VOTING RIGHTS ON THE SALE OF SHARES

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The transfer of the equitable title in shares is a curiously neglected topic in company law.[1] The general rule is that the equitable title in shares passes, in respect of a specifically enforceable agreement of purchase and sale, on the conclusion of such contract.[2] This follows from the doctrine that 'equity looks upon that as done which ought to be done, and from the date of contract the purchaser becomes owner in the eyes of equity'.[3] The purchaser being entitled to call for the transfer of the shares in pursuance of the agreement, a constructive trust arises in his favour.[4] He does not, however, acquire an absolute interest; *Musselwhite v C H Musselwhite & Son Ltd*[5] decides that until payment is made the seller retains a lien over the shares and may exercise the voting rights which attach to the shares. Although strictly the contract is specifically enforceable at this point, it will not in fact be enforced until payment is tendered;[6] if this were not so, the unpaid vendor's lien would be unprotected.[7] Upon payment the purchaser's equitable title becomes absolute and it is well established that should registration of the transfer not be forthcoming, then the seller occupies the position of bare trustee.[8]

Against this background the decision of Holland J in *Kells Investments Pty Ltd v Industrial Equity Ltd*[9] is of much interest, for it suggests that the rule in *Musselwhite* is subject to qualification, and further holds that specific performance may be ordered in circumstances previously thought to preclude it. In *Kells* the shareholders of an oil exploration company named Expo Oil were given notice of an annual general meeting at which it was proposed to pass a special resolution for the voluntary winding up of the company. Subsequently the plaintiff K, an existing shareholder in Expo and with notice of the proposed resolution, bought 11 million shares in the company on the Sydney Stock Exchange from the second defendant P. P was controlled by the first defendant I, who favoured winding up, and claimed to be entitled to defer settlement until after the meeting some four weeks later, at which I intended to vote (through P) in favour of winding up. The shares were all bought on the same day but pursuant

1. For a recent discussion see this writer 'Transfer of the equitable title in shares: some guidelines' (1985) 6 *The Company Lawyer* 225.
2. *Oughtred v IRC* [1960] AC 206 (HL) at 240; *Wood Preservation Ltd v Prior* [1969] 1 All ER 364 (CA) at 366A; *Parway Estates Ltd v CIR*[1957] Tax Rep 329, [1958] Tax Rep 193 (CA); *Chinn v Hochstrasser, Chinn v Collins* [1977] 1 WLR 1337, [1979] Ch 447 (CA), reversed sub nom *Chinn v Collins* [1981] AC 533 (HL).
3. Megarry and Wade *The Law of Real Property* 5th ed (1984) at 602.
4. *Oughtred v IRC* [1960] AC 206 (HL) at 240; *Chinn v Hochstrasser, Chinn v Collins* [1979] Ch 447 (CA) at 461. The principle has been developed primarily in respect of land law (see *Lysaght v Edwards*(1876) 2 Ch D 449) but is equally applicable in respect of contracts for the sale of shares.
5. [1962] Ch 964; see too *Shaw v Foster* (1872) LR 5 HL.
6. *Chinn v Hochstrasser, Chinn v Collins* [1979] Ch 447 (CA) at 461.
7. *Langen & Wind Ltd v Bell* [1972] Ch 685.
8. *London Founders Association Ltd v Clarke* (1888) 20 QBD 576.
9. (1984) 9 ACLR 507 (Sup Ct of NSW).

to three separate bargains, and in respect of the third it was specifically agreed that settlement should not be made before the scheduled meeting. In the period before the meeting K offered to settle and tendered payment in respect of all three bargains, but this was refused. K then sought an order for specific performance and an order requiring the second defendant P to vote at the meeting in accordance with K's directions, ie to vote against winding up. The plaintiff was successful.

I. NATURE OF THE COMMUNITY PURCHASED.

First, Holland J held that a seller of shares before settlement may be restrained from voting for the winding up of the company contrary to the wishes of the purchaser. The effect of winding up would be that the purchaser obtains a quite different commodity from that which he intended to buy, viz shares in a going concern; accordingly Holland J considered that there should be implied a promise on the part of the seller that he will not vote for a resolution for winding up.[10] This should be implied even where the parties have agreed that settlement should not be made before the meeting at which the winding up resolution is to be proposed; it is only by an express term allowing the seller to vote for winding up that he should be permitted to do so.[11]

There are cases in which a court has refused to order performance of a contract for the purchase and sale of shares where winding up has intervened. In *Sullivan v Henderson*[12] the plaintiff claimed specific performance of a contract made in October 1968 in terms of which the defendant had agreed to purchase shares from him; the company was wound up before the action commenced. Megarry J refused specific performance. He accepted that the effect of s 227 of the Companies Act 1948[13] (which provides that in a winding up by the court any transfer of shares made after the commencement of the winding up shall be void unless the court orders otherwise) was to render a transfer subsequent to winding up void as against the company only,[14] but nevertheless considered that it would be inequitable to force upon a purchaser, who had agreed to take a fully effective transfer of the shares, a transfer which he could not enforce against the company. Similarly, in *re London Hamburg and Continental Exchange Bank (Emmerson's Case)*[15] the Court refused to order the purchaser of shares purchased after a petition for winding up had been presented to complete the transaction by obtaining registration and thereby becoming liable as a contributory; neither purchaser nor seller was aware at the time of sale of the petition. The basis of these decisions must be that shares in a going concern are quite a different matter to shares in a company which has been, or is about to be wound up, although the purchaser may well be liable for damages, as was in fact the case in *Sullivan.*It is a quite logical step to hold, as in *Kells*, that a seller of shares who subsequently brings about the winding up of the company is in breach and can be restrained from doing so.

[10] At 509.
[11] Ibid.
[12] [1973] 1 WLR 333.
[13] Now s 522 of the Companies Act 1985.
[14] Following *re Onward Building Society* [1891] 2 QB 463, especially at 475.
[15] (1866) 1 Ch App 433. 1

The difficulty is reconciling this conclusion with the practical point that the seller may well hold other shares in the company, and may even hold a sufficient majority without relying upon the shares which are the subject matter of the sale to put the company into liquidation. Surely it cannot be suggested that he can be restrained from using the votes attached to these other shares, which he owns legally and beneficially, to vote for winding up?

II. SPECIFIC PERFORMANCE

Second, Holland J held that where the purchaser of shares can show a right to specific performance of the contract, that could ground a claim in equity not only to prevent the seller from voting in favour of winding up, but positively to compel him to vote against it.[16] In the instant case Holland J thought that specific performance should be granted. On general principles specific performance will not be available to either purchaser or seller if damages constitute an adequate remedy,[17] as will be the case where the shares may be purchased or sold, as the case may be, on the market.[18] The report does not disclose what the issued share capital of Expo amounted to, but it can be accepted that a parcel of 11 million shares is so large that there would be no possibility of the purchaser being able to buy in; damages could therefore not have been an adequate remedy, and there was evidence that the shares were of special value to the purchaser by virtue of its optimistic view of the company's prospects.[19]

A more formidable obstacle to granting specific performance was the fact that the seller held more than 11 million shares, and had not appropriated specified shares to the contracts with the purchaser. Until the decision in *Kells* it has been accepted, without there being any recent authority cited, that if shares are at the time of contracting unascertained, then the contract becomes enforceable, and the equitable title in the shares passes, only upon there being appropriated to the contract specified shares.[20] In *Kells* Holland J recognised that the lack of appropriation of specified shares meant that the plaintiff K had not acquired the equitable title in any specific property, but went on to say:

"However, the [seller] does not deny but affirms the contracts and its intention to complete them by transferring from its holdings the number of shares sold to the plaintiff, but only after it has used their votes at the meeting. The [seller] for the purpose of giving specific performance of the contracts would be liable to be ordered to appropriate and deliver script and executed transfers of the requisite number of shares. In these circumstances I see no need to be able to identify in advance specific shares out of the total held by the [seller]

[16] Ibid.

[17] *Llewellin v Grossman* (1950) 83 Ll L Rep 462.

[18] *Duncruft v Albrecht* (1841) 12 Sim 189 (59 ER 1104) at 199; *re Schwabacher; Stern v Schwabacher; Koritschoner's Claim* (1908) 98 LT 127 at 128; *Dougan v Ley* (1946) 71 CLR 142 at 151; *R v Milne and Erleigh (7)* 1951 (1) SA 791 (A) at 873H; *Rudder v George Hudson Holdings Ltd* [1972] 1 NSWLR 529 at 535; *re Goode, Ex parte Mount*(1974) 4 ALR 579 at 591; *Chinn v Hochstrasser, Chinn v Collins* [1979] Ch 447 (CA) at 462.

[19] At 5

[20] *Pennington's Company Law* 5th ed (1985) at 404, citing *re London Hamburg and Continental Exchange Bank (Ward and Henry's Case)* (1867) 2 Ch App 431 at 438 ; Ford *Principles of Company Law* 4th ed (1985) at 253

[21] At 510.

for the purpose of making orders as to the manner of exercise of the number of votes to which the plaintiff would be entitled on completion."[22]

This, it might be thought, begs the question of whether specific performance could be ordered at all; in the circumstances, could the seller have been ordered to appropriate and deliver script and executed transfers in respect of the 11 million shares? The weight of authority (Holland J cited no cases in support of his view) suggests that he could not, for the reason that before appropriation the shares are unascertained.

The most recent authority is the case of *Chinn v Hochstrasser, Chinn v Collins*.[23] For the purpose of avoiding capital gains tax which would otherwise accrue on the settlement of certain shares, a scheme was devised to take advantage of the provision in the governing legislation whereby capital gains tax was not payable in the case of the beneficiary of a settlement being a foreign resident. Accordingly the settlement trustees appointed the shares in question to C (the person on whom it was intended that the shares should ultimately devolve) contingent on C's surviving the period of three days from the appointment. C then assigned his contingent interest in the shares to a foreign company and by a written contract agreed to purchase from that company an equivalent parcel of shares upon the beneficial interest vesting. At first instance Templeman J held that the scheme could not succeed on the ground that C, and not the intermediary company in whom it was intended the beneficial interest should vest, became absolutely entitled to the shares as against the trustees. However the Court of Appeal reversed this decision. Even if the contract of sale was a contract for the sale of specific shares (which it was held not to be), an order for specific performance of the contract could not have been obtained since the shares in question were listed and a remedy in damages would have been fully adequate. Consequently C did not acquire the beneficial ownership of the shares by virtue of the contract of sale; rather the equitable title vested in the intermediary company which being a foreign resident was not liable to capital gains tax. In the course of his judgment Buckley LJ said:

"If, as I think was the case, the share sale agreement was for the sale of unspecified shares, it would clearly not be liable to specific performance by a court and would not have conferred upon the taxpayer [C] any equitable interest".[24]

The Court of Appeal was itself overturned by the House of Lords, but not on any point which disturbs the authority of Buckley LJ's dictum. This is quite consistent with cases on the sale of goods, most particularly *re Wait*[25] in which the majority in the Court of Appeal held that a contract for the sale of 500 tons of wheat being part of a larger cargo was not susceptible of specific performance, not being 'specific or ascertained goods' within the meaning of s 52 of the Sale of Goods Act 1893.[26] However

[22] Ibid.

[23] [1977] 1 WLR 1337, [1979] Ch 447 (CA), reversed sub nom *Chinn v Collins* [1981] AC 533 (HL).

[24] At 460; see too Goff LJ at 467-468.

[25] [1927] 1 Ch 606.

[26] The corresponding provision in the New Zealand Sales of Goods Act 1908 is s 53 which states: "In an action for breach of contract to deliver specific or ascertained goods the Court may, if it thinks fit, on the application of the plaintiff, by its judgment direct that the contract shall be performed specifically, without giving the defendant the option of

re Wait is recognised to be an anomalous case,[27] and cracks in the edifice are gradually appearing. The decision in *Kells* is one of these; *Sky Petroleum Ltd v VIP Petroleum Ltd*[28] is another. In this last case Goulding J granted an injunction against the defendant to restrain it from withholding supplies of petrol which it was contractually bound to supply and where it would have been practically impossible for the plaintiff to obtain alternative supplies. The judge recognised that the effect was to enforce performance of the parties' contract, but nevertheless considered that the rule against specific performance of a contract for the sale and purchase of chattels not specific or ascertained did not apply. This was because, according to Goulding J, 'the ratio of the rule is that under the ordinary contract for the sale of non-specific goods, damages are a sufficient remedy'.[29] If this is indeed the true basis of the rule, and there is nothing in *re Wait* to suggest that it is not, then this distinguishes *Kells* from *Chinn*, for in this last case it was clear that damages would have sufficed.

The final contention of the seller against an order of specific performance was that the rules of the Sydney Stock Exchange made provision for certain remedies on default, and the purchaser, by buying on the Sydney Exchange, was contractually bound to have recourse to those remedies first. Holland J had little trouble in sweeping this objection aside:

"In the present case it is clear that as to the first two contracts the seller has deliberately defaulted. The defendants cannot take advantage of their own default to defeat the [purchaser's] claim for relief, but, in any event, the existence of a procedure under the rules for a buyer to obtain relief when a seller fails to deliver is not enough to exclude the jurisdiction of the court to grant its remedies where they will but the rules will not do justice between the parties in a particular case."[30]

III. Voting Rights

On the question of voting rights the defendants invoked the decision in *Musselwhite* as settling that the unpaid vendor may exercise the right to vote as he sees fit. In *Kells* Holland J distinguished the earlier decision on three grounds. First, the seller in the instant case was unpaid by his own choice and refused payment in order to frustrate the wishes of the purchaser; second, since the seller fully intended performing after the meeting had been held, it could not be said here that the seller wished to retain the right to vote in order to protect his interest; and third, the design of the seller was to injure the subject matter of the sale and the interests of the purchaser.[31]

There may be grounds for suggesting that *Musselwhite* is not only distinguishable but positively incorrect. The facts were that on 21 May 1958 the plaintiffs sold to the defendants a parcel of shares for 10 000

retaining the goods on payment of damages." Note that shares, while personal property (s 82 of the Companies Act 1955), do not constitute goods for the purpose of the Sale of Goods Act (s 2(1)); see generally *Colonial Bank v Whinney* (1886) 11 App Cas 426 (HL) at 434.

27 See for example Meagher Gummow and Lehane *Equity* 2nd ed (1984) at 183 et seq; Pollock (1927) 43 *LQR* 293.

28 [1974] 1 WLR 576.

29 At 578.

30 (1984) 9 ACLR 507 at 511.

31 Ibid.

pounds, and on being paid 2500 pounds delivered the relevant share certificates and duly executed transfer forms to the company's solicitors to be held by them until payment was made in full, and it was agreed between the parties that the balance of the purchase price was to be paid in instalments over a period of five years. Subsequently the company purported to hold its annual general meeting for the year ending 31 May 1958, without notice of the meeting being given to the plaintiffs who were still the registered holders of the shares. The plaintiffs then sued for a declaration that the meeting was a nullity for want of notice, and this was granted. For the defendants it was argued that by virtue of the equitable title in the shares having passed to themselves on conclusion of the agreement, the plaintiffs, the registered shareholders, were entitled to vote only at the direction of the equitable owners for whom the shares were held on trust; this being the case there could be no requirement of notice to the plaintiffs of the annual general meeting. For the plaintiffs it was said that the unpaid vendor was not in the position of a bare trustee; a feature of the unpaid vendor's lien is that he may vote as he wishes, subject only to the qualification that he will be liable to the purchaser if his action damages the subject matter of the contract. In essence, then, the question was whether the unpaid seller of shares has a prima facie right to decide how to vote, or whether the purchaser has a prima facie right to direct the seller how to vote.

Russell J decided in favour of the sellers' contention. The route to this conclusion, in the absence of any authority directly in point, traversed the position of the mortgagee of shares and that of the unpaid seller of land. In *Siemens Bros & Co Ltd v Burns, Burns v Siemens Brothers Dynamo Works Ltd*[32] it was held that the mortgagee of shares who obtains registration in his own name is entitled to exercise the voting rights attached to those shares as he pleases, without regard to any directions which may be given by the mortgagor. Swinfen Eady MR said:

> "In the ordinary way, where shares are transferred to and registered in the name of a mortgagee it follows, from his position as owner at law of the shares, that the ownership carries with it the voting right, that this is vested in the owner of the shares; and it would require a contract to exclude that right. Sometimes, where shares form a security, there is a contemporaneous collateral agreement as to the mode in which, and the extent to which, voting rights in respect of the shares shall be exercised. But in the absence of any such agreement the voting rights would be with the legal owners of the shares, and it would require a contract to control the exercise of those rights".[33]

Russell J decided that the position of the unpaid seller of shares was analogous to that of the mortgagee. Points of similarity were the following:

> "The purchaser acquires the beneficial interest subject to the vendor's lien; the mortgagor retains the beneficial interest subject to the charge in favour of the mortgagee, in the form of an equity of redemption. In the one case the mortgagee is deliberately put upon the register to safeguard his money lent: in the other case the vendor is deliberately left on the register until all is paid to safeguard his purchase-money due".[34]

Russell J concluded that 'so far as the exercise of voting powers is concerned, an unpaid vendor remaining on the register is not to be regarded

[32] [1918] 2 Ch 324 (CA).
[33] At 336.
[34] [1962] 1 Ch 964 at 987.

as in a weaker position than a mortgagee',[35] with the result that the unpaid seller of shares may vote as he pleases, except that he may not vote so as to damage the subject-matter of the contract.

While it is true that the position of the unpaid seller of shares occupies a position similar to that of the legal mortgagee of shares, the comparison does not hold in all respects. From the reasoning in *Siemens* it is apparent that the legal mortgagee's unfettered discretion as to voting is derived simply from the fact that he is the legal owner of the shares, one of the incidents of which is the right to vote. But this is not so in respect of the unpaid seller. His right to vote supposedly arises from his lien; it cannot arise merely from the fact that he occupies the position of legal owner. The right to vote is part of the very property which the purchaser has bought[36] and which the seller holds on trust for him. This being the case, it would be more logical if the unpaid seller were to exercise the right subject to the directions of the purchaser.

There is a distinction to be drawn with the unpaid seller in land law also. The seller of land, it is well established, is entitled to the fruits of the land for himself until the date of settlement, in the absence of any agreement to the contrary. If this were founded upon his lien for the purchase price or any part of it outstanding, then this would be a compelling argument for finding that the unpaid seller of shares could likewise take one of the fruits of the shares, viz the right to vote, for himself and would not hold it on trust for the purchaser. There are two reasons why this is not so. The first is that in land law the right to the fruits is independent of the seller's lien; and second, in the case of shares, it would have the consequence that the seller would be entitled not only to vote but also to any other fruits arising, such as dividends. There is not the slightest suggestion that this is the case, and although there is no case in point all the writers on company law agree that on the equitable title passing so too does the entitlement to dividends and other rights accruing.[37]

A curious feature of the judgment in *Kells* is that strictly *Musselwhite* need not have been distinguished at all. Notwithstanding that the contracts were in the view of Holland J specifically enforceable, the judge considered that the equitable title had not passed. Accordingly there was no constructive trust in favour of the purchaser, and no right in the purchaser to give directions as to how the seller should vote; in other words, *Musselwhite* applies only where there exists a separation of the equitable and legal titles, and in the instant case Holland J did not find that this had occurred. The conclusion must be that, of the different grounds advanced for holding the seller bound to vote against winding up, it is the first that is the most convincing: where the purchaser has bought shares in a going concern, then the seller must not act in relation to those particular shares in a way which affects them adversely.

[35] Ibid.

[36] Cf *re Wimbush, Richards v Wimbush* [1940] Ch 92 at 99: "What the purchaser agrees to buy is the shares with all the rights which those shares confer in respect of the capital of the company and in respect of the profit earned up to the date of the sale".

[37] See for example *Pennington's Company Law* 5th ed (1985) at 404.