constitution may be altered by a special resolution of scheme members. This requires that the resolution be passed by at least 75% of the votes cast by members entitled to vote. The MIA further requires that prior notice setting out the proposed resolution be provided to members, directors and auditors 21 days prior to the proposed meeting. The resolution does not take effect until it is lodged with ASIC.

This power vested in the general meeting of members may serve two purposes. First, it may allow amendments proposed by the responsible entity to be passed without the need to satisfy the statutory restraint in s601GC(1)(b). The responsible entity is granted a power to call a members' meeting and may propose the required resolution for scheme member approval. In this regard, the amendment power vested in the general meeting acts as a veto for amendments by the responsible entity where it is not satisfied that the amendment will not adversely affect members' rights.

1 Section 601GC(1)(a).
2 Section 9; s252J(c). The scheme constitution may specify a longer notice requirement: s252F.
3 Section 601GC(2).
4 See 4.3.1 above.
5 Section 252A. See 7.2.3 below as to whether the action by the responsible entity in calling the meeting is subject to fiduciary obligations.
Secondly, the power may arguably be utilised in order to pass amendments proposed by scheme members themselves. Members are vested with the power to requisition meetings. Upon request by either members holding at least 5% of the votes or at least 100 members, the responsible entity must call and arrange a meeting to consider or vote on a proposed resolution. If the responsible entity fails to call the meeting, holders of at least 50% of the votes may call and arrange the meeting at the expense of the responsible entity. Furthermore, members holding at least 5% of the votes may call and arrange the meeting themselves to consider the resolution, but must bear the expense of calling and holding that meeting.

If this is the case, the ability of members to requisition a meeting to consider a proposed resolution results in a divergence from the former prescribed interest provisions. Rather than providing a source of power, the former s1069A(2) merely placed a restraint on the ability of the manager to amend the trust deed. As such, unitholders were not granted an ability to instigate trust deed amendments in the absence of a trust deed provision to the contrary. Under the current law, as s601GC(1)(b) actually vests a statutory power in scheme members to effect an amendment by virtue of a special resolution, members may utilise their power to requisition a meeting in order to have the proposal considered.

Hanrahan has questioned whether members are able to initiate resolutions on their own behalf, stating the position is 'unclear'. In support, she cites company law cases preventing shareholders from requisitioning meetings for an impermissible object, such as where the proposed action involves an area within the sole authority of directors.

It is submitted that these company law decisions do not support such a position. The cases cited by Hanrahan involve company shareholders requisitioning meetings where the proposed resolutions are not lawfully able to be effectuated as they are outside the power of the general meeting. For instance, Turner v Burner involved a proposed resolution that the directors had breached certain criminal provisions of the Act. As the decision as to the criminal guilt of the directors is a judicial power and not able to be the subject of a resolution, the directors were under no obligation to arrange the meeting upon receiving the requisition from shareholders. Similarly, NRMA v Parker involved a proposed resolution directing the board in the manner of exercise of its powers, and as such, was also not a valid requisition. The ratio of these decisions is therefore that members cannot exercise their power to requisition meetings where the proposed resolution cannot be legally carried into effect.

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8 Section 252B(1).
9 Section 252C.
10 Section 252D. Furthermore, where it is otherwise impractical, a meeting may be ordered by the Court upon application by the responsible entity or an individual member of the scheme: s252E.
11 Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 64. See also Australian Corporations and Securities Law Reporter, Vol 2, CCH at [184-600].
This is not the case with a requisition for a meeting in order to consider a constitutional amendment in a managed investment scheme, as the resolution can lawfully be passed by virtue of s601GC(1)(a). Therefore, as the proposed resolution is within the power of the general meeting, the responsible entity must conduct the meeting to consider the resolution upon a requisition from the appropriate portion of scheme members. However, this proposition is subject to the proviso that where the amendment proposed for a members’ resolution would constitute a fraud on the minority if passed, it would not legally be able to be effected, the responsible entity thereby not being under a duty to conduct the meeting at the request of members.

Hanrahan further bases her argument on general trust law principles, stating:

As a general proposition, trust law does not authorise beneficiaries to force upon trustees modifications of the trust that imposes new duties or abrogate discretions or powers already held, or to direct the exercise of such discretionary powers...it may be that members do not have the power to initiate constitutional amendments.

The authority given for this proposition is a passage from Jacobs’ Law of Trusts. However, the passage in that text relates to amendments to trust deeds by way of an extinguishment of trust under the rule in Saunders v Vautier and a resettlement on new terms. The authors of Jacobs’ Law of Trusts do not propose that this position translates to the exercise of an express power vesting in beneficiaries a right to bind the trustee in respect of trust deed amendments.

Hanrahan further proposes that the constitution may expressly reserve the power to propose constitutional amendments to the responsible entity, and therefore prevent members from requisitioning a meeting to consider amendments. This may also be queried. Scheme members are vested with a statutory power to requisition a meeting, provided the proposed resolution is legally capable of being carried into effect. This is a statutory right and cannot be excluded by the constitution. Similarly, the statutory power which allows the resolution to be carried into effect is also inalienable.

As such, by virtue of their power to requisition meetings, it would seem that scheme members are vested with a right to initiate and propose constitutional amendments to be considered by the general meeting. This position is consistent with the ALRC/CSAC recommendations. However, the ALRC/CSAC proposed that such amendments only be passed if they were consented to by the responsible entity, thereby providing the responsible entity with direct statutory protection from the imposition of unreasonable amendments. Furthermore, the position that members may

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13 See Ch 8 below in regards to fraud on the minority generally.
14 Hanrahan, op cit, at 119.
16 (1841) Cr & Ph 240; 49 ER 282. See 3.3.2 above.
17 Furthermore, no authority is provided by the authors of Jacobs’ Law of Trusts for the assertion. Authority is only provided for the proposition that beneficiaries cannot direct a trustee as to the manner in which it exercises its powers. There is no authority for the proposition that beneficiaries cannot alter trustee powers if conferred with an express power to do so by virtue of the trust instrument or legislation.
18 ALRC/CSAC Vol 1 at 122. See discussion directly below.
instigate amendments may be inconsistent with the Explanatory Memorandum to the MIA,\(^{19}\) where s601GC(1)(a) is described as allowing amendments by way of ‘approval’ by members’ resolution. This would seem to infer that members do not have a power to propose amendments to be voted on at a members’ meeting. Furthermore, it would seem inconsistent with the nature of a scheme interest, being a passive form of investment, that members be granted a right to both propose and effect amendments binding the scheme operator.

However, it is submitted that the preferable view, upon proper construction of the statutory provisions as enacted, is that scheme members do have a statutory power to requisition a meeting and pass a special resolution amending the scheme constitution, s601GC(1)(a) not being a mere right of veto. This power, however, is subject to equitable restraints.\(^{20}\)

The ALRC/CSAC Proposals

The ALRC/CSAC proposed a stricter regime for amendments instigated by a members’ resolution. The ALRC/CSAC Bill required that where an amendment was made by scheme members, the amendment did not take effect until it was approved by the responsible entity in writing under seal.\(^{21}\) The policy behind this requirement was that the responsible entity should not be required to administer provisions with which it did not agree and which were not part of the original constitution.\(^{22}\)

The legislation as enacted prescribes no requirement for consent by the responsible entity. As such, the responsible entity may be subjected to amendments which create new obligations and duties or remove discretions and powers which were originally conferred on it. This may create a situation where amendments are passed which are unworkable or unfeasible from the responsible entity’s perspective. In this regard, Hanrahan’s concern that this will allow members to initiate and pass amendment resolutions which detrimentally affect the responsible entity has some justification, the position of the responsible entity being relatively ‘unprotected’ where members are able to initiate amendments.\(^{23}\)

However, it is submitted that the issue is one of whether the amendment resolution is itself contrary to any equitable restraints placed on the amendment power, and not whether members have the right to initially propose the amendment to be considered by a general meeting. The interests of the responsible entity are not unprotected, as the courts may impose equitable restraints on resolutions by scheme members. This issue is explored further below at 9.3.

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\(^{19}\) Explanatory Memorandum to the Managed Investment Act 1998 (C’th) at 9.6.

\(^{20}\) See generally Ch 8 below, and specifically 9.3.

\(^{21}\) Section 183A(1)(b) Collective Investment Schemes Bill 1995 in ALRC/CSAC Volume 2 at 115. Note that there are also differences relating to resolution requirements, as discussed at 4.1.1 above.

\(^{22}\) ALRC/CSAC Vol 1 at 122. The proposed framework did not expressly require the responsible entity to act reasonably in withholding consent or to duly consider the interests of members. However, the responsible entity would be subject to the obligation imposed by s601FD(1)(c). The ALRC/CSAC was of the opinion that further protection would be afforded by the fact that withholding consent may be evidence of oppression. However, given that no oppression remedy was implemented into the legislation as enacted, this point does not hold. In relation to the absence of the oppression remedy, see 10.2.2(c) below.

\(^{23}\) Hanrahan, op cit, at 65.
7.1.2 Power Derived from Contract

Given that scheme members are provided with the power to amend the constitution by way of a special resolution, the issue arises as to whether the constitution may provide a further contractual right to effect an alteration. For instance, it may be possible for the constitution to provide a means of amendment which is *less* onerous than the procedure under s601GC(1), such as a requirement for a simple rather than special resolution, thereby circumventing the legislative requirement for a special resolution.\(^*\)

From the wording of s601GC(1) it would seem that while the constitution *may be modified* by the prescribed procedures, amendments by alternate procedures are not excluded. There is no requirement that amendments *may only be modified* by the stipulated methods. Therefore, where the constitution provides for amendments by a simple resolution or some lesser means, the contractual provision will be effective.\(^\dagger\)

This position may be contrasted with the requirements for amendments of approved trust deeds under the prior *prescribed interest* regime in Part 7.12. Section 1069A stated that the trust deed ‘cannot be modified’ unless a quorum of members representing 25% of the scheme value vote on the resolution and 75% of the votes are in favour of the modification.\(^\ddagger\) Furthermore, s1069A(8) excluded the operation of provisions in the deed which stipulated other member consideration requirements before an amendment could be passed. The result was that any provisions in the deed stipulating required votes or quorum for an amendment were of no effect.

Therefore, it would seem from a natural reading of s601GC(1) that whereas under the *prescribed interest* provisions it was not possible to stipulate requirements for amendments to the trust deed which deviated from the provisions in the Act, the current position under the MIA is that the constitution *can* create less onerous procedures by which members can make modifications.

It must, however, be noted that this construction is inconsistent with the *Explanatory Memorandum*,\(^\ddagger\) which states that ‘[a] scheme’s constitution may only be amended, modified or replaced’ by the two stated means, being either unilaterally by the responsible entity or by the approval of members by special resolution. This being the case, it could be argued that the legislature intended that it was not to be possible for the scheme constitution to provide some further means of effecting an amendment.

\(^*\) For a discussion of provisions which impose *more* onerous requirements, see 7.2.2 below.
\(^\dagger\) Compare this to the position regarding the amendment power vested in the responsible entity, discussed at 4.1.2 above. As that power provides an express negative stipulation, a contractual right to amend the constitution without fulfilling the requirement would be contrary to the provisions of the Act. In the case of amendments by members, on the other hand, no such negative stipulation is provided, the constitution therefore being able to provide a less onerous means of effecting an amendment.
\(^\ddagger\) Section 1069A(2)(c), (d). Certain notice requirements were also stipulated in s1069A(2)(b).
\(^\ddagger\) *Explanatory Memorandum* to the Managed Investment Act 1998 (C'th) at 9.6.
7.1.3 Power Derived from Equity

The courts have both an inherent and a statutory jurisdiction to approve variations to trust deeds. As already discussed above, these jurisdictions are unlikely to be invoked in a managed investment scheme given a statutory amendment power is provided.

In the absence of relevant legislation or provisions in the trust instrument, beneficiaries have no right to require amendments to the trust instrument. To acknowledge such a right would be to force upon the trustee new duties or extinguish rights and discretions which were previously held. Applying this to managed investment schemes, members have no right to amend the scheme constitution by virtue alone of their position as beneficiary under a trust.

In effect, however, an amendment to a trust instrument may be instigated by virtue of the rule in Saunders v Vautier which establishes a right in equity to prematurely bring the trust to an end. Based on this rule, the beneficiaries may extinguish the trust and re-settle the scheme assets upon new terms, thereby effectively altering the terms of the trust. However, as already discussed, there are both practical and legal factors which significantly restrict the likelihood of this occurrence.

Therefore, the power vested in scheme members to amend the constitution is derived from the legislation, as well as any provisions in the constitution itself which provide for an alternate means of amendment. A majority of scheme members are thereby vested with an inherent power to bind both the responsible entity and a dissenting minority to a constitutional amendment by virtue of their power to control a general meeting. As such, persons who enter the membership contract on the basis of the constitution as it then stands may have the terms of that contract altered against their will by those in the majority. However, this application of the principle of majority rule is not absolute, the courts imposing limits on the extent to which the majority may interfere with the legitimate rights and expectations of dissenting members. These restraints will be analysed once again in accordance with their source: statute, contract and equity.

7.2 Restraints on the Power

7.2.1 Restraint Derived from Statute

Provided that the resolution requirement is satisfied, the Act does not impose any express duties, obligations or restrictions on members when exercising their power to alter the constitution.

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28 See 4.1.3 above.
30 (1841) 49 ER 282. See also Queen Street Hotels Pty Limited v Byrne [1980] ACLC 40-611.
32 See above at 3.3.2.
This can be compared with the position of shareholders who are subject to various statutory restraints when seeking to change the company constitution.\(^{33}\) For instance, the legislative class rights requirements are not applicable to managed investment schemes,\(^{34}\) and there is no equivalent to the restriction on amendments requiring shareholders to take up additional shares, pay money to the company, or amendments imposing restrictions on share transfer.\(^{35}\) Furthermore, scheme members are not subject to the statutory oppression remedy.\(^{36}\)

7.2.2 Restraint Derived from Contract

It has already been shown above that the scheme constitution may provide a means by which an amendment may be effected by a less onerous procedure than the special resolution required by the Act.\(^{37}\) In the context of restraints on the amendment power, the issue is whether the constitution can make provisions which limit the legislative power.

As the constitution is a legally binding contract between members and the responsible entity, a situation could be envisaged whereby provisions in the constitution may be introduced which have the following effect, each of which will be considered in turn:

(a) The application of the statutory power of amendment is excluded.
(b) Further requirements are placed on the exercise of the statutory power.
(c) Members contractually undertake that they will not exercise their legislative power of amendment.

(a) Exclusion of the Statutory Power

In determining whether a constitutional provision excluding the statutory power of amendment is valid, assistance may be obtained from decisions relating to the power of shareholder to amend the company constitution under s136(2). It is a settled principle of company law that a company cannot deprive itself of its power to alter its constitution.\(^{38}\) In *Allen v Gold Reefs of West Africa Ltd*,\(^{39}\) in referencing to the prior English equivalent to s136(2), Lindley MR stated:\(^{40}\)

> Be its nature what it may, the company is empowered by the statute to alter the regulations contained in its articles from time to time by special resolution; and any regulation or article purporting to deprive the company of this power is invalid on the grounds that it is contrary to the statute.

\(^{32}\) See generally 10.2 below.
\(^{33}\) Part 2F.2. However, the class rights provisions may be incorporated into the scheme constitution: *ASIC Class Order 98/60*, see 4.3.2 above.
\(^{34}\) Section 140(2).
\(^{35}\) Section 246AA.
\(^{36}\) See 7.1.2 above.
\(^{38}\) [1900] 1 Ch 656. See also *Walkers' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 479-480 per Latham CJ.
\(^{39}\) Ibid, at 671. This proposition was adopted by Latham CJ of the High Court in *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 479-480 per Latham CJ.
Therefore, a company constitution is regarded as containing amongst its terms a provision that the constitution may be altered in accordance with the procedures provided for in the legislation.

The power to amend a corporate constitution by special majority in s136(2) is expressed in effectively identical terms to the correlating power of scheme members in s601GC(1)(a). As such, it would be equally contrary to the legislation if members of a managed investment scheme were prevented from exercising this right. The right granted by the Act is therefore inalienable. Moreover, any provision in the constitution purporting to exclude the power will be void.41 This construction is consistent with a natural reading of s601GC(1)(a), which states that the constitution 'may' be amended if the requisite resolution is obtained.

(b) More Onerous Requirements

Rather than expressly excluding the ability to amend the constitution, a provision may seek to impose more onerous requirements before an amendment may be effected. For instance, the constitution may require that a special resolution is of no effect unless the amendment is consented to by the responsible entity.

With regard to amendments to the company constitution, s136(3) specifically permits the constitution to provide for requirements over and above the special resolution stipulated in the Act. No equivalent statutory provision applies to managed investment schemes. As such, any provision preventing scheme members from exercising their right without complying with further contractual requirements would fall within the principle discussed at (a) above, as it would be denying members their power to alter the constitution by special resolution. The constitutional provision would therefore be invalid. The only exception to this rule is if the constitutional requirements are limited to special requirements in respect of the variation of class rights, as such provisions are expressly permitted by ASIC Class Order 98/60.42

(c) Undertaking not to Exercise the Power

The principle that companies cannot deprive themselves of the ability to amend their constitution has been extended to companies contracting themselves out of their statutory right by agreement with third parties.43 If a company enters into a contract whereby it undertakes not to alter its constitution, members are nonetheless entitled to requisition a meeting and pass a special resolution to effect the alteration.

41 In Gra-ham Australia Pty Ltd v Perpetual Trustees WA Ltd [1989] 1 WAR 65 at 81, Malcolm CJ acknowledged that various propositions relating to company articles which were outlined by Latham CJ in Peters' American Delicacy v Heath were equally applicable to unit trusts. However, he noted that the proposition that companies cannot deprive themselves of their statutory power to alter their constitution by agreement or provisions in the constitution was of no application, as unitholders were not conferred with a similar statutory power. These comments predate the MIA and are no longer the correct position as a result of the enactment of s601GC(1).

42 See 4.3.2 above.

43 Punt v Symons & Co Ltd [1903] 2 Ch 506; Peters' American Delicacy Co Ltd v Heath (1939) 61 CLR 457 at 479; Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd [1987] Ch 1.
Therefore, in relation to managed investment schemes, a contractual undertaking by scheme members that they will not exercise their right of amendment, whether that undertaking be in the constitution or a contractual arrangement with a third party such as the officers of the responsible entity, will not preclude a special resolution being passed and a valid amendment being made.

7.2.3 Restraint Derived from Equity

Following from above, it would seem that unless the scheme constitution specifies further criteria in respect of alterations to class rights, there is no fetter on the power granted to scheme members to change the constitution by special resolution. However, equity may place restraints on the power. The final section of this chapter will briefly discuss whether the constitutional amendment power is subject to any restraints by virtue of fiduciary or other equitable principles. The content, scope and application of these restraints will be explored further in the following chapter.

Fiduciary Obligations

If a fiduciary relationship is found to exist between scheme members, equity will require majority members to act in the interests of all other members upon exercising their constitutional amendment power. It must therefore be queried whether there may be a fiduciary relationship between scheme members inter se.

In the case of companies, shareholders are not in a fiduciary relationship inter se, even though they may exercise powers which will affect the interests of other members. Individual members are not under a duty to act for and on behalf of other members and may exercise their rights in their own self interest. So, in *Peters' American Delicacy v Heath*, Dixon J stated:

> The power of alteration is not fiduciary. The shareholders are not trustees for one another, and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage.

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45 (1939) 61 CLR 457 at 504. See also *Pender v Lushington* (1877) 6 ChD 70 at 76 per Jessel MR; *Carruth v Imperial Chemical Industries Ltd* [1937] AC 707 per Lord Maugham; *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 439 per Williams ACJ, Fullagar J and Kitto JJ. This is the case irrespective of whether the shareholder exercising the voting right is also a director of the company: *Burland v Earle* [1902] AC 83.
Similarly in *North-West Transportation Co Ltd v Beatty*, Sir Baggallay, delivering the judgment of the Privy Council, expressed the discretion of shareholders in exercising their vote as follows:

The general principles applicable to cases of this kind are well established. Unless some provision to the contrary is to be found in the charter or other instrument by which the company is incorporated, the resolution of a majority of the shareholders, duly convened, upon any question which the company is legally competent to deal, is binding upon the minority, and consequently upon the company, and every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company.

These observations are equally applicable to scheme members. Members are co-beneficiaries under a trust, being owed various fiduciary duties by the responsible entity. The relationship between members, in itself, is not fiduciary in nature. As well as there not being a fiduciary relationship generally, the power to vote at a general meeting to amend the constitution is not fiduciary in nature, but rather an incident of their property entitlements in their unitholdings. Members may exercise their proprietary right to vote at a resolution in their own interest and without regard to the interests of other members or the interests of the scheme.

**A Fact-Based Fiduciary Relationship?**

However, Sin has argued that the finding of a fact-based fiduciary relationship between minority and majority unitholders in a unit trust cannot be discarded if the relevant ingredients for the relationship are present. His observations are based on *Coleman v Myers*, the company law case in which the New Zealand Court of Appeal found the surrounding circumstances to give rise to a fiduciary relationship between a director and an individual shareholder. In *Coleman v Myers*, Woodhouse J described the factors giving rise to a fiduciary relationship between a director and an individual shareholder as follows: They include, I think, dependence upon information and advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it.

It is submitted that given the above criteria, the likelihood that such a relationship may be found to exist between members in a managed investment scheme is remote. The cases in which a direct duty to individual shareholders has been established invariably relate to closely-held or family companies with few shareholders, being

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46 (1887) 12 App Cas 589 at 593.
49 The particular factual circumstances of the case persuaded the court to depart from the general rule in *Percival v Wright* [1902] 2 Ch 421 that directors are not in a fiduciary relationship with individual shareholders.
50 [1977] 2 NZLR 225 at 325.
more akin to quasi-partnerships than large public corporations. These factors are unlikely to be present in a large collective investment scheme where there is a large and fluid body of members. With the exception of members' meetings, scheme members are unlikely to come into contact with each other, let alone share a relationship of confidence or a dependence upon each other's information and advice.

Furthermore, the company law cases relied on by Dr Sin relate to directors owing fiduciary obligations to individual shareholders. This is very different from finding a fiduciary relationship between shareholders inter se. As the cases recognise no such relationship between shareholders, a fiduciary relationship is equally unlikely to be found between members in a managed investment scheme. As such, while the existence of a direct fiduciary relationship in a managed investment scheme context is theoretically possible, the size of the scheme, number of members, and lack of direct interaction between the parties make such a finding highly unlikely.

Amendments Proposed by the Responsible Entity

This leaves one further issue. It was discussed above that s601GC(1)(a) may be utilised as a veto mechanism by the responsible entity, providing it with a means of proposing amendments to be considered by members in a general meeting, thereby circumventing the statutory requirement in s601GC(1)(b). This poses the question of whether the responsible entity is subject to fiduciary obligations when exercising its power to call a members' meeting and propose a constitutional amendment to be passed by members.

It is submitted that this is not the case. Amendments effected unilaterally by the responsible entity are imposed with a direct statutory restraint, requiring that the responsible entity reasonably consider that the amendment will not adversely affect members' rights. Amendments by special resolution are not imposed with such a restraint. If the responsible entity were subjected to general fiduciary obligations when proposing amendments and calling a meeting to consider the resolution, the distinction between the two amendment powers would be illusory and the utility of s601GC(1)(a) as a veto mechanism would be lost.

As such, the proper interpretation would be that the only obligation imposed on the responsible entity in calling a meeting is that it must act for a proper purpose, being the purpose to place a resolution before the meeting for consideration by members. If this duty is satisfied, it is then for the scheme members to consider the resolution. The resolution by members will thereby be subject to the restraints discussed below.

51 For instance, Coleman v Myers involved a family company in which many of the members were related. Glavanics v Brunninghausen (1996) 19 ACSR 204 involved a two-shareholder company in which the shareholders were brother-in-laws and there was direct dealings between them. Mesenberg v Cord Industrial Recruiters Pty Ltd (1996) 19 ACSR 484 similarly involved a two-shareholder company. In the latter case, Young J at 493 noted that the fiduciary duties in that circumstance were assessed in the context of case law relating to quasi-partnerships.
52 See 7.1.1 above.
53 Section 252B.
54 Section 601GC(1)(b). See 4.3.1 above.
Other Restraints on the Power?

It has been established that unlike amendments effected by the responsible entity, the amendment power vested in members by virtue of s601GC(1)(a) is not subject to fiduciary obligations such as a general duty of good faith. A scheme unit represents the property of a member, that member being able to exercise the proprietary rights attaching to the unit, such as the right to vote at a resolution to amend the scheme constitution, in his or her own interest.

It must therefore be queried whether equity imposes any fetters on the ability of scheme members to act in their own interests when exercising their amendment power. It is arguable that equitable constraints should have no application to grants of power by the legislature in situations where the power is unambiguously conferred and in its terms unrestrained. In the case of the power of shareholders to amend the company constitution, the legislature has provided express limitations on the exercise of the power. These limitations should be interpreted as an exhaustive code, leaving no room for judicial initiative. In the power conferred on managed investment scheme members, no express limitations are provided. It follows that this is evidence of a clear legislative intent that the power be unfettered.

However, irrespective of both this argument and the absence of a fiduciary relationship between members, equitable restraints on the exercise of the power do exist. In discussing non-fiduciary powers generally, Finn states:

> Increasingly...the right to act selfishly is being qualified by some level of obligation to have regard to the interests and expectations of others affected by one's actions, with the consequence that one may need to modify one's actions because of the manner in which, or degree to which, that other's interests are likely to be affected.

As is explored in the following chapter, the courts have reserved a supervisory jurisdiction with respect to such actions, requiring that they be made for a proper purpose and within the scope of the conferred power. These restraints are independent of notions of fiduciary obligations and therefore applicable irrespective of the absence of a fiduciary relationship between scheme members.

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55 See Fridman S, 'When Should Compulsory Acquisition of Shares be Permitted, and, if so, What Ought the Rules be?', in Ramsay I (ed), Gambotto v WCP Ltd: Its Implications for Corporate Regulation, University of Melbourne, 1996 at 117.

56 Section 180(3).

8. Equitable Restraint on the Power

In the preceding chapter, it was contended that the amendment power vested in scheme members is not fiduciary in nature. However, an exercise of the power must nonetheless be made in accordance with the doctrine of fraud on the power, allowing intervention by minority members where an abuse of power has been committed. With respect to amendments to company constitutions by shareholder resolution, the courts have developed a distinct approach in their intervention. Although founded upon the fraud on the power doctrine, this supervisory jurisdiction has evolved in order to allow a more interventionist approach to constitutional amendments in order to protect the rights and interests of aggrieved minority shareholders.

The first section of this chapter explores the doctrine of fraud on the minority as it applies to alterations to company constitutions (8.1). The second part analyses the applicability of the doctrine to managed investment schemes (8.2).

8.1 Fraud on the Minority in Company Law

8.1.1 The Nature of the Doctrine

In company law, the doctrine of fraud on the minority affords individual and minority shareholders standing to seek injunctive or other relief to prevent the majority from exercising their voting power improperly. The courts interfere with the actions or decisions of the majority where it is shown that they acted for a purpose which was outside the scope of implied purposes for which the power was conferred. Irrespective of technical compliance with the formal statutory requirements for amendments, the doctrine places an equitable restraint on the exercise of power and a special resolution amending the constitution may nonetheless be deemed invalid. The application of this restraint on voting power acknowledges two competing interests, being first the proprietary right of shareholders to vote in their own interest, and secondly, the fact that such exercises of power may infringe on the legitimate rights of other shareholders. The courts have sought to balance these interests.

The doctrine is often characterised as one of the stated exceptions to the rule in Foss v Harbottle, whereby wrongs committed to the company are only actionable by the company itself and not individual shareholders. As such, shareholders may commence actions in their personal capacity where a fraud is established against them, or in a representative capacity where the actions of the majority detrimentally affect the company itself.

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1 See 5.1.1 above.
3 (1883) 2 Hare 461; 67 ER 189.
5 Where the fraud is established against the company rather than individual or minority members, the action is more appropriately termed a fraud on the company. In such a case, members will commence proceedings by way of a derivative action on behalf of the company rather than a personal action: McPherson B H, 'Oppression of Minority Shareholders Part I: Common Law
Two further general observations must be made. First, in order for an action by the majority to be struck down by the doctrine, it is not sufficient that it merely affects the rights and interests of minority members. The main function of the company constitution is to regulate the relative rights and obligations of members. Any alteration to the terms of the constitution is likely to have some distributive effect on the rights of members, either as between each other or between members and the company. If the restriction was extended to all amendments affecting members' rights, this in effect would be a fetter on the ability to alter the constitution, and therefore be invalid.

Secondly, it must also be borne in mind that by definition majority members have a greater stake in the entity than their minority counterparts. In order for a commercial vehicle to operate effectively, majority control must be permitted. For reasons of commercial efficacy, the ability of the majority to make decisions such that the entity as a commercial vehicle is operated in a manner which is advantageous to the greatest number of stakeholders must not be interfered with unless there is a clear case of abuse of power. In this vein, it has been stated with respect to minority shareholders:

In assessing the facts of the present case it is necessary to remember that the petitioner is a minority shareholder. There are in the position of such a shareholder in a proprietary company many grave disadvantages but however galling and even financially damaging these may be they do not themselves constitute oppression of the shareholder...

These considerations, and the line beyond which court intervention into a members' resolution is justified, represent the underlying theme of the case law. Only where there is an instance of abuse of power or some form of equitable fraud will the sanctity of majority rule be disturbed.

8.1.2 The Development of the Doctrine

To assist in determining whether and how the doctrine of fraud on the minority is importable to the managed investment schemes sphere, it is first necessary to provide a cursory exploration of the development and general scope of the doctrine through the company law cases. The primary cases are surveyed and analysed to the extent necessary to identify and apply the relevant doctrinal investigation to a managed investment scheme context.

Relief (1963) 36 ALJ 404 at 405; Ford H A J, Austin R P & Ramsay I M, Ford's Principles of Corporations Law, 9th Edition, Butterworths, 1999 at 489, 514-530. On the distinction between personal and derivative actions generally, see Hanrahan P, 'Distinguishing Corporate and Personal Claims in Australian Company Litigation' (1997) 15 CSLJ 21. Note that the enactment of CLERB will result in the abolition of the general law right of members to proceed on behalf of the company, replacing it with a statutory derivative action: CLERB, Part 2F.1A. The distinction between personal and derivative actions is of no relevance in the current context as the managed investment scheme is not a separate legal entity, scheme members thereby being the proper plaintiffs in all breaches of both statutory and general law duties by the responsible entity.

Peters' American Delicacy v Heath (1939) 61 CLR 457 at 480 per Latham CJ. See 7.2.2 above.

Re M.Dalley & Co Pty Ltd (1968) 1 ACLR 489 at 497 per Lush J. See also Re Jury Gold Mine Dev. Co (1928) 4 DLR 735 per Middleton JA.

As such, this section is not concerned with providing a thorough critique of the doctrine of fraud on the minority. In relation to the doctrine generally, see Ford H A J, Austin R P & Ramsay I M, Ford's Principles of Corporations Law, 9th Edition, Butterworths, 1999 at 486-501; Lipton P & Herzberg
The Allen v Gold Reefs decision

The classic test was laid down by the English Court of Appeal in the decision of Allen v Gold Reefs of West Africa Ltd. In that case, the articles of association of the respondent company provided for a lien over unpaid and partly paid shares held by members for all debts and liabilities owing to the company. Upon his death, Z held both fully and partly paid shares and was the only holder of fully paid shares. The company altered the articles by special resolution in order to extend the lien to all shares held by members and not just those which were not fully paid-up. In discussing the former English equivalent to s136(2), Lindley MR stated:

Wide, however, as the language of s50 is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed.

On the facts, the alteration was found to be made within the scope of the power. Although it was clearly directed at affecting the rights of one particular shareholder, the power was exercised both bona fide and in the interests of the company in order to ensure the recovery of moneys owed by that shareholder.

Subsequent Interpretations of Allen v Gold Reefs

Irrespective of judicial pronouncements to the contrary, the words of Lindley MR have been adopted as a strict formula. Since its inception, the interpretation of the test has proved difficult. While the phrase bona fide would suggest a subjective element, requiring an examination of the motives of members in casting their votes, the phrase in the interests of the company as a whole promotes an objective requirement. In earlier cases, the test was characterised as two-fold, requiring both that:


[1900] 1 Ch 656.

12 Ibid, at 671.

13 See for instance Shuttleworth v Cox Brothers & Co (Maidenhead) [1927] 2 KB 9 at 26 per Atkin LJ.


15 Brown v British Abrasive Wheel Co Ltd [1919] 1 Ch 290; Dafen Tinplate Co Ltd v Llanelli Steel Co (1907) Ltd [1920] 2 Ch 124.
1. Shareholders exercise their power *bona fide* in a way that they themselves honestly believe to be for the benefit of the company as a whole.

2. Those rights are in fact exercised for the benefit of the company as a whole.

The application of this two-limb test has been subsequently rejected, later decisions applying a single test. For instance, in *Shuttleworth v Cox Brothers & Co (Maidenhead)*, Scrutton LJ stated:

[Counsel for the appellant] contended that the question is not what the shareholder thinks, but what the Court thinks is for the benefit of the company...that the Court must be satisfied that the alteration of the articles is genuinely for the benefit of the company...I think it is a mistaken view, based on a misunderstanding of an expression used by Lindley MR in *Allen's case*...The important words are 'exercised bona fide for the benefit of the company'. I do not read those words as importing two conditions, (1) that the alteration must be found to be bona fide, and (2) that, whether bona fide or not, it must be in the opinion of the Court for the benefit of the company. I read them as meaning that the shareholders must act honestly having regard to and endeavouring to act for the benefit of the company.

Therefore, the courts conducted a *subjective* examination as to whether the shareholders acted in what they considered to be the company's interest, rather than what is objectively for the benefit of the company. This approach is consistent with the reluctance of courts to review commercial judgements by analysing the respective merits of actions. However, there is one exception. The court may impute an improper motive where the resolution is 'so oppressive as to cast suspicion on the honesty of the persons responsible for it' or 'so extravagant that no reasonable man could really consider it for the benefit of the company'.

However, irrespective of the development of this general fetter on majority action, it has been observed that the doctrine was 'toothless', 'impotent' and, during its early life, proved substantially 'illusory' as a source of minority protection. For instance, in the *Shuttleworth* decision, irrespective of a finding by the jury that the resolution lacked good faith, the Court held that the evidence was insufficient to uphold the verdict. The high level of evidence required to obtain an order in the minority's favour resulted in successful claims being rare.
The *Peters' American Delicacy* decision

The general test in *Allen v Gold Reefs* was approved and elaborated by the High Court of Australia in *Peters' American Delicacy v Heath*. The decision related to company articles which provided that cash dividends were to be distributed to members in proportion to the amount of capital paid up on shares, while distributions by way of bonus share issues were to be made in accordance with the number of shares held. A special resolution was past which purported to amend the articles so that upon capitalisation of profits, bonus shares were issued relative to the amount paid on shares held, therefore being consistent with general dividend distributions. A circular was received by all shareholders explaining the purpose of the resolution as facilitating a restructuring of the company in order to establish a subsidiary operating company.

An action was commenced by three shareholders on behalf of all shareholders with partly paid-up shares. The three shareholders claimed that the resolution was passed solely for the purpose of benefiting the holders of fully paid-up shares to the disadvantage of holders of partly paid-up shares and was not in the interests of the company. The resolution was upheld by the High Court, being found to be neither unfair nor outside the scope of the power conferred.

The Court reinforced the single-element interpretation of the *Allen v Gold Reefs* test. As such, there is no requirement that the court determine if the resolution is *in fact* for the benefit of the company. It is for the shareholders, and not the court, to determine what is in the corporate interest. The *prima facie* general rule is that the majority action prevails, subject to the proviso that the power is not exercised ‘fraudulently or oppressively or [is] so extravagant that no reasonable person could believe that it [is] for the benefit of the company’.^^

The 'Company as a Whole'

This leaves the issue of the meaning of 'company as a whole'. In *Peters' American Delicacy*, Dixon J held that the phrase was a reference to the company as a corporate entity consisting of all the shareholders. However, in *Greenhalgh v Arderne Cinemas Ltd*,[^66] Evershed MR stated after reviewing the authorities that 'company as a whole' does not mean the company as a commercial entity distinct from its corporators, but rather the corporators as a general body. The applicable test is whether the resolution is for the benefit of an individual hypothetical member of the company.[^1951] The latter formulation was adopted by the New South Wales Supreme Court and England: 1860-1987’ (1989) 27(2) Osgoode Hall Law Journal 561 at 612. Compare *Clemens v Clemens* [1976] 2 All ER 268, where a share issue was struck down irrespective of the formal equality of the action.

[^66]: [1951] Ch 286.
[^1951]: [1939] 61 CLR 457. Evershed MR stated after reviewing the authorities that 'company as a whole' does not mean the company as a commercial entity distinct from its corporators, but rather the corporators as a general body. The applicable test is whether the resolution is for the benefit of an individual hypothetical member of the company. The latter formulation was adopted by the New South Wales Supreme Court and England: 1860-1987’ (1989) 27(2) Osgoode Hall Law Journal 561 at 612. Compare *Clemens v Clemens* [1976] 2 All ER 268, where a share issue was struck down irrespective of the formal equality of the action.

[^22]: (1939) 61 CLR 457.
[^23]: (1939) 61 CLR 457 at 512. Compare Latham CJ at 481.
[^34]: See Rixon F G, ‘Competing Interests and Conflicting Principles: An Examination of the Power of Alteration of Articles of Association’ (1986) 49 MLR 446 at 454 who describes the phrase as 'a delphic term employed by different judges in different circumstances to signify different things'.
[^26]: [1951] Ch 286.
Court in *Australian Fixed Trusts Pty Ltd v Clyde Industries Ltd*, as well as by the High Court of Australia in *Ngurli Ltd v McCann*.

### Adjustment of Conflicting Rights

While the High Court in *Peters’ American Delicacy* upheld the general test in *Allen v Gold Reefs*, it was generally acknowledged that the test was problematic. The Court observed that the mere fact that an amendment confers a benefit on one group of shareholders to the exclusion of others is insufficient to hold the resolution void. In such cases where the amendment adjusts the relative conflicting rights of different classes of shareholders, an investigation of what is in the benefit of the company is of little utility as a criterion for determining the validity of the resolution. To require a shareholder to consider only the interests of the company in such a situation would be contrary to the proprietary interest held in a share. As observed by Rixon, the test enunciated by Lindley MR was never intended to apply to such a case:

...the rule in *Allen v Gold Reefs of West Africa Ltd* has a major defect, namely that, having been formulated with reference to an alteration of articles involving a conflict of interest between a company and a member of the company, it is not serviceable in the case of an alteration involving a conflict of interest of members inter se.

On the facts of *Peters’ American Delicacy*, the resolution provided no benefit to the company itself, as it merely redistributed various rights and benefits as between groups of members. Put another way, the alteration did not generate or transfer wealth from members to the company, but merely transferred wealth between members. This may be contrasted with the facts of *Allen v Gold Reefs* where the extension of the lien to fully paid-up shares effectively transferred wealth to the company by providing security for debts owed to it. In situations such as *Peters’ American Delicacy*, where there is only a relocation of rights, the ‘benefit of the company as a whole’ investigation is meaningless. In such cases, the purpose of the resolution must necessarily be to resolve the conflict in favour of one interest over another. Unlike the responsible entity, members are not imposed with a duty of impartiality. The right of shareholders to vote in their own self-interest is only fettered by the requirement that...

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28 [1959] SR(NSW) 33 at 60 per McLelland J.
30 (1939) 61 CLR 457 at 480 per Latham CJ. However, in *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 at 291, Evershed MR of the English Court of Appeal stated that a special resolution which had the effect of discriminating between majority and minority shareholders, such that the former receives an advantage of which the latter are deprived, may be liable for impeachment. This statement is inconsistent with the principle formulated by Latham CJ in *Peters’ American Delicacy* that discrimination or a conflict of interest in itself is insufficient to establish that a resolution is invalid. The observation is also inconsistent with the decision reached by the Court. As has already been noted, applying the approach of Evershed MR would result in the company constitution effectively being immune from amendment. On the other hand, if by ‘discrimination’ Evershed MR was referring to formal discrimination as opposed to informal discrimination where all members are treated equally but the action impacts on them differently, the observations may be consistent with the other decisions.
31 (1939) 61 CLR 457 at 512 per Dixon J. See also at 481 per Latham CJ and at 495 per Rich J.
33 See 5.3.3 above.
the power must not be exercised fraudulently or for the purpose of oppressing the minority.

The Gambotto Decision

The position has shifted markedly to the benefit of minority interests as a result of the notorious High Court decision of Gambotto v WCP Ltd. A 99.7% majority of the respondent company’s shares were held by a wholly owned subsidiary, the applicants being holders of the remaining 0.3%. The company convened a general meeting resolving to insert a provision in the constitution empowering any member entitled to 90% of the issued shares to acquire the remaining shares at a set price of $1.80. The notice of meeting for the resolution attached an expert valuation of the shares at $1.36, the appellants conceding that the valuation was fair and independent. The applicant did not attend the meeting, and commenced proceedings to restrain the company from resolving to amend the articles. Evidence was provided by the respondent company that the expropriation would provide substantial financial benefits by enabling it to participate in tax savings through the transfer of tax losses, as well as relieving it from consolidated accounting obligations and the cost of separate share registry services.

On appeal from the New South Wales Court of Appeal, the High Court overruled the test in Allen v Gold Reefs in the context of a special resolution giving rise to a conflict of interest, stating that the test was ‘no longer influential’ in that context. Where amendments to a company constitution allow for an expropriation of minority shares by the majority, or an expropriation of valuable proprietary rights attaching to those shares, the High Court enunciated a two-limb test.

First, the power must be exercised for a proper purpose. On this point, the Court stated that the immediate purpose of a resolution to allow expropriation of shares or valuable rights attaching to those shares is to confer on members a power to acquire the property of minority holders compulsorily, being of itself outside the contemplated objects of the power to amend the company constitution. The definition of ‘valuable rights attaching to shares’ was not offered by the Court. However, one can assume that the Court was referring to common corporate rights such as the right to vote, to receive dividends, and to receive a distribution of surplus funds upon the winding up of the company. Discussing when amendments allowing for the acquisition of minority interests may be justified, their Honours stated:

54 (1995) 182 CLR 432; 13 ACLC 342. The decision has been referred to as a ‘ruling that has radically altered the balance of power within corporate Australia’: Australian Financial Review, 9 March 1995.
35 13 ACLC 342 at 348 per Mason CJ, Brennan, Deane, Dawson JJ.
36 Ibid, at 348.
37 For earlier cases on the expropriation of voting rights, see Australian Fixed Trusts Pty Ltd v Clyde Industries Ltd (1959) 59 SR(NSW)33; Eastmanco (Kilner House) Ltd v Greater London Council [1982] 1 All ER 437; Shears v Phosphate Co-Operative Co of Australia Ltd (1988) 14 ACLR 747.
38 See Re Adelaide, Unley, and Mitcham Tramway Co Ltd (in liq) (1907) SALR 35.

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...an expropriation may be justified where it is reasonably apprehended that the continued shareholding of the minority is detrimental to the company, its undertaking or the conduct of its affairs - resulting in detriment to the interests of existing shareholders generally - and expropriation is a reasonable means of eliminating or mitigating that detriment.

The Court provided two hypothetical examples where exceptional circumstances would justify an expropriation, being where a minority shareholder is competing with the company,\(^4\) and where the expropriation is necessary to ensure compliance with a regulatory regime governing the principal business it carries on, such as foreign ownership regulations. Therefore, it is not sufficient that the expropriation merely promotes the interests of the company as a legal and commercial entity, nor is it sufficient that the expropriation benefits only the majority shareholders, as this would be tantamount to permitting an expropriation for the purpose of some personal gain for the majority and thus made for an improper purpose. On the facts, mere administrative and taxation savings, or commercial advantage through a new corporate structure, were held insufficient.\(^5\)

Secondly, the expropriation must be ‘fair and not oppressive to the minority’.\(^6\) This requires the satisfaction of a procedural element, being that the processes used for the expropriation must be fair, requiring full disclosure of all relevant information.\(^6\) A substantive element must further be satisfied, requiring the expropriation itself to be fair, particularly in relation to the price provided for the shares.\(^7\)

In the case of expropriations, the Court further stated that the onus of proving the validity of the resolution lies on those supporting the expropriation.\(^8\) This approach may be contrasted to the earlier High Court decision of Peters' American Delicacy,\(^9\)

\(^4\) For instance, Sidebottom v Kershaw, Leese & Co Ltd [1920] 1 Ch 154 involved an expropriation of shares of members who carried on business in direct competition with the company's business. The English Court of Appeal upheld the expropriation on the basis that it was intended to protect the company's trade secrets, and was therefore bona fide for the benefit of the company. However, a similar fact scenario led to a different result in Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd [1920] 2 Ch 124, also involving a shareholder competing with the company. However, in that case, the resolution gave power to the majority to determine that the shares of any member was to be offered for sale by the Board to any person the directors shall think fit. This alteration was held to go further than was necessary to protect the interests of the company, extending in scope to members who may not necessarily be acting to the detriment of the company.

\(^5\) (1995) 13 ACLC 342 at 348. The position of the majority judgment can be compared with the individual judgment of McHugh J (at 354). His Honour took a wider view of what amounted to a proper purpose, stating that a resolution would be valid if it enabled the company to pursue some significant goal, being a beneficial course of action that would otherwise be denied if the expropriation was not effected. Unlike the majority judges, he saw no distinction between pursuing a benefit and avoiding a detriment to existing interests of the company. However, while finding the purpose of the resolution justified, the action fell under the second limb as the company did not satisfy its onus in establishing that fair and full disclosure was provided to minority shareholders.

\(^6\) Ibid at 349.

\(^7\) For a discussion on disclosure requirements in compulsory acquisitions in companies, see generally Redmond P, 'Disclosure Obligations in Corporate Squeezeouts', in Ramsay I (ed), Gambotto v WCP Ltd: Its Implications for Corporate Regulation, University of Melbourne, 1996.

\(^8\) McHugh J described the two requirements as being 'fair price' and 'fair dealings', basing his terminology on United States decisions: (1995) 13 ACLC 342 at 354-356.

\(^9\) Ibid, at 349.
where it was held that the onus is on the complainant when the validity of a resolution is challenged.47

Where amendments are passed which give rise to a conflict of interest or advantage, but do not result in the expropriation of shares or the valuable rights attaching to shares, the Court stated that the amendment will be valid unless it is 'ultra vires, beyond any purpose contemplated by the articles or oppressive as that expression is understood in the law relating to corporations'.48 As the facts involved an expropriation, the Court did not elaborate further on this formulae. A third possible category of amendments, being those where no conflict of interests arise, was not considered by the High Court. It would seem that the Allen v Gold Reefs test would still apply.

The State of the Law

The brief doctrinal survey of the doctrine of fraud on the minority conducted above illustrates how the applicable test has swayed. It was born as an investigation into whether majority actions are in the best interests of the company as a whole, and has subsequently moulded into an analysis of whether the purpose for exercising the power is proper. The current state of the law sees a substantial increase in the protection afforded to minority members in corporations when faced with an attempted expropriation of their rights or property. The High Court has adopted a new found interventionalism, no longer assuming the sanctity of majority rule and requiring majority shareholders to justify their decisions and actions.

Having surveyed the primary decisions, several observations can be offered in the current context. First, it would seem from Lindley MR’s statement in Allen v Gold Reefs that his Honour was merely expressing that the doctrine of fraud on the power is applicable when reviewing constitutional amendments.49 Individual members are under no fiduciary-derived obligation to act in the interests of the company or other members.50 Irrespective of this, however, later courts have interpreted the requirement as imposing a fiduciary-like obligation on shareholders. Contrary to their proprietary right to vote in their own interest, majority shareholders have been imposed with a requirement to ignore considerations of personal advantage and interest in favour of the interests of the company. This approach results in a conflict between a shareholder’s rights and duties.51 The obligations of the fiduciary office have been imposed without identifying the existence of the relationship itself. This approach is far removed from the underlying fraud on the power restraint upon which the doctrine is apparently founded. Professor Gower has described it as a ‘sort of fiduciary duty’.52 Similarly, Pennington refers to the obligation as a ‘limited fiduciary duty’, stating:53

47 (1939) 61 CLR 457 at 482.
49 For a discussion on fraud on the power, see 5.1.1 above.
50 See 7.2.3 above.
51 See Peters’ American Delicacy v Heath (1939) 61 CLR 457 at 504 per Dixon J and at 482 per Latham CJ.
But this is the nearest that the courts have come so far to recognising a fiduciary obligation between shareholders similar to that which partners owe one another and though it is now impossible for a general fiduciary duty to be imposed on shareholders in respect of every exercise of their voting rights, it is still possible for the limited fiduciary duty in relation to alterations to the company's constitution and to rights attaching to classes of shares to be made really effective by a more critical appraisal of the necessity of and the reasons for the alterations, and to attach more weight to the immediate effect of the alteration, so that controlling shareholders who benefit from it to a greater extent than minority shareholders are made to justify it fully if it is to be upheld.

Similarly, in the Canadian context, McIntosh has stated:\(^{54}\)

It is worth noting that although the English and Canadian courts have in the main, sedulously avoided a characterisation of evolving shareholder duties as 'fiduciary' in nature, there can be little doubt that they are fiduciary in character and substance. The unwillingness to so characterise these duties and limitations on majority action is a persistent curiosity which will likely soon become an historical anachronism.

Secondly, in acknowledging that the Allen v Gold Reefs test is of little utility where there is a conflict of interest, the more recent decisions leading to the Gambotto judgment see the doctrine return to a form which shares greater resemblance with fraud on the power. The courts are concerned with the purpose for which the power is exercised rather than whether it is in the corporate interest. However, the approach is quite distinct and unique from its equitable origins. Although the examination is conducted in terms of the purpose of the action, the courts have shifted their concern to the objective effect of the amendment rather than the subjective purpose. For instance, amendments seeking to expropriate minority interests are prima facie invalid, irrespective of the purpose for which the expropriation is sought, such as financial or taxation benefits. This places the onus on the majority to justify their actions. A similar change in judicial approach was discussed above with respect to the review of actions by company directors.\(^{55}\) While the doctrinal investigation remains in tact, the application of the basic premise, that a power can only be exercised for a proper purpose, has shifted.

The investigation has diverged from the underlying doctrine of fraud on the power in further respects. As well as determining whether the action is within the scope of the power, an additional objective requirement must be fulfilled, being that the action must be fair and not oppressive. Once again, rather than being primarily concerned with the subjective purpose for the action by those vested with the power, attention is shifted to the objective effect of the action on those who are subject to the resolution. Furthermore, where the amendment involves an expropriation of valuable rights, the onus has shifted to the defendant rather than the plaintiff to prove the propriety of the action.


\(^{55}\) See above at 5.1.2.
Therefore, a unique doctrine has evolved with respect to amendments to company constitutions by shareholder resolution. The various approaches applied and developed through the cases are aimed at balancing the proprietary rights of shareholders to vote in their own interests, and the rights of the minority not to have their legitimate rights and interests unduly interfered with. The next issue is whether the doctrine of fraud on the minority is applicable to managed investment schemes.

8.2 Application of Fraud on the Minority to Managed Investment Schemes

Though the fraud on the minority cases are found in the company law arena, there are strong reasons why they are equally applicable to managed investment schemes. Three arguments may put forward to support this proposition, each of which will be discussed in turn:

1. The doctrine is applicable to all exercises of power by majorities which affect the rights of a minority, including the power vested in scheme members to instigate a constitutional amendment (8.2.1).
2. The modern formulation of the doctrine is founded on a protection of proprietary interests, being equally applicable to the interests of scheme members (8.2.2).
3. The doctrine may be applied as a result of the common history shared by the unit trust and the company (8.2.3).

8.2.1 Doctrine Applicable to All Exercises of Power

In Allen v Gold Reefs, Lindley MR stated that the doctrine of fraud on the minority was founded on the general legal and equitable principles 'which are applicable to all powers conferred on majorities and enabling them to bind minorities'. The doctrine is an instance of fraud on the power, and as such, is not confined to a company law context. While later cases have developed the formulation and application of the doctrine, the underlying premise still remains. Therefore, as the amendment power vested in scheme members enables a majority of members to bind the minority, the doctrine is applicable.

8.2.2 Protection of Proprietary Interests

The primary basis for restricting the exercise of power by majority shareholders is to protect the legitimate proprietary interests of minority members. Members in managed investment schemes have similar interests, therefore deserving the same level of protection upon an abuse of power.

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57 [1900] 1 Ch 656 at 671 (emphasis added). However, see McPherson B H, 'Oppression of Minority Shareholders Part I: Common Law Relief' (1963) 36 ALJ 404 at 408-9 who argues that this is too wide a proposition, the doctrine of fraud on the minority only applying to either alterations of company articles specifically, or alteration of shareholders' rights generally.
The Proprietary Interest of Shareholders

Proprietary interests have the characteristic of *indefeasibility*. This incident of ownership protects the property from being defeated or destroyed except by way of voluntary transfer with the consent of the owner. The High Court decision in *Gambotto* is a direct recognition of the proprietary nature of shareholdings, and the necessary protections that flow from this recognition. The Court recognised two proprietary forms, the first being the share itself, and the second being the valuable rights attaching to the share. Although the Court did not elaborate on what these valuable rights were, one can assume that they are the standard corporate rights such as the right to receive a dividend if one is declared, the right to return of capital on winding up, and the right to attend and vote at a general meeting.

While the Court acknowledged that corporate membership is subject to constitutional alterations that may affect the various rights attaching to shares, it was held that to allow amendments which are justified on the basis that they promote or further the interests of the company as a legal and commercial entity or the interests of the majority ‘does not attach sufficient weight to the proprietary nature of a share’. As such, the ability of a majority of members to alter the constitution is necessarily constrained by equity, only being exercisable in ‘exceptional circumstances’ and for proper purposes.

The Proprietary Interest of Scheme Members

If the restraint on constitutional amendments is founded upon the necessary protection of the property in a share, this foundation may equally be applied to scheme members. Being comparable to a share, a unit confers on the holder a bundle of rights derived from statute, contract and equity. These are valuable proprietary rights attaching to the unit. As already discussed, it is debatable that the interest in a unit is itself also proprietary in nature. Furthermore, unlike shareholders, scheme members arguably have a direct proprietary interest in the underlying scheme assets, providing a third proprietary form relating to scheme membership.

This being the case, the *ratio* of the *Gambotto* decision is equally applicable to the protection of minority scheme members where their proprietary interest is interfered with by an abuse of power by the majority. One could even say that as a scheme member’s interest may be directly in the scheme property and not merely in an interposed legal entity, such interest arguably merits stronger protection.

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59 (1995) 13 ACLC 342 at 349 per Mason CJ, Brennan, Deane, Dawson JJ.
60 See Ch 3 above.
61 See 3.3.2 above.
62 It is argued at 3.3.2 that this is not the case.
Criticisms of a Proprietary Analysis

Although the High Court has explicitly acknowledged the proprietary nature of shareholdings, this basis has been the subject of substantial debate since the handing down of the decision. As an aside, it is worth briefly exploring these criticisms.

Commentators have argued that the treatment of shares as a form of property is not reflective of the true nature of shareholdings in large public companies. The legal basis of the recognition of a proprietary interest is founded on the historical nature of a company as a quasi-partnership, where members had direct control over the company's affairs and were attached to and involved in the company's underlying business. Conversely, in the modern public corporation, members are widely dispersed, not having any effective control over the management of the company and the activities of the Board. As a result, the interest of members is more appropriately viewed as purely economic rather than proprietary, their investment being merely a capitalised dividend stream. Helen Bird proposes that shares in Australian public corporations must be viewed as proprietary in name only, stating:

Investors' expectations have shifted from securing responsibility and control to acquiring income streams, capital growth and liquidity. The definition of a share by the High Court majority in Gambotto, as a thing (an investment) conferring proprietary rights, is the product of a bygone regulatory era.

The same can be said of a managed investment scheme. As an economic unit, an interest in a managed investment scheme is comparable to a share, the investor receiving distributions of profit during the scheme's operation, as well as a distribution of capital upon winding up. The scheme is operated by the responsible entity, and participation rights of members are minimal. If it can be said that a share is merely an economic unit, this would apply with greater force to a scheme unit.

However, given the Gambotto decision, it would seem unlikely that such a construction will receive judicial recognition. The proprietary nature of shareholdings has provided minority shareholders with a means of ensuring their membership rights are not unduly interfered with. This basis upon which courts review actions by majority shareholders is equally applicable to scheme members.

8.2.3 Historical Application

A third argument for the importation of fraud on the minority into a managed investment scheme context is that both the company constitution and the scheme

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64 In a similar vein, the Gambotto decision has also been criticised for the economic inefficiency of its outcome: see Whincop M J, 'An Economic Analysis of Gambotto', in Ramsay (ed), supra at 102; also (1995) 23 ABLR 276.


66 Bird, op cit, at 156.
constitution share a common history. This application has recently received judicial acknowledgment.

The Case Law

_Fraud on the minority_ has been applied to an unincorporated deed of settlement company, being the precursor to both the modern company and the unit trust. In _British Equitable Assurance Co Ltd v Baily_, a deed of settlement company proposed to alter its by-laws in order to direct part of its profits to a reserve fund rather than distributing the profits in totality to policy-holders. The respondent was one such policy-holder, not being a shareholder, but being contractually bound to the terms of the deed of settlement. The policy-holder commenced an action to prevent the alteration. On appeal to the House of Lords, Lord Lindley applied the _Allen v Gold Reefs_ test, stating:

> Of course, the powers of altering by-laws, like other powers, must be exercised _bona fide_, and having regard to the purposes for which they are created, and to the rights of persons affected by them.

In a similar vein, Lord Macnaghten observed that the restraint on the exercise of power is identical, whether it relates to alterations to the by-laws of a deed of settlement company or the amendment of the memorandum and articles of association of a company incorporated under the relevant legislation. As it was conceded by the respondent that the purported actions of the company were ‘fair, honest and business-like’, the alterations were upheld.

This decision was cited by the Supreme Court of Western Australia to support the importation of the company law cases to a unit trust deed in _Gra-ham Australia Pty Ltd v Perpetual Trustees WA Ltd_. The litigation revolved around a resolution by unit-holders approving an amendment to the trust deed via a supplementary amending deed which purported to alter the basis of determining the redemption price of units to a current value method. Prior to the amendment, the redemption price was determined as at seven days prior to the redemption request being issued.

At the time the amendment was made, the plaintiff unitholders had already given notification of withdrawal. The manager made no payment until after the resolution altering the basis of calculating the redemption price. Due to falling prices as a result of the 1987 stock market collapse, the amendment had the affect of decreasing the unit withdrawal price from $1.71 to $1.13. An action was brought by the unitholder

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67 See 2.2 above.
68 [1906] AC 35.
69 Ibid, at 42.
70 Ibid, at 38.
71 Ibid, at 43 per Lord Lindley.
72 The appeal turned on whether the alterations infringed on the personal contractual rights of the policy-holder.
73 (1989) 1 WAR 65. Further proceedings were conducted in the Supreme Court of Victoria against the unit trust manager on the basis of a personal contract between the plaintiff and the manager made on the day of the stock market crash, purportedly giving the plaintiff the right to withdraw at the established price. The claim failed: _Gra-ham Australia Pty Ltd v Corporate West Management Ltd_ (1990) 1 ACSR 682.
against both the trustee and manager of the scheme. The trustee attempted to justify the amendments on the basis that if the change was not made, those unitholders who withdrew from the trust while unit prices continued to fall would receive substantially more upon redemption than their share of the fund at the date of withdrawal. The amendment was intended to cure this imbalance.

At first instance in *Perpetual Trustees WA Limited v Corporate West Management Ltd*, Kennedy J applied the cases relating to alteration of company articles to unit trusts, stating:

So far as company cases are concerned, there are, of course, both similarities and differences between companies and unit trusts. The modern company, however, finds its ancestry in a particular kind of deed of settlement of unincorporated companies... Further...unit trusts offer to the public an investment practically indistinguishable from shares in a limited company.

On appeal to the Full Court, Malcolm CJ discussed the principles enunciated in both *Allen v Gold Reefs* and *Peters' American Delicacy v Heath*. After listing the propositions put forward by Latham CJ in *Peters' American Delicacy*, his Honour stated that they applied equally to trust deeds in unit trust schemes as they did to deeds of settlement companies under which companies were once established. The test is whether the amendment was adopted in 'good faith' and 'for the benefit of the unitholders as a whole'. Prima facie, it is for the majority of unitholders to decide if this is the case.

On this basis, his Honour held that the alteration was valid. The fact that the alteration diminished, prejudiced or altered the rights of unitholders was not sufficient to invalidate it, as it was for the benefit of the unitholders as a whole and there was no suggestion that voting unitholders acting otherwise than in good faith.

If this application is correct, the result is that there has been a cross-cultivation of principles between the trust and the company. Whilst the trust concept played a crucial role in the development of company law and the obligations of company directors, history now sees the reverse occurring, with company law being drawn upon to provide solutions to problems faced by unit trusts.

Criticisms of the Historical Application

Kam Fan Sin has questioned the application of the *Allen v Gold Reefs* formulation to unit trusts. The remainder of this chapter addresses the arguments put forward by Sin. Each of the following criticisms will be dealt with in turn:

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74 [1989] WAR 117 at 129.
75 (1939) 61 CLR 457 at 479-482.
76 (1989) 1 WAR 65 at 81. His Honour stated that all were applicable with the exception of the first relating to the statutory power afforded to corporations to amend their constitution. As already discussed above at 7.2.2, this proposition also now applies as the power to amend the scheme constitution is now derived from statute.
77 *Ibid*, at 81.
78 See 2.1 above.
(i) Unlike companies, unit trusts do not carry on a business.
(ii) Common historical origins do not justify the importation of the principles per se.
(iii) The ‘company as a whole’ formulation has no application to unit trusts.
(iv) The doctrine of fraud on the power is applicable to unit trusts, rather than fraud on the minority.

(i) Investment Activities vs Carrying on a Business

Sin first points to the distinction between deed of settlement companies, which carry on a business, and unit trusts, which merely carry on investment activities. Although conceding that the distinction may have been considered unimportant by the Court, he nonetheless asserts that the issue was not addressed in Gra-ham v Perpetual Trustees.

It is submitted that the distinction between carrying on a business and undertaking investments in other businesses is of no relevance to the issue at hand. The corporate form may be utilised as an investment vehicle in the form of an investment company, just as the trust institution may be utilised for the carrying on of a commercial operation in the form of a trading trust. This has no logical bearing on the application of the equitable restraints on majority shareholders to the unit trust.

(ii) Common Historical Origins

Sin further contends that the fact that the two institutions have the same origin should not lead to the conclusion that the same body of principles necessarily applies per se. He states that ‘brothers, despite their common parents, are not twins automatically. Directors’ duties, despite their origin in the trust, are not trustees’ duties’.

This statement is not disputed. However, the decisions discussed above do not attempt to apply the principles from the common historical source per se. In Perpetual Trustees v Corporate West Management at first instance, Kennedy J acknowledged that there are both similarities and differences between companies and trusts. On appeal, Malcolm CJ did not hold that the principles must necessarily be imported due to the two brothers having common parents, but merely that the principles apply equally to unit trust deeds as they did to deed of settlement companies. No explicit reason was offered as to why the principles applied equally. One can assume that they were applied by analogy.

Following from this, the analysis should be whether the characteristics identified in the company cases which justified the formulation of the principles are equally present in managed investment schemes. The common historical foundation merely points to the necessary characteristics not being dissimilar. Earlier it was established that membership in a managed investment scheme confers a bundle of proprietary rights in the investor, being similar in nature to the rights conferred on an investor in a registered company. The rights of scheme members are equally deserving of

80 See 1.4 above.
81 Sin, op cit. at 175.
82 [1989] WAR 117 at 129.
83 See Ch 3 above.
Part C - Amendments by Scheme Members

protection from majority abuse as are the rights of shareholders. It follows that the protection afforded to shareholders is, by analogy, equally applicable to scheme members.

(iii) The Inapplicability of the ‘Company as a Whole’ Formulation

Sin argues that the analogy is questionable on the ground that the ‘company as a whole’ formulation evolves around characteristics peculiar to companies which are not shared with unit trusts. The reasons given are that:

- Unitholders acquire rights while shareholders participate in a business.
- A company is a separate legal entity while a trust is not.
- ‘Company as a whole’ connotes a body in perpetual existence and with limited liability, neither of which are characteristics of unit trusts.

In relation to the first point, both interests in shares and scheme units may be characterised as a bundle of rights, arising from equity, the contractual basis of the entity’s constitution and by virtue of the regulating legislation. As has already been discussed, the fact that an entity operates an investment scheme rather than a business does not have any logical bearing on the issue. Sin submits that even where a unit trust operates a business, it is operated by the trustee and not the members. Surely the same can be said for the board of directors in a modern public company.

The second argument, that a company is a legal entity and a scheme is not, also has no bearing on the issue. It has not been suggested that the ‘company as a whole’ formulation be adopted, but rather that the amendments be bona fide for the benefit of the members as a whole. This is consistent with the judgment of Malcolm CJ in Graham v Perpetual Trustees. It is not proposed that the doctrine be imported in its entirety, but merely that the courts adopt an analogous approach in their supervision of purported amendments. In this regard, the approach will be adapted to the peculiarities of the managed investment scheme.

Furthermore, the ‘company as a whole’ formulation has been interpreted by the courts as not requiring an investigation into the interests of the company as a commercial entity, but rather the interests of the corporators as a general body, or alternatively the interests of a hypothetical member. The investigation is not dependent on there being an interposed legal entity and is therefore equally apt to collective investment schemes.

In relation to the third point, the argument is based on the company law cases which recognise the need in certain circumstances to consider the interests of future as well as present members of the company, and the need to consider the interests of creditors. Sin argues that these considerations are foreign to unit trusts, therefore

84 (1989) 1 WAR 65 at 81.
85 Greenhalgh v Aderne Cinemas Ltd [1951] Ch 286; Ngurli Ltd v McCann (1953) 90 CLR 425 at 438.
negating the suitability of the company law test. This argument can be countered on five bases.

First, as has already been discussed, it has not been proposed that the identical formulae be adopted, but merely the underlying approach conducted by the courts in reviewing actions instigated by a members' resolution be followed. In the case of managed investment schemes, it is the members as a whole, being all persons holding a current interest in the scheme, which is relevant. Secondly, in relation to the consideration of future members, this principle is far from settled in company law and is arguably simply a requirement that future interests of the company be regarded as well as present interests. Furthermore, it has been recognised in relation to the power of investment in pension schemes that the trustee must exercise its powers in the best interests of both present and future beneficiaries.

Thirdly, the requirements to consider both creditors and the interests of future members is merely an acknowledgment of the perpetual existence of companies and the various stakeholders that have an interest in that existence. Sin argues that this characteristic of perpetual existence is unique only to companies. This assumption that companies exist indefinitely and unit trusts do not, has little foundation. The increasing ease at which companies can effectively reduce their capital, as well as the alleviation of the requirement that schemes have a redemption provision, diminishes this distinction.

Fourthly, in relation to creditors, the obligation to consider the interests of creditors is only imposed on directors of a company, and even then is limited to situations where the company is insolvent or nearing insolvency. As it has never been proposed that majority shareholders, in exercising their votes, must consider the interests of creditors, it is curious as to why this would bear on the issue. A fifth and final point is that the requirement for voting power to be exercised for the benefit of the company as a whole is itself falling out of favour as courts apply a proper purpose test in investigating the exercise of voting powers in cases involving a conflict of interest. By attaching the criticism to the application of this formulation is to ignore the current trends in the company decisions.

(iv) Application of Fraud on the Power

Dr Sin concludes that while the company law cases concerning fraud on the minority have no application to unit trusts, the underlying doctrine of fraud on the power, as established in Vatcher v Paull, is applicable. Sin states that accepting this view will have the following ramifications.

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89 Cowan v Scargill [1984] 2 All ER 750 at 286-287 per Megarry VC.
90 See n44 at 6.2 above.
91 Sycotex Pty Ltd v Baseler (1994) 122 ALR 531.
93 Discussed above at 5.1.1.
94 Sin, op cit, at 177.
• The requirement that amendments be for the benefit of the 'unitholders as a whole' will not be relevant.
• The restrictions on voting power will operate in a negative manner rather than the apparent positive requirements now required by company decisions.

In relation to the first point, as already stated, this requirement is unlikely to be relevant irrespective of whether the company cases are applied, except in the narrow situations where no conflict of interest is in question. In relation to the second point, this will only be the case where there is an expropriation of scheme units or the valuable proprietary rights attaching to the units, as otherwise the onus remains on the party claiming fraud, the test therefore operating in a negative manner.\textsuperscript{95}

Furthermore, it is submitted that reverting to the fraud on the power formulation will create both doctrinal and evidentiary difficulties. In relation to the doctrinal difficulties, individual members are not under a fiduciary obligation to consider the interests of other members or the interests of the scheme. However, fraud on the power dictates that they may only exercise their voting power for a proper purpose, subjectively determined as a matter of fact. This doctrine was developed in the context of holders of limited powers, where the appointor had an absolute obligation to act in the interests of the beneficiaries. This is not so with scheme members. If this doctrine is strictly applied, there would be a resulting conflict between this duty and the proprietary right of each member to vote in their own interest.

Under the company law approach, however, individuals can vote in their own interest, subject to two qualifications: first, that the resolution does not achieve certain ends which are deemed to be improper, and secondly, that the resolution not be oppressive to the minority. The right of self interest is therefore not compromised, as it is the objective effect of the resolution itself rather than the subjective intention of the individual shareholders which may be objectionable.

In relation to the evidentiary difficulties, under fraud on the power, evidence would necessarily be required from each member of the majority voting in favour of the resolution in order to determine the subjective purpose for which they cast their vote.\textsuperscript{96} While this may have been possible in the context of individual trustees or holders of limited powers, it is not practical in the case of a large public company with many shareholders. In comparison, under the company law formulation, as the investigation is diverted to a consideration of the objective effect of the actions, a far more realistic approach is adopted from a procedural standpoint.

Finally, it is submitted that reverting to the original equitable doctrine would effectively require the courts to re-invent the wheel. Over this past century, the original equitable principles have been moulded to apply to a particular fact scenario, being where a majority of members in a commercial entity exercise their statutory power to amend the entity constitution in a manner which affects the rights and

\textsuperscript{95} See above at 8.1.2.

interests of minority members. No peculiarities attributed to the unit trust institution have been identified which would negate the applicability of this body of case law.

* * * *

In conclusion, scheme members are provided with a statutory power to amend the scheme constitution by virtue of a special resolution. The amendment power is not fiduciary in nature, as scheme members are not fiduciaries *inter se*. However, it is submitted that the courts must, when reviewing an exercise of voting power by a majority of members in a managed investment scheme, subject that exercise to those principles developed in the context of amendments to corporate constitutions. As the managed investment scheme is imposed with the notion of *majority rule*, being primarily a company law concept, scheme members must also receive the benefit of the protection which is afforded to company shareholders upon an abuse of power by the majority. The power cannot be exercised for an improper purpose, being where, for instance, units or valuable rights of minority members are expropriated without adequate justification, and it cannot operate oppressively upon minority members.

The following chapter examines certain selected amendments which may be instigated by a majority of scheme members.
9. Selected Amendments to the Scheme Constitution

In Chapter 8 it was established that amendments by scheme members will be subject to the doctrine of fraud on the minority. This chapter applies the restraint to three fundamental amendments which may be sought by a majority resolution of scheme members in order to provide an analytical survey of the extent to which the fraud on the minority doctrine, when imported into a managed investment scheme context, provides adequate protection for aggrieved minority members. The amendments, which will be explored in turn are:

1. The introduction of a compulsory acquisition clause (9.1).
2. The removal of a provision excluding the personal liability of members (9.2).
3. The imposition of further obligations on, or removal of existing rights from the responsible entity (9.3).

9.1 Introduction of a Compulsory Acquisition Clause

A compulsory acquisition clause, when inserted into the scheme constitution, will have the effect of squeezing out minority members. This may be achieved by various means, including the introduction of a clause which has either of the following effects:

- A provision permitting the responsible entity or a general meeting of members to compel any scheme member to sell or transfer their interest to other specified persons.
- A provision which deems any scheme member whose interest is below a designated amount to have the responsible entity appointed as agent to sell the interest to another person at a price determined by an independent valuation.

Motivations for Absolute Control

The most obvious scenario in which persons holding a controlling interest in a scheme may wish to eliminate minority interests is in the event of a takeover.97 Where an

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97 Obtaining a majority or absolute interest in the scheme is only one means of gaining control of a managed investment scheme. As an alternative, an offeror may seek to obtain the management rights of the responsible entity, thereby gaining access to the management fees. This can be achieved two ways. First, the offeror may obtain a majority of units and have the responsible entity replaced. Currently, replacement of the responsible entity will require the member to hold 50% of the votes in order to achieve an extraordinary resolution: s601FM(1). This is the case irrespective of ASX Listing Rule 13.3 which requires listed unit trusts to allow removal of the management company by ordinary resolution. However, CLERB proposes to allow replacement of the responsible entity by a simple resolution in the case of listed schemes, being based on a show of hands rather than a poll: CLERB, Schedule 3. Secondly, a takeover may be sought by obtaining a controlling interest in the responsible entity company where the responsible entity is a listed company. The takeover will be subject to the provisions of Chapter 6 of the Corporations Law. In listed schemes, changes in control of the responsible entity may be subject to the continuous disclosure requirements: ASX Listing Rule 3.1, 3.16.2(a). It has been proposed that any change in control of the manager or acquisition of the management rights of the scheme require approval by a members resolution: Department of Treasury, Corporate Law Economic Reform Program Proposals For Reform: Paper No.4
offeror succeeds in gaining majority control of a scheme, moving to absolute control may have several commercial advantages. For instance, where a takeover is conducted in order to obtain the underlying scheme assets rather than to obtain control of the scheme as a going concern, only by eliminating minority interests will the offeror be in a position to demand the transfer of the assets to itself.98 If a 75% majority is obtained, the offeror can seek to have the scheme wound up.99 This will only provide the offeror with the distribution of surplus funds upon winding up rather than the legal ownership of the scheme assets. However, being the sole member of the scheme will arguably100 allow the acquiring member to bring the trust to an end and direct the scheme property be transferred to it under the rule in *Saunders v Vautier*.101

It may also be conceived that an acquiring member may wish to maintain the trust structure but eliminate minority holdings in order to take the scheme outside the statutory regime. Deregistering the scheme would result in obvious administrative and compliance cost savings, as the scheme would no longer be required to comply with the formal statutory requirements, such as:

- registration of the scheme.102
- lodgement of an adequate scheme constitution103 and compliance plan.104
- internal management requirements for a compliance committee or half of the directors of the responsible entity being external.105
- the application of the related party provisions.106
- accounts and disclosure requirements.107

Upon obtaining absolute ownership, it may be possible for the acquiring member to have the scheme deregistered on two grounds. First, the MIA allows the responsible entity to lodge an application for deregistration where the scheme has less than 20 members, all the members agree that the scheme should be deregistered, and it was not promoted by a person in the business of promoting managed investment schemes.108 Therefore, upon obtaining absolute control, deregistration can only be achieved on this basis if the scheme was not *initially* commenced by a professional promoter. This is an unlikely scenario.

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98 An alternative approach would be for the offeror to purchase the individual assets from the responsible entity rather than attempt to acquire the scheme as a going concern.
99 Section 601NB.
100 As discussed above at 3.3.2, the rule arguably does not apply to managed investment schemes.
101 (1841) 49 ER 282.
102 Part SC.1.
103 Section 601GA(1).
104 Part SC.4.
105 Section 601JA.
106 Part SC.7.
107 Part 2M.
108 Section 601PA(2); Section 601ED(1)(b).
Secondly, the scheme may be deregistered where it is an *intra-group scheme*, thereby no longer falling under the definition of ‘managed investment schemes’. This definition expressly excludes schemes where all members are body corporates that are related to each other and to the body corporate that promotes the scheme. Therefore, upon obtaining absolute control, the acquirer may replace the responsible entity with a related company, thereby taking the scheme outside the scope of the Act.

However, these two courses of action do not automatically result in the deregistration of the scheme, but merely provide the responsible entity with a right to lodge an application for deregistration with ASIC. Upon receiving an application which complies with the provisions, ASIC must give notice of the application on its national database and the *Government Gazette*. Whilst ASIC *may* then deregister the scheme, it is under no obligation to do so.

There are further restrictions when the party attempting the acquisition is the responsible entity itself. Where the responsible entity holds or acquires an interest in a scheme, that interest is subject to the condition that it will not disadvantage other members. As such, if the takeover is attempted by the responsible entity, this clause may prevent it from compulsorily acquiring minority units, as this would be disadvantageous to other members. Furthermore, the responsible entity is prevented from voting at resolutions in which it has an interest other than a member. This will prevent the responsible entity from exercising its vote to insert the compulsory acquisition provision into the scheme constitution.

Other advantages flowing from the elimination of minority interests may include economies of scale achieved by merging the fund with other funds held by the acquirer. Furthermore, absolute ownership relinquishes the need for the acquiring member to share the return on its investment with other members where it makes a large contribution to the fund. Finally, absolute ownership eliminates conflicts of interest within members' meetings and prevents the occurrence of *greenmailing*, where dissenting minority members are unreasonable or uncooperative in their actions, preventing the fund from pursuing legitimate interests and demanding excess premiums for their units.

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109 Section 601PA(2)(c).
110 See definition of ‘related body corporate’ in s50.
111 Section 9 definitions, (e). It is assumed from the language that ‘the body corporate that promotes the scheme’ is reference to the body currently promoting the scheme rather than the original promoter.
112 By virtue of s601FM.
113 Section 601PA(3).
114 Section 601FG(b).
115 Section 253E.
116 Note that it would be more common that an acquiring member would attempt to eliminate a minority interest prior to it being appointed as the responsible entity, therefore not being subject to this restriction on voting.
117 Obtaining absolute ownership in companies has the further advantage of giving access to group tax loss treatment under Division 170 of the *Income Tax Assessment Act* 1997 (C’th). For a discussion of the advantages of absolute ownership in the corporate context, see Boros E, ‘Compulsory Acquisition of Minority Shareholdings – The Way Forward?’ (1998) 16 CLSJ 279.
The Legality of a Compulsory Acquisition Clause

A compulsory acquisition clause contained in the scheme constitution upon formation of the scheme is valid and enforceable. For instance, in Elkington v Moore Business Systems Australia Ltd, a provision in a unit trust deed deemed the compulsory acquisition provisions in the Companies (Acquisition of Shares) (NSW) Code to apply mutatis mutandis as if they were specifically incorporated in the deed. The New South Wales Court of Appeal held that the clause was valid.

This may not be the case, however, where the scheme is listed on ASX. Compulsory acquisition clauses may be unenforceable as a result of ASX Listing Rule 15.14, which prohibits a sanction or penalty entitling the responsible entity, or any other person, from enforcing a constitutional provision relating to the acquisition of units above a substantial holding limit. An example given in the Listing Rules is a constitutional provision allowing the enforcement of a compulsory acquisition power. As such, whilst a compulsory acquisition provision itself is not prohibited, a provision imposing a sanction or penalty upon the non-observance of the provision is unenforceable. The result is that the right to compulsorily acquire minority interests may exist, but it cannot be enforced. Furthermore, ASX Listing Rule 6.12 states that a member cannot be divested of his or her units, except under the following cases:

- The divestment is under Australian legislation or is required in order to comply with legislation.
- The divestment is under a constitutional provision which is permitted by the ASX Listing Rules or has been approved by the ASX as appropriate and equitable.
- The divestment is under either a court order or a lien permitted by the ASX Listing Rules.

The result is that although such provisions are common in practice, contractual incorporation of the compulsory acquisition provisions in the constitution of listed schemes are unenforceable.

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118 (1994) 15 ACSR 292.
119 The compulsory acquisition provisions are currently found in s701.
120 However, statutory provisions which conferred jurisdiction on the courts to hear and determine applications were held incapable of being incorporated into the constitution. To the extent the constitution attempted to confer jurisdiction on the courts, it was void but severable.
121 The policy justification for the rule is that schemes should not be able to interfere in the market for corporate control: ASX Guidance Notes - Trusts, issued 16 November 1998.
122 See the conflicting cases of AF & ME Pty Ltd v Aveling (1994) 14 ACSR 499 and West Merchant Bank v Rural & Agricultural Management Ltd CLS 1996 NSWSC CA 45, 4 April 1996. The better view would be that a provision prohibiting the acquisition of a certain level of interest (eg, 20%) except in accordance with the takeover provisions is not prohibited by Listing Rule 15.14 per se. However, a provision preventing the registration of transfers, requiring the disposal of units, or imposing some other penalty or sanction upon contravention of the requirement would be unenforceable.
123 There are no statutory procedures for divestment of units in managed investment schemes. In the case of companies, an example would be the statutory power to acquire shares following a successful takeover bid: s701.
124 The ASX may grant approval, for instance, where the divestment is necessary to maintain a licence or approval for the business.
The Introduction of a Compulsory Acquisition Clause

Returning to non-listed schemes, the issue at hand is whether and in what circumstances majority scheme members can exercise their constitutional amendment power in order to introduce a compulsory acquisition clause, thereby disenfranchising minority members. While pre-existing compulsory acquisition provisions may be contained in the constitution, importing such a provision after the establishment of the scheme is another matter. This distinction is drawn by the majority of the High Court in *Gambotto*, which in discussing compulsory acquisition provisions, stated:¹²⁵

The inclusion of such a power in a company’s constitution at its incorporation is one thing. But it is another thing when a company’s constitution is sought to be amended by an alteration of articles of association so as to confer upon the majority power to expropriate the shares of the minority.

As established in *Gambotto*, amendments which allow for the expropriation of minority shares must be made for a proper purpose.¹²⁶ The immediate purpose of an expropriation clause is to compulsorily acquire the property of the minority, being prima facie improper. Such an amendment is only justifiable in exceptional circumstances, such as where it is a means of eliminating or mitigating some detriment to the company resulting from the minority interest. Furthermore, the expropriation provision cannot go beyond what is reasonably necessary to mitigate the detriment at hand, as the means must be proportionate to the detriment which is intended to be mitigated.¹²⁷

Applying the law to the amendment at hand, the insertion of an expropriation clause for the purpose of gaining absolute control is in itself improper. Eliminating the minority in order to obtain the legal title to the scheme assets will be characterised as being for the purpose of expropriating the minority members’ equitable interest in that property, and so will be invalid. Similarly, if the amendment is motivated by a desire to have the scheme deregistered, resulting in a savings in administrative and compliance costs, the amendment will not stand, as was the case in *Gambotto* where the submission that the purported amendment was justified on the basis of taxation and administrative savings failed.

Only where the minority members pose some threat to the interests of the scheme will the amendment be permissible. For example, there may be instances of greenmail in general meetings or the minority members may be in competition with the fund and be utilising information obtained in their capacity as members to benefit their outside

¹²⁶ Ibid, at 348. See 8.1.2 above. See also the earlier decisions of *Brown v British Abrasive Wheel Co Ltd* [1919] 1 Ch 290; *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154; *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd* [1920] 2 Ch 124; *Re Bugle Press Ltd* [1961] Ch 270; *Palazzo Corporation Pty Ltd v Hooper Bailie Industries Ltd* (1988) 14 ACLR 684. Compare *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154 and *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd* [1920] 2 Ch 124. In the former case, a compulsory transfer provision was expressly confined to shares held by members conducting competing businesses with the company, and was therefore proportionate to the detriment it was aimed at eliminating. In the latter case, on the other hand, the power was of a more general nature and was therefore found to be beyond the scope of the amendment power.
interests to the detriment of the scheme. Even then, the amendment must both only extend so far as necessary to eliminate that threat and satisfy the second limb of the test, being that it is 'fair and not oppressive to the minority'.

Statutory Elimination of the Minority

This restriction on the ability of majority members to eliminate minority interests by the insertion of an expropriation clause is particularly limiting in the context of managed investment schemes due to the lack of any statutory ability to eliminate minority interests. In respect of corporate takeovers, acquisition clauses in the constitution are by no means the only method of eliminating minority shareholders and obtaining absolute control of the general meeting. Majority company shareholders currently have the ability to remove minority members by virtue of three statutory processes, being namely:

- The power conferred on the majority to acquire outstanding shares in the bid class following a successful takeover bid.
- The power to acquire or cancel minority shares under a scheme of compromise or arrangement.
- A selective reduction of capital which cancels shares not held by the majority.

These mechanisms resolve the conflict between the majority and the property rights of the minority in favour of the majority shareholders, subject to certain safeguards on

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129 Section 701. Exercise of this power is subject to the following preconditions: s701(2).
- The offeror has made takeover offers and has become entitled to not less than 90% of the shares in the relevant class.
- Where the shares subject to the acquisition constitute less than 90% of the shares in the class, either 75% of offerees must have disposed of their shares to the offeror or 75% of the registered holders immediately prior to the serving of the Part A statement must not be registered holders one month after the end of the offer period.

Minority shareholders may seek a court order setting aside the acquisition where it can be shown that the acquisition is unfair: s701(6); Re Hoare & Co Ltd [1933] 1 All ER 105; Eddy v W R Carpenter Holdings Ltd (1985) 10 ACLR 316; Elkington v Vockbay Pty Ltd (1993) 10 ACSR 785. See also s414 which provides a similar power pursuant to a 'scheme' or 'contract', thereby applying to unregulated takeovers falling outside Chapter 6. Note that CLERB proposes to substantially rewrite the company takeover provisions. The proposals allow post-takeover acquisitions to proceed if accepted by votes representing 75% by value of the outstanding shares rather than 75% of the number of shareholders as currently required: CLERB, proposed s661A.

130 Sections 411-412. A cancellation and reduction scheme involves the cancellation of issued shares in the target company by way of reduction of capital, and may also involve a re-issue of new shares in the target company. Alternatively, a transfer scheme may provide for the acquisition by the offeror of minority interests for consideration. See for instance Re Savoy Hotel Ltd [1981] Ch 351 at 357. A scheme of arrangement requires court approval.

131 Part 2J.1. This would involve the cancellation of all issued shares not held by the offeror. Unlike the former s195, the current provisions do not require court approval for a selective reduction provided the following requirements are satisfied: s256B(1)
- The reduction is fair and reasonable to the shareholders as a whole.
- The reduction does not materially prejudice the company's capabilities to pay its creditors.
- The reduction is approved by shareholders.
- A special resolution of shareholders and a special resolution by those shareholders whose shares are to be cancelled (s256C(2)).
the entitlements of dissenting minority shareholders, such as high acceptance thresholds and requirements for full information to be provided to offerees. As they are regulated procedures sanctioned by Parliament, Gambotto does not apply.\(^{132}\)

In the takeover of a managed investment scheme, the offeror will not have the benefit of the above statutory procedures. Therefore, unless the scheme constitution contained a compulsory acquisition provision upon inception, the insertion of such a provision in the constitution is the only means by which a majority member may obtain absolute control in a takeover scenario. In comparison to the company situation, the limiting of this ability to insert an acquisition clause as a result of the Gambotto decision is all the more restricting in the managed investment scheme context. The balance between the interests of majority and minority scheme members is clearly in favour of the latter. On the other hand, the absence of the statutory regimes may be detrimental to scheme members, as they do not receive the benefits of the disclosure, time and equality requirements of the takeover provisions.\(^{133}\)

However, this position will change with respect to schemes listed on the ASX upon the enactment of CLERB, which proposes to apply the takeover provisions of the Corporations Law to listed managed investment schemes.\(^{134}\) As such, the compulsory acquisition provisions in Chapter 6A will be available in the event of a scheme takeover, providing the bidder with the ability to compulsorily acquire units in a bid class following a takeover bid where the bidder holds 90% of the units in that class and has acquired 75% of the units subject to the bid.\(^{135}\)

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132 See *Gambotto v WCP* (1995) 13 ACLC 342 at 349, where their Honours stated that allowing the importation of acquisition clauses into company constitutions would 'open the way to circumventing the protection which the Corporations Law gives to minorities who resist compromises, amalgamations and reconstructions, schemes of arrangement and takeover offers'. It necessarily follows from this that the standards discussed in the *Gambotto* decision are not applicable to these statutory regimes, such as when the court is exercising its jurisdiction to approve a scheme of arrangement under s411. However, see the Report by the Legal Committee on Compulsory Acquisitions (January 1996) at 7-10 which states that Gambotto may have adverse implications to the application of the statutory regimes. Given the above, this is unlikely to be the position. Similarly, see Department of Treasury, *Corporate Law Economic Reform Program Proposals For Reform: Paper No.4 – Takeovers*, 1997 at 27, n48. See also Renard I, 'The Implications of Gambotto for Takeovers: A Comment' in Ramsay I (ed), *Gambotto v WCP Ltd: Its Implications for Corporate Regulation*, University of Melbourne, 1996 at 76, where it is argued that although the Gambotto decision is not directly applicable to the legislation, the decision indicates that the High Court is now more likely than earlier courts to refuse compulsory acquisitions where there is less than full disclosure, indicating a change in the court’s basic philosophical approach to compulsory acquisitions.


134 Proposed s604(1), s660B. This adopts the recommendation by the Wallis inquiry that takeover provisions should apply to unit trusts: *Financial Systems Inquiry Final Report*, March 1997, Recommendation 87. The reasons given for the provisions only applying to *listed* schemes is that listed schemes are less likely to provide a redemption facility, the units therefore trading at the market value and providing an incentive for bidders to pay a premium over market price for undervalued units. Unlisted schemes, on the other hand, provide a disincentive for bidders to pay a price above the value for which units can be redeemed, being based on the value of the underlying scheme assets rather than the market value of the unit: Department of Treasury, *Corporate Law Economic Reform Program: Commentary on Draft Provisions*, 1998 at 107.

135 Proposed s661A. Minority members may apply to the court to prevent the acquisition on the basis that the consideration is not fair value for the units: s661E. As well as a right of acquisition, the Bill
Part C - Amendments by Scheme Members

CLERB further provides for the compulsory acquisitions of minority interests irrespective of whether it follows a takeover bid. Where a person holds 90% of the units in a class, either alone or with a related corporation, those units may be compulsorily acquired.\(^{136}\) The bidder must issue a notice to members containing various stipulated information,\(^ {137}\) as well as an independent expert valuation on the consideration provided for the units.\(^ {138}\) Where at least 10% of scheme members subject to the acquisition object, the acquisition cannot be conducted unless court approval is obtained.\(^ {139}\) In determining whether to approve an acquisition where there is dissatisfaction amongst members, the court must be satisfied that a fair value is being offered for the units.\(^ {140}\) The proposed compulsory acquisition procedure is expressly intended to overcome the limitations resulting from the Gambotto decision.\(^ {141}\)

Therefore, the application of the Gambotto decision to managed investment schemes places a fundamental restriction on the ability of majority members to obtain absolute control. However, the enactment of CLERB will provide members holding majority interests alternative means by which to move to a 100% interest, both within and outside a scheme takeover scenario.

9.2 Removal of Exclusion of Members’ Liability

This section is concerned with the validity of constitutional amendments which seek to remove a provision limiting or excluding the personal liability of scheme members.

Personal Liability of Scheme Members

Trustees are liable as principals for any debts or other liabilities incurred in the operation and management of the trust.\(^ {142}\) Depending on the terms of the trust deed, however, the trustee will have a right of indemnity exercisable as against the scheme property for any liability incurred in the proper administration of the trust.\(^ {143}\) This right of indemnity extends beyond the trust property and is enforceable against the beneficiaries in their personal capacity where the property is insufficient to meet the

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\(^{136}\) Proposed s664A.

\(^{137}\) Proposed s664C.

\(^{138}\) Proposed s667A. The Bill provides a means of determining the fair value of scheme units: Proposed s667C.

\(^{139}\) Proposed s664E.

\(^{140}\) Proposed s664F. Note that the Bill requires persons to inform the responsible entity where they begin to have a substantial holdings in a scheme, or where their interests move by at least 1% where they already have a substantial holding: s671B.

\(^{141}\) Department of Treasury, Corporate Law Economic Reform Program Proposals For Reform: Paper No.4 - Takeovers, 1997 at 27.

\(^{142}\) Re Johnson (1880) 15 Ch D 548 at 552; Vacuum Oil v Wiltshire (1945) 72 CLR 319 at 324

\(^{143}\) Bennett v Wyndham (1862) 4 DeC&J 259; 45 ER 1183; Re Raybould [1900] 1 Ch 199; Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 at 371. The trustee holds a charge or right of lien over the scheme assets in order to enforce the right of indemnity: Vacuum Oil Co Pty Ltd v Wiltshire (1945) 72 CLR 319.
liability. Furthermore, in the event of the insolvency of the trustee, creditors may subrogate to the trustee’s right of indemnity. The result is that scheme members are burdened with potentially unlimited liability for the debts of the scheme. This may be compared to the company shareholder whose liability is limited to the amounts, if any, unpaid on shares.

As beneficiaries under a trust, one would assume these principles apply equally to scheme members. However, it could be argued that they are not applicable to managed investment schemes. In Wise v Perpetual Trustee Co it was held that trustees in an unincorporated association only had a right of indemnity against the trust property and not personally against members. In discussing the right of indemnity, Lord Lindley stated:

...this principle by no means applies to all trusts, and it cannot be applied to cases in which the nature of the transaction excludes it. Clubs are associations of a peculiar nature. They are societies the members of which are perpetually changing. They are not partnerships; they are not associations for gain; and the feature which distinguishes them from other societies is that no member as such becomes liable to pay to the funds of the society or to anyone else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member. It is upon this fundamental condition, not usually expressed but understood by everyone, that clubs are formed; and this distinguishing feature has been often judicially recognised.

As with clubs, managed investment schemes have a perpetually changing membership. Furthermore, it could also be argued that members have an expectation based on the commercial nature of the scheme as a passive investment that they will not be liable for amounts beyond their contributions. However, it is submitted that this exception to the right of indemnity in clubs is not applicable to managed investment schemes, as it is primarily founded on the fact that clubs do not operate for a profit. The trustee’s right of indemnity finds its justification on the basis that as beneficiaries obtain the benefits of the trust property, they should equally bear the burden. As members of non-profit organisations do not obtain financial benefit from their membership, they are not imposed with the financial burden beyond their contributions. Managed investment schemes, on the other hand, are commercial enterprises, scheme membership being primarily a source of financial benefit. Scheme members should therefore be under an obligation to indemnify the responsible entity

144 Hardoon v Belilios [1901] AC 118; J.W.Broomhead (Vic) Pty Ltd (in Lig) v J.W.Broomhead Pty Ltd [1985] VR 891. The personal indemnity arises where the trustee incurs the liability by acting within the scope of its powers and for the benefit of the beneficiaries. Only where the trustee need not have incurred the liability and has acted outside the scope of its powers in doing so will it be necessary to show that the beneficiaries authorised or ratified the action: Hardoon v Belilios, supra, at 124-125 per Lord Lindley.

145 Re Johnson (1880) 15 Ch D 548; Re Blundell (1889) 44 Ch D 1; Re Frith (1902) 1 Ch 342; Vacuum Oil Pty Ltd v Wiltshire (1945) 72 CLR 319; McLean v Burns Philip Trustee Co Pty Ltd (1988) ACLR 926 at 939.

146 See s9 definition of ‘company limited by shares’.

147 [1903] AC 139.

148 Ibid, at 149.


150 Hardoon v Belilios [1901] AC 118 at 123 per Lord Lindley.
for debts and liabilities incurred where such debts cannot be satisfied from the scheme property.\(^\text{151}\)

The position has been changed somewhat with the enactment of the MIA. The ALRC/CSAC proposals found unlimited liability 'unsatisfactory for public investment vehicles’, proposing that the liability of members should be limited to any unpaid amounts of their contributions.\(^\text{152}\) This proposal was not implemented. The MIA does, however, result in liability being limited in the absence of constitutional provisions to the contrary. Section 601GA(2) provides that any right of indemnity from scheme property for liabilities and expenses incurred by the responsible entity must be specified in the scheme constitution. In the absence of such a provision, the responsible entity will have no recourse against the property.\(^\text{153}\) As the right of indemnity against members is reliant on the right against the trust property being insufficient, this provision also has the effect of excluding the responsible entity’s right of recourse against members directly in the absence of an express power in the scheme constitution.

However, one would assume that the majority of, if not all, managed investment schemes will provide for a right of indemnity against scheme property, as otherwise creditors’ rights will be limited to recourse against the responsible entity company.\(^\text{154}\) Where the right of indemnity against scheme property is granted, there will also be a correlating right to be indemnified by members where the property is inadequate to satisfy the liability.

\(^{151}\) The trustee’s right of indemnity was held to apply to a private unit trust with four beneficiaries in J.W.Broomhead (Vic) Pty Ltd (in Liq) v J.W.Broomhead Pty Ltd [1985] VR 891. The right was also applied to larger trusts in McLean v Burns Philp Trustee Co Pty Ltd (1988) ACLR 926 and Poignand v NZI Securities Australia Ltd (1992) 109 ALR 213 at 221 per Gummow J. The ALRC/CSAC also assumed the right of indemnity applied: ALRC/CSAC Vol 1 at 130. Compare Quindo Pty Ltd v Queensland and Drilling Ltd, Supreme Court of Western Australia, unreported, 26 September 1989. See Ford H A J, 'Public Unit Trusts', in Austin R P & Vann R (eds), The Law of Public Company Finance, Law Book Company, 1986 at 417, where Professor Ford argues that where promotional material such as the scheme prospectus suggests that members are only hazarding the value of their investments, an estoppel against the right of indemnity may exist. Sin argues the right of indemnity does not apply to a unit trust while it is a going concern, the rule in Hardoon v Belilos being limited to bare trusts where the trustee has no function to perform other than to transfer the property to the beneficiaries on demand: Sin K F, The Legal Nature of the Unit Trust, Clarendon Press Oxford, 1997 at 178-184. However, this argument does not limit the personal liability of unitholders for debts upon the winding up of the scheme.

\(^{152}\) ALRC/CSAC Vol 1 at 130.

\(^{153}\) A contrary argument could be that only ‘agreements or arrangements’ which purport to provide a right of indemnity will have no effect, based on the limiting effect of the second paragraph of s601GA(2). As the general law right of indemnity cannot be properly characterised as an ‘agreement or arrangement’, it is not excluded by the provision, the responsible entity merely being in breach of s601GC for not complying with the content requirements of the constitution. This argument is supported by Hanrahan: Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 36-37; Australian Corporations and Securities Law Reporter, CCH, Vol 2 at [184-100]. However, it is submitted that the better view is that the second paragraph of the provision does not in any way limit the operation of the primary requirement. If there is no express right conferred by the constitution, the responsible entity does not have any right to be indemnified out of scheme property.

\(^{154}\) Note that it would be common for financing contracts by the responsible entity on behalf of the scheme to only provide the creditors with limited recourse against the scheme assets, and not the responsible entity personally.
A provision in the scheme constitution can exclude or limit the responsible entity's right of indemnity against scheme members.\(^\text{195}\) This places the scheme member in a similar position to the company shareholder, being personally liable only to the extent of his or her contribution to the company or scheme. For all concerned, the scheme gains the characteristic of limited liability. Therefore, in relation to managed investment schemes, limited liability is achieved by the inclusion of both:

- A provision providing the responsible entity a right to be indemnified from scheme property for liabilities properly incurred in the performance of its duties and operation of the scheme.
- A provision excluding the right of indemnity against scheme members personally when the scheme property is insufficient to satisfy the liabilities.

**Removal of Liability Exclusion Provisions**

The issue at hand is whether, after a member joins a scheme, the constitution may be amended in order to remove a liability exclusion clause contained in the constitution at the time of formation of the scheme. Amendments to company constitutions which increase the liability of shareholders to contribute to share capital or otherwise require them to pay money to the company are not binding on members unless individually agreed to in writing.\(^\text{196}\) There is no equivalent statutory restraint on amendments to scheme constitutions. It must therefore be queried whether the general law provides adequate protection to members.

It must first be queried whether the *proper purpose* test in *Gambotto* must be satisfied. The test was stated to apply where an amendment purports to expropriate valuable proprietary rights attaching to a member's interest. If the test applies to the amendment at hand, it will be *prima facie* invalid unless it is justified on the basis of preventing some detriment to members. Therefore, the issue is whether the removal of the exclusion clause involves the expropriation of a *right*.

A *right* may be defined as an interest or expectation which is recognised and guaranteed by the law.\(^\text{197}\) However, the amendment at hand does not involve the removal of a *right* as such, but rather the imposition of an *obligation*. Rather than removing a right from members, the amendment vests a new right in the responsible entity, being the right of indemnity, and imposes a correlating obligation on members to satisfy that right. It is submitted that this distinction is semantic rather than substantive. Legal relationships involve both rights vested in one party and correlating

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\(^1\) *Hardoon v Belilos* [1901] AC 118 at 127 per Lord Lindley; *McLean v Burns Philp Trustee Co Pty Ltd* (1988) ACLR 926. In England, Schedule 1 of the *Financial Services (Regulated Schemes) Regulations* 1991 (UK) requires authorised unit trust deeds to contain a clause limiting unitholder liability. No such clause is required under Australian law. See Ford H A J & Hardingham I J, "Trading Trusts: Rights and Liabilities of Beneficiaries", in Finn P D (ed), *Equity and Commercial Relationships*, Law Book Company, 1987 at 83-84 who question the desirability of allowing commercial associations to obtain limited liability without state sanction. Note that exclusion clauses cannot operate if used for a fraudulent purpose, such as to enable persons to avoid creditors, or excludes liability for negligence or breach of trust: *McLean v Burns Philp Trustee Co Ltd*, supra, at 940 per Young J.

\(^2\) *McLean v Burns Philp Trustee Co Ltd*, supra, at 83-84.

duties imposed on the other. The former is merely the ability to enforce the latter. In the case at hand, the law states that an amendment cannot remove a right which a member currently holds unless it is for a proper purpose. An amendment which imposes an obligation on a member which currently does not exist, thereby vesting a new right in the responsible entity, deserves the same level of protection. The amendment must therefore comply with the proper purpose requirement.

Following from the above, an amendment purporting to remove a liability exclusion clause is *prima facie* invalid unless it is shown that the amendment is aimed at preventing some detriment to the scheme. The scenarios in which one can envisage this onus of proof being satisfied are limited. The amendment may be justified on the basis that it may allow the scheme to increase its gearing, as financing is more likely to be obtained where creditors have a right to subrogate to the responsible entity's right of indemnity against members. Where the continuing operation of the scheme is dependant on financing being provided, the removal of the limited liability clause may be characterised as preventing a detriment.

Similarly, it may be justified on the basis that it would not be feasible for the responsible entity to continue operating the scheme where the scheme's liabilities are at a level where they cannot be satisfied by the scheme assets. In such cases, it may be argued that removing the limited liability clause and allowing the scheme to continue as a going concern rather than winding up is in the best interests of members.

However, these grounds would seem tenuous and unless the onus is satisfied the purported amendment will be invalid. What is more likely is that the amendment will be characterised as being for the purpose of benefiting the responsible entity by ensuring it is not liable personally for the debts of the scheme.

9.3 Amendments Affecting the Responsible Entity

To this point, constitutional amendments have been examined from the perspective of the protection of members, either from abuse by the responsible entity or by members holding majority or controlling interests. The final amendment which is examined is one which either imposes further obligations or removes existing rights from the responsible entity.

Assuming they hold the required interest, scheme members may arguably initiate an amendment by requesting a general meeting be held in order to consider the required resolution. In its draft legislation, the ALRC/CSAC proposed that amendments by members' resolution would not take effect unless accepted by the responsible entity in writing under seal. The justification given was as follows:

The Review considers that an operator should not be required to administer provisions with which it does not agree and which were not part of the original constitution.

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158 See 7.1.1 above. However, see Hanrahan P, *Managed Investment Law*, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 64.
159 Section 183A(1)(b) *Collective Investment Schemes Bill 1995* in ALRC/CSAC Vol 1 at 115.
160 ALRC/CSAC Vol 1 at 112.
The proposal is not reflected in the MIA as enacted. Provided a special resolution is obtained, the constitution can be amended by scheme members without the consent of the responsible entity. This poses the question of whether amendments can be imposed on the responsible entity which increase its obligations, limit rights originally vested in it by the constitution, or in some other way affect its ability to operate the scheme. For instance, the following amendments may be sought:

- Increasing the duties owed by the responsible entity to scheme members, such as an increase in the degree of care and diligence.
- Limiting the responsible entity's right to recover fees or be indemnified out of scheme property.
- Excluding the responsible entity's right of indemnity against scheme members by introducing a limited liability clause.

The company law cases explored above at 8.1 and applied to managed investment schemes concern the protection of the rights of shareholders when faced with constitutional amendments. For instance, Gambotto provides protection for shareholders when faced with an expropriation of their proprietary rights. While they may be applied to assist members in managed investment schemes, these decisions do not assist in protecting the rights of the responsible entity. However, it is submitted that the same approach must be adopted when a court is reviewing an amendment which infringes on the legitimate rights of the responsible entity. The following points can be offered in support of this proposition.

First, as already discussed, unlike traditional trusts for the disposition of property, managed investment schemes are formed by virtue of the mutuality between the parties. A contract exists between the responsible entity and scheme members. The scheme represents not only the financial investment of scheme members, but also the business enterprise of the responsible entity. The responsible entity is the entrepreneur and operator of the scheme. Hanrahan observes that s601FB(1) appears to both require the responsible entity to operate the scheme, as well as conferring a power on it to do so. In this respect, the office of the responsible entity is a source of valuable rights. Unlike directors who have no proprietary interest in the management of the company, merely being subject to their stated tenure in accordance with the company constitution, the responsible entity has a proprietary interest in the management and operation of the scheme. As such, it is not only members but also the responsible entity who obtains valuable rights by virtue of the Act, the constitution, and the rules of equity. This being the case, the legitimate rights and interests of the responsible entity must be subject to judicial protection.

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161 Section 601GC(1)(a).
162 Duties contained in the scheme constitution will have statutory force by virtue of s601FC(1)(m).
163 Section 601GA(2).
164 Being the reverse of the situation explored above at 9.2.
165 See 4.2.2 above.
166 Parkes Management Ltd v Perpetual Trustee Co Ltd (1977) 3 ACLR 303, discussed above at 4.2.2.
167 Section 601FB(1).
168 Hanrahan P, Managed Investment Law, Centre for Corporate Law and Securities Regulation and CCH Australia Ltd, 1998 at 66.
169 See Parkes Management Ltd v Perpetual Trustee, supra, at 310-311.
170 However, this management right is by no means indefeasible, being subject to the right vested in members to remove the responsible entity from its office under s601FM(1).
Secondly, it was established above\(^{171}\) that the amendment power must be characterised in order to give *reasonable* and *practical* effect to the scheme in a manner which is most consistent with the balance of power struck by the Act and the scheme constitution. The responsible entity is responsible for managing the scheme and is vested with various rights, duties and obligations in its performance. Members are unable to direct the responsible entity in the exercise of its powers.\(^{172}\) It would undermine this internal management structure if members were provided with a power to fundamentally alter the nature of the responsible entity’s office, either by imposing further duties and obligations or eliminating rights originally held. Therefore, it is submitted that the protection afforded to minority members when faced with a constitutional amendment by a members’ resolution must also be available to the responsible entity. The amendment power must be exercised for a proper purpose. An amendment which purports to remove a valuable right which was vested in the responsible entity upon the formation of the scheme, such as its right of indemnity from either the scheme property or against members personally, will be invalid unless justified in terms of the prevention of some detriment to the members as a whole. This similarly applies to the imposition of further duties and obligations which did not exist upon the inception of the scheme. Such amendments are *prima facie* invalid unless it can be shown that they are necessary in order to prevent some detriment to the scheme.

**Should the MIA be Amended?**

Although the management interests of the responsible entity are protected to some extent by the general law, it may be queried whether such protection is adequate, particularly given the fact that the legislature may not have intended to provide members with an ability to instigate constitutional amendments. Relying on the general law results in the scope of members’ ability to instigate amendments being somewhat uncertain. Although unlikely to be exercised in practice, such an ability does pose a threat to the legitimate expectations of the responsible entity.\(^{173}\)

Two legislative alternatives may be offered. *First*, the ALRC/CSAC proposals may be adopted,\(^{174}\) requiring the responsible entity to consent to amendments made by members. In exercising its right of consent, the responsible entity would be imposed with its various trustee and fiduciary obligations, requiring it to consider the interests of members and not merely its own position. *Alternatively*, assuming it is correct that the power was not intended by legislature to extend to amendments proposed by members, this may be expressly stated in the legislation, thereby reserving the power of amendment by way of members’ resolution as a veto mechanism.

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\(^{171}\) See 4.2.2 above.

\(^{172}\) *Re Higginbottom* [1892] 3 Ch 132; *Re Brockband* [1948] Ch 206.

\(^{173}\) Although no more a threat that the power vested in members to call a meeting to consider whether the responsible entity should be removed: s601FM(1).

\(^{174}\) See 7.1.1 above.
10. Comparison with the Company Shareholder

The various restraints placed on both scheme members and the responsible entity upon exercising the constitutional amendment power have been explored. This final chapter compares the level of protection afforded to scheme members by virtue of these restraints with the position of company shareholders. As the power to amend the company constitution is limited to a special resolution of shareholders in a general meeting, this comparison can only be made in the context of amendments by scheme members and not amendments by the responsible entity.

A major premise of this thesis is that when reviewing exercises of power in managed investment schemes, courts may obtain guidance from the company law approaches to reviewing exercises of power by both company directors and majority shareholders. The importation of the company law decisions and doctrines is based upon both the common historical foundations of the company and the unit trust, as well as the analogous nature of the two legal institutions from a functional and commercial perspective. As was noted in the introduction to this thesis, one means by which the adequacy of the restraints placed on the participants in managed investment schemes is evaluated is by means of a comparison with the company law position. Therefore, as well as providing a source from which doctrinal direction may be sought, the company also provides a benchmark by which the adequacy of those principles may be judged. The basis of this comparison is illustrated by the justifications provided in the CLERB proposals for applying the company takeover provisions to unit trusts:

- Entities which perform substantially the same role should prima facie be subject to similar regulation. This will enhance regulatory neutrality and increase market efficiency. At one level public companies and managed investment schemes perform different functions. The vast bulk of major public companies are vehicles for business enterprises, while managed investment schemes are usually vehicles for the pooling of funds for passive investment activities. However, the reverse is also true for many companies and schemes...from an investor's perspective there is little difference between holding units in a scheme or shares in a company. Although a unit is legally different from a share, the rights attached to units often approximate the rights attached to shares. Both unitholders and shareholders have the power to amend their trust deeds or articles of association respectively. Unitholders are often in a similar commercial position to shareholders with respect to returns on their investment. In addition, the management of a scheme is usually conducted by the manager in a fashion which is closely analogous to the management of a company by its directors. The manager and trustee usually owes fiduciary duties to the unitholders under the

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1 See 5.1.3 and 8.2 respectively.
2 See 2.2 above.
3 See 1.3 above.
4 The other means of evaluating the adequacy of the restraints is by means of application of the law to various selected restraints, conducted in Ch 6 and Ch 10 above.
5 Department of Treasury, Corporate Law Economic Reform Program Proposals For Reform: Paper No.4 - Takeovers, 1997 at 40-41. See also AF & ME Pty Ltd v Aveling (1994) 14 ACSR 499 at 524 where Heerey J stated: 'Listed unit trusts and listed company shares are, as a matter of commercial reality, closely analogous to one another not withstanding their conceptual legal differences'.

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scheme's trust deed, which are similar to the duties owed by company directors to the company.

A comparative analysis of the relative protection afforded to both scheme members and shareholders upon amendments to the constitution of the relevant vehicle is conducted by way of a discussion of the various statutory restraints placed on corporate constitutional amendments which are not available in the managed investment scheme context. The first section of this chapter briefly discusses the legal nature of the corporate constitution, comparing it to the constitution in managed investment schemes (10.1). This is followed by a discussion of the constitutional amendment power in company law and the various statutory restraints placed on that power (10.2). These restraints are analysed in order to determine whether they provide company shareholders with additional protection which is not available to scheme members.

10.1 The Company Constitution

The company constitution is comparable, but not identical to the constitution utilised by managed investment schemes, essentially performing the same function of governing the internal relations between the various organs of the entity. Furthermore, as explored in Chapter 2, the constitution in both the company and the managed investment schemes share a common historical origin in the deed of settlement.

10.1.1 The Section 140 Contract

The internal management of a company is governed by both the constitution and the provisions of the Act which apply as replaceable rules.\(^6\) In order to ensure the constitutive provisions are binding on members who join the company after its formation, the Act deems the constitution and replaceable rules of a company to have the effect of a contract under which each party agrees to be bound by the provisions.\(^7\) The contract is between the following parties:

- the company and each member.
- the company and each director and company secretary.
- members and each other member.

This reveals the first distinction between the scheme and the company constitution. In companies, shareholders are in a contractual relationship with each other and can enforce the constitutional contract laterally as between each other. In managed investment schemes this is arguably not the case, the Act only requiring that the scheme constitutions be binding between members and the responsible entity, and not between scheme members inter se.\(^8\) As such, scheme members are not privy to the constitutive contract and cannot enforce undertakings against each other.\(^9\)

\(^6\) Section 134. The constitution may displace or modify the replaceable rules: s135(2).
\(^7\) Section 140(1).
\(^8\) Section 601GB. See 3.2.1 above.
\(^9\) See Smith v Anderson (1880) 15 Ch D 247 at 274 per James LJ; AF & ME Pty Ltd v Aveling (1994) 14 ACSR 499 at 519-522 per Heerey J. However, it has been found in unit trusts that the manager may be held as trustee of the contractual promises of unitholders for the benefit of other unitholders:
There are further differences between the company and scheme constitution, the most obvious being that the scheme constitution provides the terms of a trust relationship while the company constitution does not. Furthermore, while the provisions of the legislation relevant to managed investment schemes requires the constitution to be legally binding, a company constitution is deemed to be contractual in nature by virtue of the legislation and is not reliant on an independent binding contract.

A further difference relates to the consequences flowing from a breach of the relevant constitution. Section 135(3) provides that failure to comply with the replaceable rules is not in itself a breach of the Act. In contrast, the responsible entity in a managed investment scheme has a statutory obligation to comply with any duties stipulated in the constitution which are not inconsistent with the Act. Furthermore, where it can be shown that an officer of the responsible entity failed to take steps that a reasonable person would take in order to ensure the responsible entity complies with the constitution, a breach of s601FD(1)(f)(iii) results. These provisions have the effect of giving the scheme constitution indirect statutory force, breach of which may lead to civil penalty or criminal sanction.

Although being deemed a contract, certain peculiarities arise with respect to the company constitution which result in it being different from other private agreements. These provide further distinctions between the scheme and company constitution, being namely:

- While scheme members have direct standing to enforce the terms of the scheme constitution, shareholders are restrained by virtue of the rule in *Foss v Harbottle*.

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*West Merchant Bank v Rural & Agricultural Management Ltd* CLS 1996 NSWSC CA 45, 4 April 1996. It could further be argued that a multipartite contract does in fact exist between scheme members based on the contract law decision of *Clarke v Dunraven* (1897) AC 59. See also *Rayfield v Hands* [1960] 1 Ch 1; *Re Caratti Holding Co Pty Ltd* (1975) 1 ACLR 87. This is supported by the obiter observations of Handley JA in *Elkinson v Moore Business Systems Australia Ltd* (1994) 15 ACSR 292 at 296. See further Sin K F, *The Legal Nature of the Unit Trust*, Clarendon Press Oxford, 1997 at 90; Sin K F, 'Enforcing the Unit Trust Deed Amongst Unitholders' (1997) 15 CSLJ 108.

*West Merchant Bank v Rural & Agricultural Management Ltd* CLS 1996 NSWSC CA 45, 4 April 1996.

*Foss v Harbottle* [1843] 2 Hare 461; 67 ER 189. The rule provides an obstacle confronting members when seeking to enforce the terms of the constitution, subject to certain stated exceptions: *Edwards v Halliwell* [1950] 2 All ER 1,064 at 1,067 per Jenkins LJ; Ford H A J, Austin R P & Ramsay I M, *Ford’s Principles of Corporations Law*, 9th Edition, Butterworths, 1997 at 514-517. Stated simply, where a breach of the constitution is characterised as a wrong against the company rather than the member, the company itself is the proper plaintiff for the action and individual members are denied standing. Furthermore, where the majority of members can ratify the conduct complained of, standing is also denied to individual dissenting members. Therefore, shareholders have no personal general right to have the business conducted in accordance with the constitution: *Stanham v National Trust of Australia (NSW)* (1989) 15 ACLR 87. They are prevented from enforcing certain rights provided by the constitution where the rights are characterised as corporate rather than personal, unless the situation falls under one of the stated exceptions or the conduct is oppressive or unfairly prejudicial under s246AA: see 10.2.2(c) below. Furthermore, there has been a lack of consistency by the courts in drawing the line between personal and corporate rights: *Residue Treatment and Trading Co Ltd v Southern Resources Ltd* (1988) 51 SASR 177 at 202 per King CJ. See generally Hanrahan P, ‘Distinguishing Corporate and Personal Claims in Australian Company Litigation’ (1997) 15 CSLJ 21; Boros E J, *Minority Shareholders’ Remedies*, Clarendon Press Oxford, 1995 at 188; Egert G A.
• The statutory contract is enforceable as against company officers while the scheme constitution is not binding on the officers of the responsible entity.

• Damages are not available against the company for breach of the statutory contract.

• Unlike a scheme constitution, the courts will not rectify the statutory contract.

Irrespective of these doctrinal divergences, however, it is clear that the company and the scheme constitution satisfy the same function, being the regulation of the internal management of the relevant entity.

The Legal Effect of the Memorandum and Articles of Association of a Company after the introduction of the Companies and Securities Legislation (Miscellaneous Amendments) Act 1985 (1987) 3 QITLJ 45 at 55-56. This restriction is not applicable to managed investment schemes, where each individual member has standing against the responsible entity as both a contractual party to the constitution and a beneficiary under the trust. The underlying justification behind Foss v Harbottle, being that the company is a separate legal entity and is therefore the proper plaintiff to commence action for harm against it, is not present in a scheme. Furthermore, scheme members have no means of ratifying a breach of the constitution by the responsible entity by a mere majority due to the individual standing of dissenting members: see 5.4.1 above. Note that CLERB will provide shareholders with a statutory derivative action, allowing members with leave of the court to commence or join an action on behalf of the company: CLERB, Part 2F.1A.

Section 140(1)(b); Jones v Money Mining NL (1995) 17 ACSR 531.

Bath v Standard Land Co Ltd [1911] 1 Ch 618; Hurley v BGH Nominees Pty Ltd (1982) 1 ACLC 387 at 390 per King CJ; ASC v AS Nominees Ltd (1995) 18 ACSR 459 at 475-6 per Finn J. However, the directors may be found to be trustees de son tort, thereby being responsible for a breach of trust by the responsible entity: Barnes v Addy (1874) LR 9 Ch App 244 at 251-252 per Lord Selborne LC; ASC v AS Nominees Ltd, supra, at 476 per Finn J; Ford H A J & Hardingham 1 J, ‘Trading Trusts: Rights and Liabilities of Beneficiaries’, in Finn P D (ed), Equity and Commercial Relationships, Law Book Company, 1987 at 58-68. A member may also seek injunctive relief against the actions of officers of the responsible entity by virtue of s1324(1). Furthermore, under the MIA, officers of the responsible entity are under a fiduciary-like obligation to act in the best interests of scheme members: s601FD(1). They are also under an obligation to take all steps a reasonable person would take to ensure the responsible entity complies with the constitution: s601FD(1)(f)(iii). See generally Hanrahan P, ‘Managed Investment Schemes: The Position of Directors under Chapter 5C of the Corporations Law’ (1999) 17 CSLJ 67.

Houldsworth v City of Glasgow Bank (1880) 5 App Cas 317; State of Victoria v Hodgson (1992) 2 VR 613; Webb Distributors (Aust) Pty Ltd v The State of Victoria (1993) 179 CLR 15. Compare Ardlethan Options Ltd v Easdown (1915) 20 CLR 285. The restriction on damages arguably only applies where the company is in liquidation, where the rule has received statutory recognition in s563A, which acts to postpone the ranking of debts owed to members to debts of outside parties. With respect to managed investment schemes, a suit for damages will be against the responsible entity rather than the fund. If the responsible entity has a right of indemnity, entitling it to draw on the fund in order to satisfy a claim against it, an action by a scheme member for breach of the constitution would be entrenching on the capital available to members and creditors, and Houldsworth v City of Glasgow Bank would arguably apply. However, this is unlikely to be the case, as a right of indemnity only operates in respect of liabilities incurred in the proper performance of the trustee’s duties, the trustee being disbarred from indemnification where there is a breach of trust relating to the subject matter of the indemnity: s601GA(2); Vacuum Oil Co Pty Ltd v Wiltshire (1945) 72 CLR 319; Corozo Pty Ltd v Total Australia Ltd [1987] 2 Qd R 11.

Scott v Frank F Scott (London) Ltd [1940] Ch 794; Santos Ltd v Pettingell (1979) 4 ACLR 110.
10.2 Amendments to the Company Constitution

10.2.1 Source of the Power

The Act states that the company constitution can be modified or repealed by a special resolution of shareholders.\(^9\) Therefore, amendments may be instigated in a similar manner to scheme amendments by a members' resolution.\(^9\) However, while the responsible entity is granted the power to amend the scheme constitution unilaterally in certain circumstances, no such power is afforded to company directors, being the functionally equivalent organ to the responsible entity. The company constitution can, however, provide directors with such a power.

As with the scheme constitution,\(^21\) the company constitution may (arguably) provide for a less onerous means by which an amendment may be effected. Furthermore, in relation to contractual restraints, the Act provides that the company constitution may impose further requirements before an amendment may be made.\(^22\) Hence, unlike the scheme constitution,\(^23\) the company constitution may contain a provision limiting the power of amendment.

10.2.2 Restraints on the Power

The power of amendment vested in shareholders is subject to various statutory restraints, being namely the:

(a) Specific statutory restraint in s140(2).
(b) The class rights provisions.
(c) The statutory oppression remedy.

These restraints are not imposed on amendments in managed investment schemes. It must therefore be queried whether their absence has any ramifications in terms of investor protection upon amendments to the scheme constitution. Each restraint will be considered in turn.

(a) Section 140(2) Restraints

Certain modifications are not binding on company members without their consent if made after they became members, being modifications which either:\(^24\)

- require shareholders to take up additional shares.
- increase the liability of shareholders to contribute to the share capital, or otherwise pay money to the company.
- impose or increase restrictions on the transfer of shares already held by the member.\(^25\)

\(^9\) Section 136(2).
\(^9\) Section 601GC(1)(a).
\(^21\) See 7.1.2 above.
\(^22\) Section 136(3).
\(^23\) See 7.2.2 above.
\(^24\) Section 140(2).
These restrictions are not applicable to managed investment schemes. However, it is submitted that their absence is of little consequence as these amendments are likely to be struck-down under general equitable restraints. For instance, an amendment removing a liability exclusion clause and thereby requiring members to pay money to the scheme was found to be prima facie invalid.\(^\text{26}\) Following from this, irrespective of the absence of the direct statutory restraint, amendments requiring scheme members to pay additional money to the scheme or take up additional units would be likely to be invalid under the \textit{proper purpose} requirement. Furthermore, an amendment removing members' withdrawal rights was also found to be invalid.\(^\text{27}\) Amendments restricting or removing unit transfer rights would similarly be struck-down for being an action for an improper purpose.

\textbf{(b) Class Rights}

Where an amendment to the company constitution varies or cancels rights attached to classes of shares, the \textit{class rights} provisions require that a special resolution of members in that class be obtained.\(^\text{28}\) Furthermore, where a resolution is passed and 10% of members in that class object to the alteration, they may apply to the court to have the amendment set aside on the basis that it is unfairly prejudicial to the applicants.\(^\text{29}\) In order to fall under the definition of 'class', a category of shares need not be specifically referred to as a separate class in the constitution, provided those shares have distinguishable rights and benefits attaching to them.\(^\text{30}\)

These provisions provide a source of additional protection for minority shareholders where those shareholders belong to a particular class. This is illustrated by the \textit{Allen v Gold Reefs} decision, discussed above.\(^\text{31}\) On the facts of that decision, the English Court of Appeal held that an amendment purporting to extend a lien to fully paid-up shares was within the scope of the power, irrespective of the fact that it was directed at affecting the rights of one particular shareholder. No \textit{fraud on the minority} was committed. However, partly paid-up shares may be considered a different class to fully paid-up shares.\(^\text{32}\) This being the case, under the present law the amendment would have to comply with the class rights provisions, requiring the consent of the

\(^{25}\) Except in the circumstances where the company is changing from a private to a public company, or where it is introducing a takeover approval provision under s671: s140(2)(c)(i), (ii).

\(^{26}\) See 9.2 above.

\(^{27}\) See 6.2 above.

\(^{28}\) Section 246B. Alternatively, written consent of 75% of the members in that class can be obtained rather than a special resolution: s246B(2)(d). Where the constitution provides a further procedure for the variation or cancellation of class rights, that procedure must be complied with and can only be altered if the procedure itself is satisfied: s246B(1).

\(^{29}\) Section 246D. The amendment takes effect one month after the amending resolution if no application is made to the court: s246D(3). Where there is unanimous consent from members in the affected class, the amendment takes effect upon the passing of the resolution: s246E.

\(^{30}\) \textit{Clements Marshall Consolidated Ltd v ENTLtdimS}) 13 ACLR 90 at 93 per Neasey J.

\(^{31}\) [1900] 1 Ch 656. See 8.1.2 above.

\(^{32}\) Support for this proposition may be found in \textit{Re Campaign Holdings Pty Ltd} (1989) 15 ACLR 762 at 765 per Fullagar J, although that case concerned court approval for a reduction of capital rather than class rights. See also \textit{ASX Listing Rule} 6.2 which prohibits listed entities from having more than one class of ordinary securities unless 'the additional class is of partly paid securities which, if fully paid, would be in the same class as the ordinary securities', thereby implicitly recognising that partly paid securities may constitute a separate class. However, see Ford H A J, Austin R P & Ramsay I M, \textit{Ford's Principles of Corporations Law}, 9th Edition, Butterworths, 1999 at 503-504.
shareholder to which the purported amendment was directed. A similar observation can be made with respect to the Peters' American Delicacy decision, involving the variation of rights between fully and partly paid-up shareholders. As such, the statutory class rights provisions provide a further protection to shareholders when faced with an alteration or extinguishment of their rights which goes over and above the protection provided by the general law.

The class rights provisions do not apply to managed investment schemes. However, as already discussed, the scheme constitution may incorporate class right restrictions by way of a constitutional provision by virtue of ASIC Class Order 98/60. Therefore, while the protection is not provided to scheme members per se, it may be provided by the scheme constitution, either by the inclusion of provisions providing similar restraints to constitutional amendments, or by the incorporation of the legislative provisions mutatis mutandis. Furthermore, both the statutory and equitable law duty of impartiality imposed on the responsible entity will temper the absence of direct statutory class rights provisions.

A final issue relates to whether an incorporated class right provision can be removed from the scheme constitution by special resolution, or whether the procedure established in those provisions would first need to be satisfied before it can be removed. In the case of corporations, the Act stipulates the latter. No such provision applies to managed investment schemes. However, it is submitted that the class rights procedures would need to be complied with irrespective of the absence of specific legislative sanction. The right to vote at a resolution of a specific class of members when an alteration of class rights is proposed is a class right in itself, derived from the provisions of the scheme constitution. The removal of the provisions providing that right, therefore, is an alteration or extinguishment of class rights, and can only be effected by satisfying the procedures established in those provisions, such as a resolution of members in the affected classes.

(c) Oppression

Shareholders are provided with a statutory recourse in the case of oppressive or unfairly prejudicial conduct in the operation of the company. Section 246AA provides individual shareholders standing where either the affairs of the company generally or a specific act, omission or resolution is shown to be oppressive, unfairly prejudicial to, or unfairly discriminatory against a member or members, or contrary to

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33 (1939) 61 CLR 457. See 8.1.2 above.
34 See 4.3.2 above.
35 It would not be possible, however, to provide members with a right to apply to the court for an order that the amendment is unfairly prejudicial, as is provided to shareholders in s246D(1), as this is a matter of jurisdiction and can only be conferred by the legislature. The absence of a direct statutory recourse for unfairly prejudicial actions is discussed immediately below at 10.2.3.
36 See 5.3.3 above.
37 Section 246B(1).
38 The statutory oppression remedy has been utilised in a wide range of situations, including breach of an agreement, misappropriation of assets, excessive remuneration, improper share issues, and exclusion from management: Ramsay, I, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 ABLR 23 at 29.
39 For the definition of 'affairs of the company', see s53. See also Australian Securities Commission v Lucas (1992) 7 ACSR 676.
the interests of members as a whole. The grounds stipulated in s246AA do not provide separate grounds for relief, but are rather different aspects of the one essential criteria, being 'commercial unfairness', as discussed by Richardson J in Thomas v H.W.Thomas Ltd.40

The three expressions overlap, each in a sense helps to explain the other, and read together they reflect the underlying concern of the subsection that conduct of the company which is unjustly detrimental to any member of the company whatever form it takes and whether it adversely affects all members alike or discriminates against some only is a legitimate foundation for complaint.

The court has the power to issue any order as it thinks fit,41 including the winding up of the company, an order regulating the affairs of the company in the future,42 an order requiring the purchase of the aggrieved member’s shares,43 or any other order requiring a person to do a specific act or thing. Bringing an action under the statutory remedy therefore provides shareholders with a wide source of remedies and not merely an injunction or declaration that the action is invalid, as is the case under the general law.

While previously interpreted narrowly,44 the statutory oppression remedy is wide in its scope and application, the courts interpreting the provisions broadly and in a flexible manner.45 The provision extends the grounds upon which the courts may intervene, resulting in a greater ability for the courts to review commercial decisions of directors.46 As a result, the statutory oppression remedy has accommodated cases and situations which would previously have attracted the fraud on the minority doctrine. In this vein, the authors of Ford’s Principles of Corporations Law state:47

The consequence of such broad framing is that the statutory remedies are overtaking the equitable remedies. In particular standing is generally more easily satisfied and the court generally has power to order an indemnity for costs. Furthermore, the courts have shown a willingness to interpret some of these statutory remedies broadly: eg the oppression remedy.


41 Compare the proposed CLERB provisions which stipulate that conduct must be either contrary to the interests of members as a whole or oppressive, unfairly prejudicial or discriminatory: CLERB, s232.


43 Compare the proposed CLERB provisions which stipulate that conduct must be either contrary to the interests of members as a whole or oppressive, unfairly prejudicial or discriminatory: CLERB, s232.

44 See for instance Roberts v Walters Developments Pty Ltd (No 2) (1992) 10 ACLC 1734.

45 Prior to the 1983 amendment which incorporated the reference to ‘unfair prejudice’, the provision was interpreted narrowly as requiring actual illegality or invasion of legal rights, lack of probity, or behaviour which was ‘burdensome, harsh or wrongful’: Scottish Co-Operative Wholesale Society Ltd v Meyer [1959] AC 324; Re Jermyn Street Turkish Baths Ltd [1971] 1 WLR 1042; Re Broadcasting Station 2GB [1964-65] NSWR 1648; Re Bright Pine Mills Pty Ltd [1969] WR 1002.

46 See Wayde v NSW Rugby League Ltd (1985) 10 ACLR 87 at 94 per Brennan J who observes that the remedy ‘extends the grounds for curial intervention’.

As with the other statutory restraints already discussed, the oppression remedy is not applicable to managed investment schemes. The ALRC/CSAC recommended that scheme members be provided a right to apply for an order under a provision based on the company oppression remedy.\(^4^8\) Irrespective of wide support from public submissions, the recommendation is not reflected in the current law. The result is that a fundamental statutory recourse which has now become the predominant source of minority and individual investor protection in corporations is not available to scheme members.\(^4^9\) However, it is submitted that the absence of an oppression remedy will not be detrimental to scheme member protection in a constitutional amendment situation. The following three points are offered in support of this proposition and are discussed in turn:

(i) The substantive distinction between the general law and the statutory restraints has narrowed since the Gambotto decision.

(ii) The applicability of the statutory oppression remedy to large managed investment schemes will be narrow.

(iii) Scheme members may seek to have the scheme wound up on just and equitable grounds as an alternative to a statutory oppression remedy.

\(^{i}\) The Convergence of the Two Restraints

Although originally distinguishable based on the nature of the investigation, the doctrine of fraud on the minority and the oppression remedy are converging as a result of the Gambotto decision. The primary distinction between the two actions is that with respect to the oppression remedy, the courts are concerned with the objective impact or consequence of the impugned conduct upon the petitioning member, ie, whether it is oppressive or unfairly prejudicial.\(^5^0\) It is a question of the commercial fairness of the action, judged objectively by way of a commercial bystander test.\(^5^1\) The subjective knowledge of the persons exercising the power is not in issue, except to the extent that the reasonable bystander is assumed to have any special skills or knowledge held by the shareholder.\(^5^2\) As a result, the fact that the action was taken in good faith and for a proper purpose does not exclude a claim by an aggrieved member, provided the action was unfair, oppressive or prejudicial in its consequences on the petitioning shareholder.\(^5^3\) No lack of probity or dishonest motive, purpose or

\(^{4^8}\) ALRC/CSAC Vol 1 at 127. The proposal is reflected in s260AQ Collective Investment Schemes Bill 1995.

\(^{4^9}\) Professor Ramsay has observed that there is evidence that the statutory oppression remedy ‘is one of the most widely-used corporate law remedies available to shareholders of Australian companies’: Ramsay, I, ‘An Empirical Study of the Use of the Oppression Remedy’ (1999) 27 ABLR 23 at 23.

\(^{5^0}\) Re M Dalley & Co Pty Ltd (1968) 1 ACLR 489; Re R.A.Noble & Sons (Clothing) Ltd [1983] BCLC 273; Re Sam Weller & Sons Ltd [1990] Ch 682. See Shears v Phosphate Co-operative Co of Australia Ltd (1988) 14 ACLR 747 which involved a petition against a resolution amending the articles of a company where the action was brought both under the oppression remedy and fraud on the minority.

\(^{5^1}\) Morgan v 45 Flers Ave Pty Ltd (1986) 10 ACLR 692; Wayde v NSW Rugby League Ltd (1985) 10 ACLR 87 at 95 per Brennan J.

\(^{5^2}\) Wayde v NSW Rugby League Ltd (1985) 10 ACLR 87 at 96 per Brennan J.

\(^{5^3}\) Explanatory Memorandum to the Companies and Securities Legislation (Miscellaneous Amendments) Bill 1983, para 482.
intention need be proved. In this vein, Brennan J stated in *Wayde v NSW Rugby League Ltd* in the context of actions by directors:^4^ Nevertheless, if directors exercise a power – albeit in good faith and for a purpose within the power – so as to impose a disadvantage, disability or burden on a member that, according to ordinary standards or reasonableness and fair dealing is unfair, the court may intervene under [s246A]... The operation of [s246A] may be attracted to a decision made by directors which is made in good faith for a purpose within the directors’ powers but which reasonable directors would think to be unfair.

Under the general law doctrine of *fraud on the minority*, on the other hand, an analysis of the *subjective* belief by the persons exercising the action as to the effect the action will have on the company is undertaken. As a result, the oppression remedy is wider and more interventionist, actions being objectionable even where they are made for a proper purpose and within the scope of the power, resulting in standing to complain of an action which would not otherwise be objectionable under the general law. In this sense, the statutory remedy enlarges the substantive rights previously available at general law.^5^

However, as a result of the Gambotto decision, the investigation with regard to *fraud on the minority* has shifted to an *objective* determination, involving an analysis of whether the action is ‘fair and not oppressive to the minority’. As such, where an action is taken which is made both in good faith and for a proper purpose, the action may still be objectionable under the general law where it is unfair or oppressive to minority shareholders. Even though based on the general law, the language used by the High Court indicates a blurring of the distinction between the statutory and the general law actions. The result is a convergence of the two causes of action. While the oppression remedy has subsumed those cases which would have ordinarily been brought under the general law restraint, the general law doctrine has widened in its scope, resulting in a doctrine of equal standing to its statutory equivalent. This point is illustrated by the following observations by Dr Boros:^6^ The shift to a proper purpose test represents a departure from the essentially subjective nature of the ‘*bona fide* for the benefit of the company’ test. As such, Gambotto’s case appears to bring the grounds for challenging an alteration to the articles at common law closer to those which would apply under the statutory remedy against oppressive or unfairly prejudicial conduct.

^4^ *Wayde v NSW Rugby League Ltd* (1985) 10 ACLR 87 at 96 per Brennan J. See also *Residue Treatment and Trading Co Ltd v Southern Resources Ltd (No.2)* (1989) 7 ACLC 1,130 at 1,153.

^5^ See 8.1.2 above.

^6^ A further distinction between the two actions is that the oppression remedy requires the court to consider whether the cumulative effect of the company’s conduct is oppressive or unfairly prejudicial, rather than there being a need for a single action to be improper: *ASC v Multiple Sclerosis Society of Tasmania* (1993) 10 ACSR 489; Boros E J, *Minority Shareholders’ Remedies*, Clarendon Press Oxford, 1995 at 138. However, as we are presently concerned with exercises of specific powers and not the general conduct of the company or scheme, this distinction is not relevant.

^7^ See Boros, supra, at 226-227 who argues that *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 would have been decided differently if brought under the statutory remedy.


^9^ Mitchell V, ‘The High Court and Minority Shareholders’ (1995) 7(2) Bond LR 58 at 58

Part C - Amendments by Scheme Members

The assimilation of the two tests results in the absence of the oppression remedy for managed investment schemes being less significant in terms of comparative protection of scheme members and company shareholders. The legislative gap is filled by the willingness of courts of equity to review actions, both of a fiduciary and non-fiduciary nature, to ensure no abuse of power is committed. The detriment caused by the absence of the statutory remedy in terms of scheme member protection is thereby diminished substantially.

(ii) Application to Large Schemes

The instances where the statutory oppression remedy has been brought in a listed public company are few. In fact, the recommendations which led to the original enactment of the oppression remedy in the United Kingdom were restricted to private companies. The limited application to public companies is primarily due to the reluctance of courts to provide a remedy where the aggrieved shareholder has the option to exit the company through the secondary market. For instance, in relation to the just and equitable grounds for winding up, Smith J of the Victorian Supreme Court has stated:

It would seem to be true...that in the case of a public company the rule will commonly be excluded if the petitioner is a shareholder and he is able to sell his shares at a reasonable price, for he then has no need to seek the aid of the Court to extricate his investment.

Whilst there have been petitions brought for oppression and unfair prejudice in listed companies, it can nonetheless be said that the remedy is primarily relied on in cases of proprietary companies and small family quasi-partnerships. This is illustrated by the fact that the most common relief ordered under s246AA (and its precursors) is an order for the purchase of the shares of the petitioner, a remedy which is of no utility in a public company where investment is liquid. In public companies, as a result of the high cost associated with litigation, it would be more common that shareholders would relinquish their membership by selling the holdings on the stock exchange rather than commence proceedings where they are dissatisfied with the management or actions of the company. In this regard, Hill states:

...the impact which oppressive or unfair conduct has upon a minority shareholder may be more dramatic and potentially damaging in a close

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61 See Stapledon G P, 'Use of the Oppression Provision in Listed Companies in Australia and the United Kingdom' (1993) 67 ALJ 575. Upon surveying decided cases involving the statutory oppression remedy in Australia, Professor Ramsay has observed that almost 75% of the cases involved private companies, whilst 45% involved companies with five or less members: Ramsay, I, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 ABLR 23 at 27.


Part C - Amendments by Scheme Members

corporation context. In a public company, most conduct by management which might be labelled oppressive will result in damage, through, for example decrease in dividends or share value, distributed equally between shareholders. Damage to any particular shareholder will be further diluted by the fact that the shareholder is likely to have diversified by investing in shares in other companies. Also, a shareholder dissatisfied with management decisions in a public company has a swift and effective means of exit from the company through sale of shares on an active market...The position may be very different in a close corporation.

Managed investment schemes are more analogous to public companies than small proprietary companies. The number of investors is large and fluid. Furthermore, scheme members are likely to have a means of relinquishing their membership, either by virtue of a redemption provision, or via the secondary markets where the scheme is listed with the ASX. As such, the utility of a statutory oppression remedy will be limited.

(iii) Winding Up on Just and Equitable Grounds

Although no equivalent to s246AA is available to members in a managed investment scheme, they may still have standing to seek a winding up order on the same grounds which would provide standing under such a remedy. Individual members have standing to apply to the court for a winding up order where such an order is *just and equitable*. A similar ground is available to company shareholders, although the scope of operation of the ground has diminished in recent times due to the development of the statutory oppression provision. In particular, the cases which previously would have resulted in a winding up order have been subsumed by the oppression action due to the wider range of less extreme remedies available to the courts.

As scheme members have standing to seek a winding up order, but are not provided with an oppression remedy, it is therefore arguable that a winding up order would be available under the *just and equitable* basis upon factors which would otherwise have justified an order under the oppression remedy if it were available. As such, scheme

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67 Section 601ND.
69 *Re J.E.Cade & Sons Ltd* [1992] BCLC 213 at 233-234 per Warner J; Boros E J, *Minority Shareholders' Remedies*, Clarendon Press, Oxford, 1995 at 166-167. However, Professor Ramsay has observed that one third of cases surveyed involving the oppression remedy also pleaded s461(k). The reason for this is that s467(4) provides that the court will not issue a winding up order where other remedies are available and the plaintiff is acting unreasonably in not pursuing those other remedies: Ramsay, I, 'An Empirical Study of the Use of the Oppression Remedy' *(1999)* 27 ABLR 23 at 26.
70 *Re Norvabron Pty Ltd* (No 2) [1986] 11 ACLR 279; *Re Dalkeith Investments Pty Ltd* [1984] 9 ACLR 247 at 25; *Morgan v 45 Flers Avenue Pty Ltd* [1986] 10 ACLR 692.
71 The same considerations are relevant in a determination for *just and equitable* winding up and the oppression remedy: *Re Norvabron Pty Ltd* [1987] 5 ACLC 184 at 214 per Derrington J; *Re Dalkeith Investments Pty Ltd* [1985] 3 ACLC 74 at 80 per McPherson J. Note that s461(1)(f) & (g) provide companies with specific grounds for winding up upon oppressive or unfairly prejudicial conduct, thereby reproducing the grounds for the oppression remedy. However, it is submitted that actions which would ordinarily fall under these specific provisions would be actionable under the *just and equitable* ground in the case of managed investment schemes, the specific oppression and unfair prejudice grounds not being available to members.
Part C - Amendments by Scheme Members

members are not without a remedy in such circumstances. However, as with the oppression remedy, a winding up order will be unlikely where members have the ability to sell their interests, either by a public listing or a redemption facility.72

The result of the above is that the absence of a statutory oppression remedy does not result in scheme members being left without a means of redress. In company law, the oppression remedy is an important means by which shareholders can obtain locus standi where otherwise the action would be blocked by the rule of Foss v Harbottle.73

In managed investment schemes, where members have direct standing against the responsible entity by virtue of their position as beneficiary, this advantage does not apply. Although not detrimental, the absence of a statutory oppression provision does, however, provide certain disadvantages to aggrieved scheme members. First, the scope of remedies available to scheme members upon an oppressive exercise of the amendment power by a resolution of scheme members is limited. Self-help remedies, such as exit through the secondary market or a redemption facility may be available. Furthermore, injunctive or declaratory relief may be sought by virtue of the doctrine of fraud on the minority, or an action seeking a winding-up order may be pursued. Where the scheme remains a going concern, a winding up order may be drastic and not suitable in the circumstances, acting to the detriment of other members in the scheme. The less extreme remedies available to shareholders by virtue of s246AA(2) are not available to scheme members, such as an order that the affairs of the company be conducted in a specific way in the future.74 As such, the introduction of a provision based on s246AA, although not being crucial, will nonetheless increase the remedies available to aggrieved minority scheme members.

Secondly, the general law doctrine of fraud on the minority, though increasing in its scope, still lacks certainty. To this end, the observations of Jacobs J in Crump ton v Morr ine Hall Pty Ltd seem fitting:75

It seems to me that the truth is that the courts in each generation or in each decade have set a line up to which shareholders have been allowed to go in affecting the rights of other shareholders by alteration of Articles of Association, and beyond which they have not been allowed to go. It seems to me that no amount of legal analysis or analytical reasoning can conceal the fact that the decision has in the past turned, and must turn ultimately, on a value judgement formed in respect of the conduct of the majority - a

72 However, see Re William Brooks & Co Ltd [1962] NSWR 142 where a winding up order was issued to a public company where the misconduct of the majority had suppressed the share trading price.

73 (1843) 2 Hare 461; 67 ER 189. Section 246AA(2)(f) allows the court to order that either the company commence proceedings or authorise the petitioning member to commence proceedings on behalf of the company, thereby circumventing the rule in Foss v Harbottle. Note that Part 2F.1A of the CLERB proposes to provide shareholders with an ability to commence proceedings on behalf of the company when certain preconditions are met.

74 Section 246AA(2)(d). For a survey of the most common relief sought under the statutory oppression remedy, see Ramsay, I, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 ABLR 23 at 28. Professor Ramsay observes that while 37.5% of the cases surveyed involved parties seeking to have the company wound up, in only 4% of the cases were courts willing to issue a winding up order. The most common relief granted was an order that the company purchase the petitioner's shares.

75 [1965] NSWR 240 at 244.
judgment formed not by any strict process of reasoning or bare principle of law but upon the view taken of the conduct.

Although the courts have also swayed in their interpretation of the statutory oppression remedy, the remedy does provides greater predictability of the outcome of actions. As such, while the absence of the oppression remedy is by no means detrimental to the protection of members, it does impose certain limitations in terms of the certainty and remedial consequence of minority actions upon injurious exercises of the constitutional amendment power by a majority of scheme members.

* * *

I conclude that the absence of the various statutory restraints on amendments to the scheme constitution are by no means detrimental to the level of protection afforded to scheme members. The specific restrictions on company amendments in s140(2) only express what would otherwise be the case upon a claim under the general law. Furthermore, while the class rights provisions do create an additional source of protective rights to company shareholders, they may be incorporated into the scheme constitution, thereby providing scheme members with equal opportunity to have their rights and interests protected. Finally, although the absence of the statutory oppression remedy creates remedial limitations and requires reliance on the less predictive general law, scheme members may nonetheless seek injunctive and declaratory relief, as well as petition for the winding up of the scheme when faced with amendments which would ordinarily fall within the statutory remedy. The result is that comparable, although not equal protection is afforded to both scheme members and company shareholders upon constitutional amendments by members' resolution.
11. Conclusions

Two objectives were identified at the commencement of this thesis: first, the identification of the appropriate law to be applied upon judicial review of the constitutional amendment power in a managed investment scheme, and secondly, the determination of whether the applicable law is adequate in protecting the rights and interests of the participants in a managed investment scheme. The following conclusions can be offered with respect to these objectives.

Identification of the Appropriate Law

In order to identify the appropriate law, a rights based perspective of the managed investment scheme has been adopted. As a vehicle utilised for passive collective investment, members forego their right of management of their contribution. In consideration for relinquishing control of their funds, they receive a bundle of valuable rights derived from the Corporations Law, the scheme constitution, and the law of trusts and fiduciary obligations.

The scheme constitution may be amended either unilaterally by the responsible entity, or by a special resolution of scheme members. As the constitution provides both the source of contractual rights, as well as the means by which the incidents of trust and fiduciary obligations are moulded in order to accommodate the commercial nature of the scheme, amendments to the constitution may therefore extinguish or alter the contractual and equitable rights which members obtain upon acquiring an interest in the scheme. Members’ rights are therefore subject to the actions of both the responsible entity and other members who hold a majority or controlling interest in the scheme. Furthermore, as it may be possible for members to utilise their right to requisition a meeting in order to propose an amendment to be considered by that meeting, the responsible entity may also be subject to the actions of a majority of members.

As the amendment power has the potential to infringe on valuable rights, it is not unfettered. As with the rights in which it may affect, the restraints on the power are derived from various sources, namely legislation, contract and equity. In relation to statutory restraints, the responsible entity must reasonably consider that a proposed amendment will not adversely affect members’ rights before an amendment may be instigated. No correlative statutory restraints are placed on scheme members upon exercising the power. The scheme constitution may provide further restraints on the power by incorporating class rights provisions similar to those found in the Corporations Law.

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1 1.3 above.
2 Ch 3 above.
3 4.1 and 7.1 respectively.
4 7.1.1 above.
5 4.3.1 above.
6 7.2.1 above.
7 4.3.2 and 7.2.2 respectively.
Conclusions

Equity provides further protection to participants in managed investment schemes by imposing various duties on parties exercising the amendment power. In this regard, the common historical derivation and analogous commercial nature of the company and the managed investment scheme provides a fertile doctrinal source for the identification of the appropriate approach to be taken by the courts. In relation to the responsible entity, it is under an obligation to exercise its powers for a proper purpose. Importation of company law decisions relating to exercises of power by company directors provide assistance in this regard, requiring courts to adopt a less stringent and more commercial approach to reviewing actions. Further equitable restraints placed on the responsible entity are drawn from its position as trustee of the scheme assets, such as the requirement that it act in the best interests of scheme members and treat them impartially. These duties are both reinforced and to some extent modified by the provisions of the MIA.

As well as affecting the balance of power between scheme members and the responsible entity, constitutional amendment may also involve conflicts between scheme members inter se. Although not subject to direct statutory restraints or fiduciary law, amendments by members' resolution are similarly open to judicial review based on equitable obligations drawn from a company law context, being the requirement that the amendment not involve a fraud on the minority.

As such, the appropriate law in reviewing exercises of the constitutional amendment power is drawn from and emphasises the interplay between a wide array of sources, reflecting the nature of the managed investment scheme as a legal vehicle which is sui generis. As well as direct statutory and constitutional restraints, the duties imposed by equity are derived from the law applicable to other bodies performing analogous roles, both fiduciary and non-fiduciary. These include company directors and shareholders, traditional trustees and donees of powers of appointment. These restraints attempt to strike a balance between the need for the responsible entity to have the ability to efficiently operate the scheme, and the rights of members to commence petitions upon an abuse of power.

The Adequacy of the Restraints

The second objective of this thesis is to evaluate the adequacy of the applicable restraints. Given the doctrinal nature of the analysis conducted, the effectiveness of such an evaluation is limited. The criteria for their adequacy can, however, be identified. The managed investment scheme is a commercial entity, established in order to pool resources for investment purposes. Members cannot have excessive opportunity to interfere with either the management of the scheme by the responsible entity, nor the decisions made by the majority. Majority opportunism cannot be replaced with minority opportunism. To do so would be to the commercial detriment of the scheme. Alterations to the scheme constitution are essential in order for the scheme to adapt to the changing commercial environment, and as such, the amendment power cannot be unduly fettered. But upon this stands one proviso: those exercising the power cannot abuse their position to the detriment of other participants in the scheme.

8 5.1 above.
9 5.3 above.
10 Ch 8 above.
Given the above limitations, the adequacy of the law has been evaluated in two regards. The first approach involved the application of the restraints to various selected amendments which may be passed by either the responsible entity or scheme members. It was concluded that when applied to these selected amendments, being particularly harsh in nature in terms of their effect on the rights of participants, the restraints placed on the amendment power offered sufficient protection to both aggrieved members and the responsible entity. To this may be added one proviso: assuming scheme members are vested with a power to introduce amendments to be considered by a members’ meeting, the general law restraints imposed on members may be inadequate in protecting the legitimate management rights of the responsible entity.

The second method involved the adequacy of the law being judged by way of a comparison with the protection afforded to company shareholders, based on the common commercial and economic nature of companies and schemes from the perspective of investors. This involved an analysis as to whether the additional statutory protection provided to shareholders results in a greater level of protection as compared with their managed investment scheme counterparts. It was concluded that the absence of these statutory restraints in managed investment schemes is not detrimental to scheme members, as the legislative void is adequately filled by the various equitable duties and obligations applicable upon exercises of the amendment power. However, the absence of the statutory provisions, and in particular the absence of the statutory oppression remedy, does have ramifications in terms of the scope of applicable remedies available to complainants, as well as the certainty and predictability of the law. In this regard, while its absence is not pernicious, the application of the oppression remedy would assist in ensuring the legitimate interests of scheme members are adequately protected.

A conclusion that the law is adequate is difficult to make given the competing interests which must be balanced. Several alternatives may be offered in attempting to strike this balance. First, it may be possible to adopt the extreme position of prohibiting the application of constitutional amendments to scheme interests already acquired. However, this approach would be detrimental in terms of loss of flexibility, particularly given the commercial context within which the scheme operates. The scheme must have the capacity to adapt to the changing commercial and regulatory environment in which it participates in, an absolute restriction on constitutional amendments unduly fettering this capability. Secondly, amendments may be made subject to either court approval or approval from an administrative body such as ASIC. Once again, this approach would see the balance sway to the detriment of flexibility and would come at a cost – both private and public.

A third and more realistic option would be to retain the current reliance on equitable restraints, while increasing the statutory requirements for amendments. For instance,
the ALRC/CSAC proposals may be implemented into the current legislative framework, requiring amendments by the responsible entity to be only minor and to be vetoed by a members' resolution. Furthermore, amendments instigated by scheme members would require the written consent of the responsible entity, thereby circumventing the concerns expressed above. This approach may also involve the adoption of a statutory oppression remedy similar to the provision available to company shareholders, increasing the scope and flexibility of remedial orders available to participants upon petitioning to the courts. The increased statutory restraints would not, however, negate the need for supplementary equitable protection upon exercises of the power.

Whether this final option is necessary in order to ensure the legitimate rights and interests of participants are adequately protected is not open to speculation given the nature of this thesis. Research of a more positive and empirical nature is required in order to ascertain the nature of amendments commonly instigated, the rights and interests effected by such amendments, and the satisfaction of parties in terms of the protection afforded and remedial consequences of petitioning to the courts. Irrespective of this, it can be concluded that the appropriate balance is obtained by the imposition of both statutory and equitable restraints, the former providing predicability and certainty, while the latter offering flexibility upon applying the relevant law to an emerging and novel legal vehicle.

17 The inclusion of an oppression remedy for managed investment schemes was recommended by the ALRC/CSAC: s260AQ Collective Investment Scheme Bill 1995 in ALRC/CSAC Vol 2 at 152-154.
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