MUTUAL FUNDS

This article is devoted principally to a discussion of what are in effect private superannuation funds investing in real estate. Institutions conducting this type of business have adopted the name Mutual Fund and this title will be used throughout in reference to them although their structure and operation is different from that of most institutions in other countries that carry on operations under that name. The underlying theme is one of investor protection and the suggestion will be made that our law could give more protection to the unsophisticated investor in large mutual investing schemes.

No suggestion whatsoever is made or intended to be made either expressly or by implication that any of these institutions involve illegal practices of any type. In order to expand the theme of this article it is necessary to discuss *potential* misbehaviour and mismanagement on the part of those concerned with the organisation and operation of these funds; no suggestion is made that any such behaviour or fault actually has occurred or is occurring.

By far the most prominent type of mutual fund appeared on our financial scene as recently as 1968. There were at least six of these institutions operating on a semi-national basis at the end of 1971. Also a National Association of Mutual Funds has been established.

The other type of "mutual fund" operating in New Zealand attempts to follow the original American mutual fund tradition of standing ready to buy and sell at any time its own shares directly to and from the investing public and offering their shareholders a proportionate interest in a diversified holding of shares in other companies. The number of shares held both in and by such funds fluctuates. American companies are free of course to buy and sell their own shares whereas ss. 75-80 of the Companies Act 1955 prohibit such activity here. In an attempt to avoid these restrictions the one company operating a fund along these lines has resorted to the use of an unlimited company structure. This is because such companies may reduce their capital with the impunity that is denied by statute to other types of companies. The right to do so lies in s. 25(d) of the Companies Act read together with the form set out in Table E of the Third Schedule to this Act. The latter contains a draft set of Articles of Association, cl. 3 of which states that "the [unlimited] company may by special resolution . . . (e) . . . reduce its share capital in any way."

While this might at first glance seem to provide this American type fund with the flexibility to issue and redeem shares at will which is necessary to its function, yet other provisions in the Companies Act have been both a deterrent to the development of this type of fund and a bulwark to their success. The deterrent lies in the fact that there seems to be no way these funds can issue and redeem their shares without making themselves continually liable to a penalty. This

is simply because such companies in continually offering shares at fluctuating prices, seem to be unable to comply with the requirements of paragraph (5) of the Fourth Schedule of the Act. This provision requires a prospectus to state the amount that is payable on application and allotment of each share.

The barriers to the viability and success of such funds are first the stigma of unlimited liability which makes informed investors, at least, shy away from investing in such organisations. The second and greater barrier lies in the advertising and marketing restrictions imposed by the Companies Act. Widespread glossy advertising and the use of vigorous encyclopaedia type salesmen are vital to this type of operation and are two of the main reasons for the success that these funds have achieved in the United States. Thus, although these funds can operate here they do so under difficulty and consequently they are relatively insignificant and unspectacular. Their most commendable feature in comparison with the new type of fund is the very fact that they fall within the regulation of the Companies Act whereas the others do not.

Mutual (Superannuation) Funds:

This new breed of mutual funds may be more precisely described as superannuation trust funds. These bodies invest and reinvest investors' lump or periodic contributions until they retire (or emigrate) and subsequently make provision for repayments to the investors of retirement or old age benefits. In fact their aim, as we shall see shortly, must be to provide income on retirement. The funds in operation here differ from overseas pension funds, however, in that they are not set up by employers; the contributions are not necessarily paid by an individual's employer and the funds aim at present to invest in commercial real estate (by choice) and Government stock (by direction) rather than in equity securities or shares, although provision for this eventuality is generally made in their deeds.

This type of fund has a board of directors which contracts out the day to day management of the fund to an external company. From its conception the fund develops along these lines —

(1) A group of people form a limited liability company the object of which is to establish a mutual fund.

(2) The directors of this company become directors of the fund which they then establish. Their company becomes the First Trustee for contributors to the fund. Investors contribute not to the company which established the fund but to the fund itself. However the fund is not per se a separate legal entity and any investments made with, or property purchased with the fund contributions are held or registered in the name of this "First Trustee".

(3) Prior to the soliciting of contributions the First Trustee appoints as "Second Trustee" one of the recognised Trustee Companies the function of which is continually to scrutinise the operation of the Fund for the investors.

(4) Having appointed the Second Trustee, the First Trustee appoints a "separate" management company to organise the day-to-day operation of the Fund — advertising, enrolling new members, investing their contributions, collecting rents and interest, etc. The investment policy for the Fund is made by the Fund directors who direct the Management Company as their agent to orientate its activities to achieve that goal.

(5) Finally, when an investor decides to make a lump, or periodic, contribution to the Fund he enters into a "Trust Deed", the parties to which are the First Trustee (or company which established the Fund) "of the first part"; the Second Trustee "of the second part"; and "(all other) such persons who shall, by signing an application form annexed hereto, become members of the Fund, of the third part."

Thus to sum up the structure and operation of the Fund we can say that there may be five entities involved. First there is the investor, secondly the director of the Fund (a company called the First Trustee) which contracts out the management of the Fund to the third entity, a Management Company. Associated with at least one fund's organisation is also an "Advisory Panel". Little is disclosed about it apart from the fact that it is utilised by the First Trustee to help make policy and investment decisions. Whether it actually meets as a group (and could thus loosely be termed as a fourth entity), and if it does who the actual members of the group are, is not clear. The fifth and last entity involved is the disinterested watchdog — the Second Trustee. The third and fourth entities are not parties to the Trust Deed.

The First, and arguably the Second, Trustees are in a fiduciary relationship to the Fund's contributors. The legal obligations of the Management Company, agents of the First Trustee are not to the investors but to the First Trustee alone. The contract is between these two companies and not between the Fund and the Management Company. The Fund itself is not a legal entity. When an investor becomes a party to the trust deed he becomes bound to each other investor and they become bound to him and each of them enters into certain covenants binding on the First Trustee and not on the Fund as such.

Before looking in more detail at the liabilities of certain of these entities and the reason why these mutual funds are operated in this particular fashion, the applicability of various laws which govern similar vehicles for investment by the public will be discussed.

Regulatory Legislation:

What statutory controls or restrictions govern this new breed of mutual funds? The first and perhaps the most disconcerting point to be made is that these funds are not incorporated as companies although

as with some other unincorporated associations,[1] such as the proprietary type, management of the Fund is carried on by a limited company; the promoters who established the Fund are also limited companies of necessity as both groups will be "carrying on business for profit or gain". As with unincorporated clubs and societies the legality of mutual funds depends on their not carrying on business for their own gain or for that of their members. Otherwise they will be illegal if their membership exceeds 25 persons and they are not incorporated.[2] Mutual funds might appear to fall within this category but for the fact that while the term "any business for the acquisition of gain" has been construed fairly widely,[3] yet it has been held that the gain "must result from a business". It would seem that a superannuation fund[4] or a combination to purchase land[5] or investments[6] or to collect royalties[7] will be lawful simply because these activities do not involve carrying on a business. While it has been held that "business" means something other than (mere) "trade"[8] yet in relation to mutual investing the leading case of *Smith* v. *Anderson*,[9] (which dealt with investments in unit trusts) reversed an earlier decision in which these trusts had been held to be illegal, as contravening the equivalent of s. 456 of the Companies Act 1955. In *Smith* v. *Anderson* it was held that there was no "associating" between the holders of the beneficial interests and that the trustees were not "carrying on business" since the holding and varying of investments was not conceived of as a business; thus the trust was not illegal and did not require registration as a company. This would seem to apply *mutatis mutandis* to the mutual superannuation funds which is unfortunate because that Act has three very laudable aims. Primarily these are first to prevent fraud (as far as possible); secondly to disclose the affairs of the business for the benefit of investors and creditors, and thirdly to impose some administrative controls (while still permitting shareholder democracy to take its course).[10] People who deal with and invest in mutual funds need this type of protection. At present they are not getting it because the Funds do not fall within the ambit of that legislation. What of other statutes that provide similar protective controls? The realisation that these institutions are not subject to the Companies Act triggers off an almost reflex feeling that they must fall under the jurisdiction of the legislation governing Unit Trusts. These provisions relate to the type of investment declared by *Smith* v. *Anderson* to be legal yet outside the purview of the Companies Act and which is now duly regulated

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1 See Gower, *Modern Company Law* (3rd ed. 1970), p. 220.
2 Companies Act 1955, s. 456.
3 Cf. Gower (supra n. 2), p. 223 n.
4 *Armour* v. *Liverpool Corporation* [1939], Ch. 422.
5 *Re Siddall* (1885), 29 Ch. D. (C.A.).
6 *Smith* v. *Anderson* (1880), 15 Ch. D. 247 (C.A.).
7 *Commissioner of Inland Revenue* v. *Marion Steam Turbine Company Ltd.* [1920] 1 K.B. 193.
8 *Rolls* v. *Miller* (1884), 27 Ch. D. 71, 79.
9 Supra, n. 6.
10 Wedderburn, *Company Law Reform*, Fabian Tract 363, pp. 1-3.

by a separate enactment, the Unit Trust Act 1960. However, at the present time our mutual funds cannot be said to be within the very strict provisions of the latter Act simply because in the definition of "unit trusts" certain associations are specifically excluded, one of which being "any superannuation fund approved by the Commissioner under s. 2 of the Land and Income Tax Act 1954."[11] Thus, provided these funds hold the approval of the Commissioner, they would seem to be immune from the yoke that compliance with that Act would otherwise entail.

The question then is whether these institutions exist in a vacuum free from statutory regulation? One suggestion has been that perhaps they fall within the Friendly Societies Act 1909. This proposition seems unsound because even if their structure were such that they could be registered under that Act,[12] nowhere is registration made mandatory. It would seem, however, that the only factors which would prevent their registration under that Act are ss. 11(2) and 51 which in effect state that no friendly society which contracts with any person for the assurance of an annuity exceeding $208 per annum, or a gross sum exceeding $3,100, is to be registered under the Act. Mutual funds may of course provide sums in excess of these figures and so could not come under this legislation even if they wished.

Furthermore, neither the Protection of Depositors Act 1968 nor its Companies Act equivalent[13] will apply because the term "deposit" is there defined to mean "a loan of money". It is clear that investors in mutual funds are not simply lending their money to the fund, at least not in the conventional sense in which the term "lend" is normally understood.

Had our mutual superannuation funds come within any of these pieces of legislation then not only would the position of the investor and creditor be more certain but the legal anomalies in relation to other institutions and undesirable aspects from the viewpoint of investor protection which are associated with these funds would probably not have arisen.

At present the only governmental supervision of these bodies is by way of the Land and Income Tax Act 1954. It consists of the qualification requirement that a "mutual fund" must obtain the status of a "superannuation fund" within s. 2 of that Act. If that is surmounted and the Commissioner's approval is given, a number of advantages accrue both to contributors and to the fund —

(1) Under s. 85 the investors are given a tax exemption for their contributions.

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11 Unit Trusts Act 1960, s. 2(1)(f).

12 Friendly Societies Act 1909, s. 11. Several registered Friendly Societies have in fact been running mutual superannuation funds for members for some years; the fund assets of one such group (the Druids) now stand at over five million dollars.

13 Companies Amendment Act 1966, s. 12.

(2) Under s. 86D the income of the fund itself is exempt from income tax, and,

(3) Employers' contributions (if any) on behalf of employees, entitle them to tax deductions.

But there is an accompanying disadvantage for the fund. In the past the majority of private superannuation funds were operated through life assurance companies and were therefore subject to the voluntary public sector investment requirements applying to those companies. The 1970 Budget made like provision for the new mutual funds to bring them also within the compass of monetary controls. All these funds are now required to maintain a minimum of 30% of their total assets in the form of government and local authority securities in order to qualify for exemption from income tax. Schemes existing at that date were allowed up to five years to make any necessary adjustment to their assets.[14]

This new requirement affected the prior calculations of most funds. Many of their brochures and accompanying graphs were worked out at a compounding interest rate of 10% which was claimed to be conservative. The considerably lower returns from government stock as opposed to commercial property returns have necessitated some funds altering the predicted growth rates set out in their original brochures.

The Criteria for a "Superannuation Fund":

The Commissioner of Inland Revenue will declare that a scheme is a permissible "superannuation fund" if he is sure that the genuine aim of the fund is to provide a pension for the contributors. The Commissioner's concern is to ensure that the fund is not simply a disguised tax free savings fund. The stipulations he makes are fully consistent with his role as protector of the public revenue and any protection that accrues to investors through his activities is really incidental simply because that is not primarily his area of concern.

Some of the Commissioner's requirements are that —

(1) Sixty is to be the retiring age for males.

(2) The contributor to a mutual fund may on retirement take 25% of the assessed value of his investment or an amount capable of purchasing a retirement annuity of $104 p.a. in cash, tax free. The remainder is to be converted by the fund managers into one of a number of income annuities which are taxable.

(3) Contributions cannot be withdrawn from the fund by the investor at any time but must remain invested until he reaches the retiring age. These first three factors are inter-related and need to be more clearly explained to investors than at present.

14 The 1970 N.Z. Budget, Government Printer, p. 16; Land and Income Tax Amendment Act 1970, s. 13.

Among other things the Inland Revenue Department requires that a mutual superannuation scheme should be set up under a Trust Deed which should provide that any amendment to it must not prejudice the rights and interests of a member without his consent and must be submitted to the Department for continued approval of the scheme. The trust deed should also provide for a Second Trustee with the power to have the fund wound up (together with provisions governing a winding up) if for any reason the first trustee (if a company) should go into liquidation voluntarily or otherwise, or (if an individual) he becomes incapable of carrying out his duties, or if it is found by the court that the fund has not been properly administered or managed. The Second Trustee is generally appointed from within the ranks of the existing trustee companies.[15] It has been claimed that they maintain a watching brief on behalf of all contributors.

The Jenkin's Committee[16] placed much emphasis on independent trustees for investors in similar ventures to our mutual funds. The Canadian Committee on Mutual Funds discussed both the benefits and difficulties associated with the American "independent director"[17] and the British "independent trustee"[18] with supervisory powers on behalf of fund investors and rejected making this a statutory requirement for a number of reasons. Instead it placed greater reliance and responsibility on the scrutiny of the auditor. However the Canadian report was in favour of a "custodian"[19] (in effect a trustee), which was not the fund directorate or the management company, holding the assets of the fund. It is interesting to note that one of the requirements relating to this "custodian" was that it would be "subject to inspection by federal or provincial regulatory authorities".[20] Also a stringent procedure was recommended by which and to whom assets would be released by the custodians. Leaving argument as to the best methods of scrutiny and control aside, it is obvious that in the absence of regulatory legislation in New Zealand the Second Trustee is in the position where it should be performing an extremely important supervisory function, especially since it seems it (unlike the Unit Trustee) has not custody of the fund's assets nor are they vested in its name.

In relation to their administration the directors of some of the funds make much of the fact that the day-to-day management, enrolment of members, etc., is performed by management companies which are independent of the funds. One of the funds states that this is a requirement placed on it by the Commissioner of Inland Revenue.

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15 E.g. Perpetual Trustee Estate and Agency Co. of N.Z. Ltd., or The Trustee Executors and Agency Co. of N.Z. Ltd.

16 *Report of the Company Law Committee* (The Jenkins Committee U.K.), 1962, Cmnd. 1749, para. 308, 316, 327, referred to in later footnotes as "The Jenkins Report".

17 *Report of the Canadian Committee on Mutual Funds and Investment Contracts* (Provincial and Federal Study 1969), p. 160 para. 6.31-6.44.

18 Ibid., 173 para. 6.60-6.68.

19 Ibid., 177 para. 6.69 et seq.

20 Ibid., 239 para. 8.24(2).

However, the Department denies that it makes any such requirement. In this case it would seem that the Department could not have made a further stipulation that the majority of the Management Company's directors must not be directors of the fund itself. Loss, speaking of investment companies in general (but his views are applicable to mutual funds) says that their assets "are usually liquid and readily negotiable so that control of them offers many opportunities for unscrupulous managers".[21] It may be for this very reason that the First Trustee, in whom the fund's assets are vested, and the company managing the fund have been in theory segregated by some trust deeds but the value of this seems doubtful. First it does not ensure that the charges and commissions will be entirely separated from any dealings in the fund's assets because of the wide powers of the First Trustee. Secondly it seems to be of dubious value to replace the First Trustee which is in law in a definite fiduciary relationship to the investors, by a body (the management company) which has no certain legal relationship to the investors. Thirdly the interposition of yet another entity or group adds to the cost of investing in the fund. In the Unit Trust situation one finds only the Trustee and the Manager and that arrangement has operated without comment for a decade in New Zealand and longer periods in other countries. The Jenkins Committee expressed the view that the existing unit trust organisation was satisfactory.[22] It is true that it recommended that the Manager and Trustee should be independent of one another but the trustee that was referred to is, in the Unit Trust situation, the equivalent of the Second Trustee and while at present the Mutual Fund's Second Trustee is in fact independent from management, the same cannot conclusively be said in relation to the First Trustee. Yet in the mutual fund situation it is this First and *not* the Second Trustee in whom all the fund's assets are legally vested. In the Unit Trust organisation the group assets are vested in the one independent Trustee who also has some controls and checks on aspects of the management for the protection of the investors. Furthermore the Jenkins Committee reiterated that the trust deed could not exempt the trustee from, or indemnify him against liability for breach of trust where he failed to show the degree of care and diligence required of him as trustee.[23] In the Mutual Fund situation the First Trustee holds the assets and in one instance the trust deed purports to exempt it from all liability for loss except that arising from *wilful* default.

Mutual Funds' Advertising and Soliciting:

There are no restrictions on the advertising of these private superannuation funds, consequently much of it is generalised, flamboyant and misleading in that it does not disclose all the facts and because much of it is based on future assumptions concerning the state of the

21 Loss, *Securities Regulation,* Vol. 1 (2nd ed. 1961), p. 146 Boston, Little, Brown.
22 Jenkins Report, paras. 313 to 316.
23 Ibid., 316(iv).

economy, continued inflation, the value of commercial property, the maintenance of interest and earning rates, and the investor's future income, some of which tend to be unpredictable.[24]

A number of miscellaneous features of these funds seem insufficiently emphasised. For example, the investor needs to be made more aware of the fact that his share in the fund is not negotiable. Although it may be possible to assign or transfer this interest to another it would be of very little value as collateral or security for a loan simply because of the time and annuity factors which are prevailing features of this type of investment. He should be made aware of this.

Most of the funds' brochures stipulate that if a contributor no longer wishes to make payments into the fund he must give the fund prior notice of his intention to cease payment otherwise he may be penalised either by not receiving his interest evaluation for the year in which his payments ceased or a fine for each month that it is overdue.[25] When contributions and fines have been overdue for six months, membership ceases but all accrued benefits (less fines) must remain invested in the fund until the normal retirement date.

If the investor dies before retiring, his share in the fund "immediately" forms part of his estate. But if he dies following retirement, no matter how soon after that event, his annuity terminates unless he has purchased a joint life annuity in which case payment continues until "the death of the remaining spouse". Few fund brochures clearly state this possibility and yet it is an important factor and needs to be spelt out precisely for the consideration of investors. The reason lies in the fact that many people do not realise what an annuity is and that this is in fact the way that it operates. Thus it is important because the termination on death factor impinges on the ultimate "safety" of the principal invested, at least in so far as the deceased investor's estate is concerned. A more comprehensive explanation of such points as this should be stipulated in statutory regulations.

The fact that these institutions are not subject to the Companies Act or the Unit Trust Act means that they have a considerable advantage in soliciting subscriptions by advertisement. Also this places them on an equal footing with Insurance Companies in so far as the

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24 A graph used by one Fund in its advertising brochure purports to demonstrate the comparative value of investing in real property and in shares and covers the period 1950-1967. Both these years 1950 and 1967 were years when shares were at a low ebb either because of market immaturity or budgetary measures and it would seem that the share market values increased at a greater rate than those of real property after 1967. It is interesting to note that the U.S. Securities Exchange Commission requires all advertising material to be filed with it and according to Dawson (V.U.W. Research paper *Unit Trusts and Mutual Funds in N.Z.* 1970) it takes the strongest exception to charts or graphs of this kind. Cf. Motley, Jackson and Barnard *Federal Regulation of Investment Companies since 1940* (1948-49), 63 Harv. L.R. 1134.

25 Actual examples of penalty provisions taken from two superannuation fund brochures.

deployment of salesmen is concerned. The efficiency of this "asset" which has been denied registered Companies and Unit Trusts may not even have been reduced by the Door to Door Sales Act 1967. That Act purports to regulate the sale of *goods* on credit or the hiring of goods where the agreement is made at a place other than trade premises. The Act defines goods as in the Sale of Goods Act 1908. This would seem to preclude the sale of interests in Mutual Funds from being renounceable within seven days, in terms of that Act.

Thus on both the issue of advertising and the deployment of salesmen, the funds would seem in effect to have a complete carte blanche. Anyone seeking to show that this was not so would be hard pressed to find existing legislation that affects the advertising presentations of funds. For example the rather dubious argument has been made in Australia,[26] where most forms of mutual investing are covered by the strict provisions of the Companies Acts, that the mutual investing institutions are offering a "commodity" and in seeking investment they are competing against all the other types of consumer products, durables and comestibles, which are not so restricted, for a share of the income or savings of the general public. This argument, that a co-operative investing institution, like our mutual superannuation fund, is selling investment as a commodity, was used in Australia in an endeavour to liberate their funds from what the operators saw as the suffocating effect of the strict advertising restrictions in the Companies Act.

If these funds are selling a commodity, it could be argued in New Zealand, at least, that at present the Consumer Information Act 1969 applies to the advertising of our mutual funds. This is an Act, which among other things, aims to prevent deceptive and misleading advertising. The commodity argument might be further advanced by the fact that the term "goods" as defined in s. 2 means "any article or product of any type that is intended for sale for use or consumption, and includes services". It is stated in s. 9(4) that "no person shall publish . . . any advertisement that contains any express or implied representations as to the nature, quality . . . or effects of any 'goods' [read 'service'] if he knows or ought to know that the representation is false or misleading in a material respect". This same formula is applied by s. 10(2) to any representation as to price in any advertisement.

It could be submitted that even if it is specious to argue that a sale of investment in mutual funds is a sale of goods, the activities of the funds might still be caught by the Consumer Information Act if the funds could be said to be "services". The fact that they are geared to the provision of annuities on retirement could support this view. If either of these arguments is valid then the provision of that Act, at least, would apply to their advertising. However, even this would still leave the investor insufficiently safeguarded in this area.

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26 *Rydges Magazine* (Aust.), Jan. 1970, p. 65.

For example there is a contract between the company which establishes the fund (the First Trustee) and the company hired to manage the fund, which provides for charges and commissions. The investor does not see this and in fact the funds' brochures make little or no mention of it. One brochure simply states that the management company will receive fees not exceeding a maximum agreed upon between the two companies and subject to periodic revision. For all the benefit that this statement is to the investor it might as well have been omitted. While this issue may be more a question of inadequate disclosure than bad advertising yet both these facets go hand in hand and both need to be uniformly regulated so as to present to the public an honest and balanced picture of the investment propositions. The history of the development of company law has shown that statutory remedies are needed both to prevent over-ambitious advertising and to stimulate diligent material disclosure.

The Trust Deed:

Under the present circumstances this document occupies a vitally important position in the investor-"fund" relationship. If people are to contribute jointly to a venture seeking a benefit, and if they are to share in some equitable way in the proceeds of its operations, a basis for determining their rights among themselves must be specified. In the company situation this is fulfilled by the constitution (memorandum and articles); in other business ventures it is the formal deed to which all participants become parties. The signing of this contract gives the signer a proportionate right in the powers, privileges and obligations set out in it. The importance of the content of the deed to the investor in a situation in which the soliciting institution is unregulated by statute, cannot be over emphasised.[27]

The law relating to deeds is distinct in many aspects from that relating to simple contracts. The essence of a simple contract is a bargain which involves consent and consideration. Traditionally a deed is said not to depend on bargain at all. The parties become bound because they have executed it with solemn formality and not because they have made a bargain. So a promise by deed can be enforceable without consideration and one party to it may be bound even though the other has not consented to the transaction.

Burrows[28] says the theory is that a man can be bound by a deed as soon as he has signed and delivered it despite the fact that the other party has not yet signed it. This would seem to be the logical conclusion if neither consent nor consideration is necessary. Authority[29] is cited for this proposition, and the view put forward that offer and acceptance have practically no place in the deed. He considers therefore that the parties to a deed may become bound at different times.

27 Canadian Mutual Fund Report, 1969, p. 26, para. 1.58.
28 Burrows J. F., *The Law relating to Deeds* (1971), 2 Otago L.R. 255.

If these rules are applicable to superannuation fund deeds then at first sight they could place the investor in an invidious position if, for example, he signs and delivers the deed and the First Trustee (per medium of its officers) fails to reciprocate. On the reasoning in the *Naas*[29] case the investor would be bound by the deed and all it contained whereas possibly the First Trustee-operator of the Fund, would not. However there are two grounds on which the court, if called upon, might hold the investor not bound by his signature in this type of situation. (1) It may find that he did not intend to be bound until all the parties had executed the document (i.e. that it is an escrow). (2) Or, the court might not enforce it against him if the obligation is now different or if it would lead to injustice because he signed on the faith of getting some return for his promise. Were it not founded in equity this latter aspect would seem tenuous in light of the view that consideration does not enter into deed law. That aside, while these grounds for holding an investor not bound by his signature may be good in so far as the law is concerned it is suggested that they have no application to, and would be no protection for, the investor in a superannuation fund if his signature to the deed is not reciprocated, because his contributions are locked into the fund until retirement owing to the requirement of the Commissioner of Inland Revenue that investments once made cannot be withdrawn from the Fund until sixty years of age (for males).

One would like to be able to assert that despite the fact that the investor cannot withdraw if the First Trustee's failure to reciprocate came to his notice, a court would hold the investor not bound by those provisions in the deed governing his relationship with the First Trustee on one of the grounds mentioned above. However, as with most equitable matters, such a finding would turn on the discretion of the court. Even if such a decision were reached, the investor might still be bound vis a vis the other investors or fundholders.[30]

Types of Clause Contained in Mutual Funds' Deeds:

The nature of the provisions contained in these funds' trust deeds can be illustrated by examining the following clauses taken from one particular deed used by a Mutual Fund in New Zealand.

(1) A clause which sets out the ways in which the fund may be invested. It permits a wide range of investments and gives the First Trustee power "to borrow by way of mortgage, debenture or otherwise such sum or sums as the First Trustee may determine." The only limitation on this power would seem to be that such borrowing is to be for the purchase of lands or in the erection or alteration of offices or other buildings thereon.

(2) Subsequent paragraphs in the clause give the Trustee power

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29 *Naas* v. *Westminster Bank Ltd.* [1940] A.C. 366.
30 *Clarke* v. *Dunraven* [1897] A.C. 59.

to invest in shares, bonds, debentures, first mortgage (subject to some limitations), Savings Banks, and the "official short term money market in New Zealand"; "all investments shall be made under the general advice of an independent panel of persons who are qualified to give advice on all aspects of the investment of money . . ."

Nowhere are the investors specifically told who constitute this independent panel or what their qualifications are to advise on such matters. In one brochure a technical panel consisting of a number of named architects, civil engineers and valuers' firms is referred to and this same list appears in a report under the heading "Advisory Panel". It is not clear if this is the group that advises on types of investment. In this writer's opinion, the panel is insufficiently identified by listing the name of several firms of valuers, engineers and architects.

Such a wide reference to them even when accompanied by a statement of the fee paid to them is inadequate disclosure, and of little value to the investor. A fee which would on its face appear modest may in fact be excessive having regard to the number of persons on the panel or the number consulted.

A further subclause sets out various criteria that this panel must take into account in determining investment policy but it concludes by purporting to relieve the panel from all liability for loss arising from its activities. There would appear to be little value in setting out criteria when failure to consider these criteria incurs no liability despite the fact that loss may be directly attributable to that failure.

(3) A clause related to accounts and audit. The yearly account "shall be prepared by the First Trustee and shall show the First Trustee's estimated market values of the investment of the Fund at that date." This should be a warning light. The debacles of both the Reid Murray collapse in Australia[31] and the more recent JBL collapse in New Zealand[32] should have taught company managers and investors at least one lesson — that estimates of the market value of a company's investments by its managing director or board alone is totally unsatisfactory and a source of real danger, especially when associated with a power to borrow.[33]

A mandatory valuation (which cannot be exceeded by the directors) made by qualified persons is probably the only satisfactory answer.

(4) A clause relating to management expenses, fees and commissions of those connected with the First and Second Trustees, the Advisory Panel and those providing services for the First Trustee states that they shall be charged "equitably" against contributions or moneys paid to the First Trustee at its complete discretion. This discretion, both as to the amount to be paid and the number of

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31 See *The Interim Reports on Reid Murray Holdings Ltd.*, Government Printer, Victoria, 1963.

32 Birchfield, *The Rise and Fall of JBL*, NBR 1972.

33 Perhaps the main argument against such a practice is that it does not present the "true and fair" view required by the Companies Act 1955.

eligible recipients, is extremely broad. Obviously the more they receive, the less there will be to invest for the benefit of the fundholders. Such a wide discretion, including the setting of its own remuneration, could give rise to a serious conflict of interests. There is no suggestion of any impropriety having taken place or taking place. All that is being suggested is that this type of clause is unsatisfactory in that as it stands it could too easily be misused.

The Jenkins Committee stated[34] in relation to the question of the control of unit trust managers' charges that the legislation should provide that the trust deed state the maximum level of charges which may be made by the manager, distinguishing between the maximum permitted initial charge, expressed as a percentage of the value of the unit, and the maximum permitted annual charge expressed as a percentage of the value of the trust fund. If this were done there may not be any need to put direct statutory controls on managers' charges. This is equally applicable to mutual funds and could be made mandatory for mutual funds (and all related modes of investment) so that investors can see more clearly and conclusively how much the operation of the fund is costing them, or will cost them if they then decide to invest.[35]

(5) A clause purporting to make the assessed interest of the contributor in the fund totally inalienable inter vivos but providing that on death *before* retirement it will pass to his estate.

If this is effective then it would exclude such persons as the Official Assignee of a bankrupt contributor, at least until the bankrupt's retirement or prior death. The aim of this seems to be to protect the position of the Fund. While insurance policies enjoy certain similar protections the aim in their case seems to be to protect the policyholder; this protection given to him was specifically granted by s. 65 of the Life Insurance Act 1908.

That privilege applies to most policies, with minor exceptions, and is limited to a prescribed amount.[36] Subsection (4) of s. 66 emphasises that this protection is a privilege made possible only by that enactment and lapses if the policy was taken out to defraud creditors. The clause in the fund deed is an attempt to obtain a similar type of protection primarily for the fund, so that contributions cannot be attached. It is suggested that the attempt to achieve this by way of a simple deed cannot be effective especially in relation to any persons who are not parties to the deed.[37] The decision in *Macintosh* v. *Pogose*[38] makes it clear that the owner of property cannot, by contract or otherwise, qualify his own interest by a condition determining or controlling it in the event of his own bankruptcy, to the prejudice of creditors.

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34 Jenkins Report, Recommendation (q) in para. 329; discussed at para. 319.
35 Canadian Mutual Fund Report 1969, p. 103, para. 4:09-4:12.
36 Life Insurance Act 1908, s. 66(3) limits it to a sum assured of $4,000 plus bonuses or an annuity up to $208 p.a.
37 See Spratt and McKenzie, *Law of Insolvency* (2nd ed. 1972) at p. 86.
38 [1895] 1 Ch. 505, 511.

(6) A clause purporting not merely to limit liability but in effect to exclude it totally. This exclusion claims to cover the First and Second Trustees and the management agents except for loss or damage directly attributable to the *wilful* neglect or default of any of these three groups. The insertion of the word "wilful" greatly increases the difficulty in proving loss from their activities. Admittedly this type of exclusion clause has been adopted in the so-called standard form contracts for goods and services but neither company promoter,[39] nor director,[40] nor unit trustees or managers,[41] nor the directors of building societies,[42] may be exempted from liability in this way. It may be that the clause is an ineffective attempt to exclude liability arising from a fiduciary relationship, independent of contract, but it seems doubtful[43] whether the management company, for one, is in the position of a fiduciary and thus, like the manager of unit trusts, would need some legislative provision to prevent it from excluding corresponding liabilities.

(7) Finally there is a clause which relegates the Second Trustee (about whom much is heard in the funds' advertising) to a passive role. For example, it has not control over the expenditure on advertising, unlike the unit trustee or Registrar of Building Societies,[44] and it would seem that it does not legally hold the property of the Fund on trust nor is it the custodian of the Fund's title deeds, certificates or scrip. Legal ownership and custody are in the name and hands of the First Trustee.

These 7 features taken from this one deed in this writer's opinion detract from the soundness from a legal point of view of the mutual fund venture as an investment proposition and indicate, when considered in conjunction with the subsequent sections of this paper on accounts and liability, that the investor needs more protection than the fund deed alone.[45]

The Annual Report and Balance Sheet:

As the funds are subject only to the Land and Income Tax Act there is *no* mandatory requirement that a copy of the report and balance sheet be sent to investors. Some of the funds do however provide such documents and while they are to be commended for it, yet in this writer's opinion these documents are inadequately explained and tend to be misleading on certain points. Three matters common to two of these reports warrant comment.

(1) First, the inclusion of capital appreciation each year as an

39 *Gluckstein* v. *Barnes* [1900] A.C. 240 and *Burland* v. *Earle* [1902] A.C. 83.
40 Companies Act 1955, ss. 204 and 205.
41 Unit Trusts Act 1960, s. 24.
42 Building Societies Act 1965, s. 107.
43 Gower, *Modern Company Law* (3rd ed. 1970), p. 225, n. 47.
44 Sections 3 and 67 of their respective Acts (supra n. 41 and 42).
45 See also Canadian Mutual Fund Report 1969, p. 26, para. 1:58 et seq.

asset. (The capital value of all the investments of the fund or its assets are revalued annually.) Two points arise here —

(a) As was indicated earlier, if this amount is computed not by an independent valuer but by the First Trustees, directors of the fund, the practice is fraught with danger.[46]

(b) While it seems accepted that capital appreciation may be included each year as an asset yet it would also seem that the better practice is to show that unrealised amount as a separate figure.

The Act requires that a company's balance sheet and profit and loss account give a true and fair view of the state of affairs of the company and supply the detailed particulars set out in the Eighth Schedule. The aim of this latter requirement is to prevent the aggregating or non-disclosure of items which must be stated separately if they are to be of real value in disclosing the position of the company.

The Jenkins Committee[47] strongly criticised the view that the function of a company's balance sheet is to show the directors' opinion of the worth of the undertaking or of its assets. The Committee considered that this was not the function of a balance sheet and that such a balance sheet could be seriously misleading unless the company is about to be liquidated. It reaffirmed that the historical cost basis is the acceptable method of preparing these statements.

(2) The second matter relating to the annual report is that there seems to be some confusion as to what entity the report, statement and balance sheet relate to. Do they relate to the fund or to the First Trustee (that company which established the fund)? The auditors seem to be uncertain. One group addresses its report to the Members of .... Fund Ltd., i.e. that small number of shareholders in the First Trustee Company which persons are often the directors of that company. These are *not* the members of the fund and yet the accounts purport to be a "statement of the fund" and to disclose "the value of the fund". In another instance the auditors address their report to the trustees and members of the fund yet they speak in terms of "the company" and compliance with the Companies Act.[48] This indicates a tendency to treat the First Trustee and the fund itself as one and the same entity whereas they are not. While there is nothing sinister in this, it can be deceptive in that the investors

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46 See text at n. 31.

47 Jenkins Report, para. 333, and see Cohen Committee on Company Law Amendment 1945 Cmd. 6659, para. 98.

48 Since the preparation of this article some changes in the presentation of some of the Funds' reports has occurred. At least one of the Fund Auditors' Reports is now addressed to the Trustee and certifies that the accounts (and note thereto) have been prepared in accordance with the Contributors Trust Deed and that these give a true and fair view of the state of the Fund's affairs for the year.

in the fund are *not* shareholders in the First Trustee Company — they do not have the rights which the Companies Act guarantees to that company's shareholders. They do not have the mechanisms such as the Annual General Meeting where grievances can be aired and the directors "put on the mat", interrogated and democratically removed if found to be unsatisfactory. Further this coalescing of entities would seem to mean that only one set of accounts is being kept. In other words the accounts, etc., of the First Trustee are treated as the accounts, etc., of the fund. This means that the First Trustee is "living within" or "living out of" the fund.

In this writer's opinion, while there is nothing contrary to law in this procedure (if it is in fact what is happening), it does not seem satisfactory, because the liabilities and debts specific to the First Trustee should be its own liabilities. It is desirable that separate accounts be kept in order clearly to distinguish between the liabilities of the First Trustee which established the fund (and which may establish others)[49] and the liabilities of the fund itself.

(3) The third point relates to the various expenses which the fund must meet and their treatment in the accounts. The size and number of expenses associated with the management of a fund warrant more detailed explanation than is at present being offered. On its face, management fees and commissions for two of these funds amounted to approximately 26%, reducing to 16% the following year for one fund and 22% reducing to 15% for another of the total values of each of these funds. This charge was separate from a list of "overheads" which included such items as: property management fee; investment advisory panel's fee; secretarial fee, etc. The former amount presumably is paid to the management company while these latter amounts are paid to the First Trustee. When these two fees are added together the aggregate remuneration taken by management, first and second trustee, rise slightly to approximately 27½% reducing to 17%, and 22% reducing to 15% of the total value of the two funds respectively. No suggestion is to be taken that these are anything other than legitimate charges on the fund but again in this writer's opinion a fuller explanation of these charges should be made to provide the investor with a better assessment of the value he is receiving for his investment.[50] More disclosure in relation to the "management fees and commissions" in particular, would be of value

49 The memorandum of one of these First Trustee limited companies provides that the object of the Company is: "To create, establish, control, manage and administer either on its own behalf or as agent for a person, firm or corporation a Superannuation Fund *or Funds* for the purpose of . . ." The possibility of "organising" more than one Fund at once highlights the necessity of keeping separate accounts.

50 The 1972 Annual Report of one fund contained an auditors' report which stated that the auditors had tested the calculations and crediting of the accrual and calculation and debiting of management expenses to the contributors' accounts and that in the auditors' opinion these were made on a basis which was fair and equitable between the contributors to the Fund.

in this regard. How are the fees and commissions calculated? Is a contract price negotiated prior to, or is a bill sent subsequent to, the year's operations? How much actually goes to the management company for performing its managerial function and how much (if any) to agents and salesmen?

The other point here is the question whether the First Trustee has treated the amount of management fees and commissions as an expense, which in this writer's opinion is the normal accounting practice. If not, why not? No reason is given to explain why these sums should not be treated as an expense. In two instances looked at, if the expenses of the funds were to include "overheads" plus management fees and commissions, the subtraction of the figure produced from that representing the income of the funds shows in both instances an operating loss or a net loss on the operation of these funds for the two years in question. (This loss figure will vary slightly depending on whether unrealised capital appreciation is included in calculating the income of the fund.)[51]

It is suggested that it is unfortunate that investors in these funds, unlike company shareholders, do not have available to them any machinery such as an Annual General Meeting which they are entitled to attend, whereby an explanation of such matters could be obtained.

The Liabilities of Mutual Fund Organisers:

Bearing in mind the structure of our mutual funds, but leaving aside any disclaimer of liability in the deed, the question of the possible liability of the operators of these funds is somewhat uncertain. It seems clear however that the company which establishes the fund (the First Trustee) will be in a fiduciary relationship to the contributors. It is interesting to note that the First Trustee seems to have an absolute discretion in relation to matters affecting contributors to the fund. Two points would seem to arise from this. First, at common law if this "trustee" has an absolute discretion, the investor-beneficiaries (unlike the shareholders in a company) may not be able to force these director-trustees of the fund to do anything. They would not, for example, be able to force the trustee to make sure that the Second Trustee was actively performing its role of watchdog; or, more importantly, that its agent, the management company, was diligently performing its contract. They could not in fact force the "trustee" to bring an action against the management company for loss or default.[52]

In *Tempest* v. *Lord Camoys*[53] the trustee had an absolute discretion to sell, mortgage and buy real estate property. Two trustees wished to buy a certain property; the third refused to agree. The beneficiaries

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51 The balance sheets looked at were pre-1972 statements. The 1972 accounts of these two Funds show an improvement in their financial position, and on ordinary accounting principles both would now be making a profit.

52 There is no authority for a representative or derivative action in these circumstances.

53 (1882) 21 Ch. D. 571.

petitioned to have the purchase carried out. Despite this near unaminity of trustees and beneficiaries Chitty J. held that the Court had no power to interfere with the one trustee's bona fide exercise of the discretion conferred on him by the settlor. On appeal the Judges said that the Court would interfere with a trustee's power in order to prevent its improper use and to see that it was exercised within a reasonable time but as they felt that neither was in point in that case, they dismissed the appeal.

Section 29 of the Trustee Act 1956 must also be considered. It exempts a trustee from liability for loss caused by the acts or defaults of an agent if employed in good faith. In *Re Vickery*[54] a similar section in England was construed to mean that on the facts the trustee was not liable for failure to exercise supervision over the acts of his agent.

Even without the disclaimers then, these authorities could protect the First Trustee from liability not only for their own acts or defaults but also for those of both the advisory panel and the management company.

The obligations of the management company to the First Trustee are governed by its contract. Since *Suisse Atlantique*[55] and especially since *Harbutts Plasticine Ltd.* v. *Wayne Tank & Pump Co. Ltd.*,[56] it would seem, at least in theory, that the management company could not contract out of *all* liability in relationship to its management because this would on one line of reasoning amount to a negation of the contract itself. However, provided consideration is not completely illusory, the Court will not say that the contract falls. Thus the management company could, and presumably does, contract out of or disclaim specific instances of liability and by picking judiciously the areas where liability is most likely to arise it could leave the contract intact but in effect exclude virtually all liability. This is because the court will not look at the adequacy of the consideration but only at whether the exclusion clause amounts to an option to perform the contract or not. If it does not, the Court will not enquire into adequacy.

Applying the law as outlined above to the mutual fund system, what is to be the liability of the Management Company to the First Trustee or the investors in the Fund, if it is not to be in tort or contract? The Management Company does not create the "fledgling" fund so no analogy in its case to the fiduciary relationship that evolved around the promoters of companies[57] can subsist.

In this situation there would seem to be little authority to sustain

54 [1931] 1 Ch. 572.
55 *Suisse Atlantique* v. *N.V. Rotterdamsche* [1967] 1 A.C. 361, [1966] 2 All E.R. 61.
56 [1970] 1 Q.B. 447.
57 *Erlanger v. New Sombrero Ltd.* (1878) 3 App. Cas. 1218; *Lagunas Nitrate Co.* v. *Lagunas Syndicate* [1899] 2 Ch. 392.

liability, but from the investor's point of view the observations of Fletcher Moulton L.J. in *Bath* v. *Standard Land Company*[58] in his dissenting judgment become attractive. The logicality of his remarks, coupled with commercial development over the past sixty years, give his views more chance of being accepted and applied by our courts today. In that case the plaintiff employed the defendant company to manage his farm. He authorised this undertaking together with other instructions, by deed. The company on its part covenanted to manage the farm and the plaintiff agreed to pay for this service. The deed also authorised the company to "incur any costs, etc., necessary for the purpose (of the management)". Briefly, the company, over and above its remuneration, charged the plaintiff for (a) keeping the accounts and (b) the fees paid to directors of the company employed in their individual professional capacities in the management of the farm by the company. The plaintiff disputed these additional costs. The trial judge disallowed and struck out both of these charges made by the company but on appeal the decision as to item (b) was reversed. It was said that the directors were not in a fiduciary position in relation to the plaintiff who employed the company to manage his farm so as to be precluded from keeping the fees paid to them by the company for their professional assistance in the management of the farm.

The trial judge (Neville J.) had declared that the company was not entitled to charge for or pay the directors or any of them, or any firm of which such director was a member, for anything done by such directors or any of them in relation to the agreement. This earlier decision would have applied nicely in the mutual fund situation where generally some of the directors of the company established as the First Trustee are also "employed" as members of the board of the management company and presumably are paid in both capacities. Furthermore it does not seem unlikely that should a particular director have some special skill or professional qualification that he might also find himself on the advisory panel as well for which capacity a further fee would probably be paid. From the point of view of a possible conflict of interests it is respectfully submitted that it was unfortunate that the majority of the Court of Appeal did not accept the view of Neville J. They thought that it was not important to decide on the precise nature of the relationship involved between the owner and the directors when employed by the company. They simply expounded the view that whatever the relationship was, the company could not claim more of the profits from running the farm than was provided for in the agreement. However, they went further and stated that the company could not be called to account for profits which it did not receive but which were received by its directors. They said the directors stood in a fiduciary relationship to the company but not to a stranger with whom it dealt. The company acted through its directors but that did not mean that if a breach of trust were committed

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58 [1911] 1 Ch. 618.

by a company, acting through its board, a beneficiary could maintain an action against the directors for breach of trust. They dismissed rather summarily the two cases which were contrary to their opinion.[59]

Based on their reasoning it would seem that a conflict of interest and duty could only arise where a fiduciary relationship exists between the parties. Thus the directors, in their view, stand in a fiduciary relationship only to the company not to its creditors, not even to individual shareholders of the company, still less to strangers dealing with the company, and this applies whether the relationship between the company and the stranger is *one purely of contract such as principal and agent, or is one of trustee and cestui que trust.*[60] Buckley L.J. added that a fiduciary relationship can arise only by contract or by implication of law and that here the directors were not parties to the contract between the plaintiff and the company and no implication arose on the facts.

The position of the plaintiff in the *Bath* case is analogous to that in which the contributor to a mutual fund finds himself in relation to those directors of the First Trustee who are employed either on the fund's advisory panel and/or the management company. Taking one of the directors who was also employed as a solicitor for an example, Buckley L.J. gave as his reason for not depriving him of payment for his services (even though he was a director of the company which employed him), the reason that the company could not perform that particular service itself.

The only proviso that his Lordship was willing to allow was this: "That in investigating whether payment was reasonable or proper the fact (that the solicitor employed was also a director of the company) may increase the onus on the company to show that the appointment was properly made, but it goes no further than that.[61] This is only a minor concession because of the difficulty of proof of a conflict of interest, fraud or other misfeasance. This problem has arisen in relation to mutual funds management in the United States and eventually culminated in regulatory legislation.

The dissent expressed by Fletcher Moulton L.J. in *Bath* was his attempt to find an answer within the principles of equity and common law. His views are important in retrospect mainly because, of the several judges, he alone seemed to appreciate the more general importance of the issue before them — i.e. the difficult question which stems from an "increasing tendency to employ companies to execute trusts".

He commenced constructing his argument on the basis that the rule which states that no profit can be made by those administering

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59 *Kavanagh* v. *Workingmen's Society* [1896] 1 I.R. 56; *Nicholson* v. *Tutin* 3 K.&J. 159.

60 *Bath's* case supra n. 58 at p. 625 per Cozens Hardy L.J.

61 Ibid., at p. 645.

a trust was established to prevent self interest diverting the trustee from his duty. Then he said that if this rule were held inapplicable to individuals who in the case of trustee companies are the people who really administer the trust, i.e. the directors, and if they can use their power to their own profit without incurring liabilities to the cestui que trust, the whole security of the latter is gone. For example, if there is a sale of trust property to the directors, the company says there is no breach of trust because it did not get the profits; the directors on the other hand say that they have no duty to the cestui que trust. The latter therefore cannot impeach the sale even though the purchasers had a hand in fixing the price. Furthermore, if the directors are liable to the company, it alone can complain (and generally the directors will decide whether it will or not); if it does not, the beneficiaries are helpless unless they can make out a negligence action which is more difficult and a poorer substitute for equity.

The real crux of Fletcher Moulton L.J's. view is that the proposition (which the other judges accepted), that an agent of a trustee cannot stand in a fiduciary relationship to the cestui que trust, is *incorrect*. Rather in his view[62] the correct rule is that a man does not come into this relationship merely by becoming an agent of a trustee. But the mere fact that he is only an agent to the trustee does not per se place him outside the scope and ambit of that relationship. In order to establish the existence of this relationship between a beneficiary and an agent of the trustee you must look at the facts of the case. The judge was emphatic that it is the acts which he does and the knowledge he possesses at the time he did the acts which should decide whether he is an agent or a trustee. Thus if his acts are sufficient to make him liable to the beneficiary his being an agent of a trustee is no defence against his being held liable.

Unfortunately his Lordship was somewhat premature in conceiving such notions. He was ahead of his time in that in effect he was (at least in these instances) obviously more than willing to lift the veil of corporate personality[63] to expose and then prevent the extra profits reaching that particular company's directors. The other judges were not willing to do so although this is not surprising in view of the fact that barely a decade had passed since the House of Lords' momentous decision in *Salomon* v. *Salomon Land & Co. Ltd.*[64] Had they been willing to do so or had they concurred with Fletcher Moulton L.J's. enunciation of the principles as to agents of trustees, the liability of the management company to the mutual fund contributor at common law would not have been quite so uncertain today.

However, it is arguable that, should this issue arise, the manage-

62 Ibid., at p. 633-634 and 639.
63 The separate entity is confirmed by s. 29 of the Companies Act 1955 and the sanctity of this principle established by the House of Lords in *Salomon's* case (infra n. 64).
64 [1897] A.C. 22.

ment company might still be held to be in a direct fiduciary relationship to the actual contributors on the basis of the decision in *Fawcett* v. *Whitehouse*.[65] Liability would stem from its activities in inducing people to contribute to the fund. These activities can be said to place on it a duty to disclose fully and honestly *all* material facts.

The Court in *Fawcett* held that a person employed on behalf of himself and his co-partners to negotiate a lease, is not entitled to any private advantage from the lessors. If he receives any such advantage he must hold it in trust for the partnership.

The reasoning of Lyndhurst L.C. is not limited to partnership situations. It is suggested that that his views could well apply to the mutual fund. Clearly, an agent who takes advantage of his position to obtain a personal benefit is accountable to his employer. While the management company of a mutual fund is covered by the rule, yet the problem remains that it is not employed by the contributors but by the First Trustee (which often, at least in part, consists of members of this company) which may in some circumstances have to be compelled by the contributors to make the unfaithful agent account. *Fawcett's* case would seem to overcome this and provide a direct fiduciary relationship. This would rest on the argument that he who induces others (whether fraud, misrepresentation or non-disclosure is involved or not) to enter into any venture, thereby places himself in a position of trust in relation to them.

A superficial reading of *Fawcett's* case might lead one to think that it does not go so far but it is suggested that the management company of a mutual fund places itself in a fiduciary relationship to those persons whom it induces to enter the fund. If its methods or means used to induce contributions can be shown to be false, misleading or made without full material disclosure, it should bear the consequential liability. The relevance of this question may be more extensive than it might seem at first sight in view of the fact that, to continue to be viable economic propositions, these funds of their very nature must attempt continually to attract new contributors. It may well be, however, that the liability would be confined to the circumstances mentioned and not for a general fiduciary relationship. This would place the management company in a similar but not identical position to that of the promoter of a company. As Lord Lindley M.R. said in the *Lagunas Nitrate* case,[66] a promoter discharges his responsibilities to the company if the real truth of the transaction is disclosed to those who have been induced by the promoter to join the company. However instead of the duty being owed to the employer company by the agent company in the mutual fund situation it would, under the argument outlined above, be owed directly by the management company to the contributors whom it induced to enter the fund.

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65 [1829] 1 Russ & M. 132, 39 E.R. 51.
66 [1899] 2 Ch. 392 at 426.

LIABILITY AND FEES

How the Management Company Problem Has Been Met Overseas:

Justifiable concern that mutual funds in the United States (which have a different legal structure) were not being managed in the best interests of shareholder - contributors stimulated recent legislation throughout that country. The Securities Exchange Commission there had criticised fund managers for using fund assets, in the form of brokerage commissions, to stimulate further fund growth through the sales of new shares to the public, because of the conflict of interest inherent in this practice.[67]

In the United States a recent trend has been the attempts to control the size of the management and advisory fees so that they have a reasonable relationship to the services rendered. The legislation is commendable in its design to increase the arms-length bargains between managers and funds by strengthening the position of the independent fund directors. The Investment Companies Act 1940 (U.S.) now requires that the management contract be renewed annually by the majority vote of the shareholders or of the uninterested directors personally at a special meeting for that purpose. The term "interested" is defined very widely. These directors (presumably the equivalent of our First Trustee members who are not on the board of the management company) are placed under a statutory duty to "request and evaluate" while the managers, etc., must furnish all information as may be reasonably necessary to evaluate the terms of the management contract. Furthermore, the contract must "precisely describe all compensation to be paid to the management company".[68] This provision far surpasses the discretionary clauses governing this matter which exist at present in at least one of our mutual fund's deeds.

Despite the attractiveness of these provisions from an investor's point of view, the critics[69] say that it leaves a loophole in that the management company (equivalent of our First Trustee) need only "look harder for congenial 'uninterested' directors", and the approval by these "uninterested" directors of an unfair contract will still not subject them to any penalty. Also the only bargaining weapon they (the First Trustees) have is power to refuse to renew the contract in which case they may not find a replacement manager. On the question of fees the 1970 United States laws add a provision which places the advisors and managers under a fiduciary relationship in relation to their receipt of remuneration for services from the fund. Also the Securities Exchange Commission can now intervene to aid a private suit.

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67 See: *Conflict of Interest in the Allocation of Mutual Funds Brokerage Business*, 80 Yale L.J. 372 (1970-71).
68 15 U.S.C. 80a-15(a) (1) 1964; op. cit. n. 67 supra at p. 374.
69 80 Yale L.J. at p. 375.

In Great Britain the same issue arose in relation to the sums charged by the managers of Unit Trusts. The level of charges had been controlled by the Board of Trade since 1950 as part of its general price control policy. But the Jenkins Committee felt that this direct control had not been Parliament's original intention and for this and other reasons suggested that it be abolished provided it was made mandatory for the trust deeds of these organisations to disclose the maximum permitted initial and annual charges expressed as a percentage of the value of the unit and of the trust fund respectively.[70] The Committee made other recommendations which could as equally and as usefully apply to our mutual funds. These suggestions included the absolute prohibition of door-to-door sales;[71] implementation of a registration system giving the Board of Trade various controls and the power to cancel registration and thus make further sales to the public illegal, until reinstated, and the provision of inspectors who could investigate the affairs of the registered Unit Trust (or fund) on their own initiative on an application of the manager, trustee or 10% of the unitholders.[72]

We have no Securities Exchange Commission nor Board of Trade in New Zealand but that role could easily be performed by some official such as a registrar but even if the important intervention provision of the British legislation is left aside, the other safeguards in the American legislation are guides to the type of provision which would benefit our investors in superannuation funds. Our investing public receives only slight protection at present from the one regulatory source, the Commissioner of Inland Revenue, whose function to protect the public revenue. He is neither empowered nor equipped to ensure that investment propositions are fairly offered and conducted.

The whole question of control, uniform regulations and remedies in relation to our mutual funds compares poorly with the rules governing Unit Trusts which are strictly regulated by the Unit Trust Act 1960.

The Unit Trust Act 1960:

The aim of this enactment was to give investors in unit trust schemes similar protection to that enjoyed by company shareholders. Their structure and main features are not dissimilar to those of the mutual funds, in that the manager and the trustee are separate companies and the property of the trust rests in the latter (the difference here being that the Unit Trustee must be appointed from the ranks of the Trustee Companies[73] whereas in mutual funds that disinterested group is relegated to the more remote position of Second Trustee). It should be noted that the definition of a Unit Trust used in the 1960 Act is in fact wide enough to include trusts which invest

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70 Jenkins Report, para. 319.
71 Ibid., para. 324, recommendation VIII.
72 Ibid., paras. 323 and 322 respectively.
73 Unit Trusts Act 1960, s. 22 and s. 26 respectively.

in property other than equity securities, i.e. mutual funds. However, as mentioned earlier the Commissioner of Inland Revenue is given a power of dispensation in relation to superannuation funds. This is a potent discretion. His approval of a fund as such and thus its removal from the ambit of the Unit Trust Act is "for the time being" so that where approval is given, there would seem to be no reason why it could not subsequently be withdrawn; this is likely to happen only where the public revenue is being unlawfully deprived of its due, e.g. if the fund failed to comply with the basic prerequisites of a superannuation scheme. This is perhaps to some degree influenced by the problem of the effect on investors' contributions to a fund if the approval was to be withdrawn.

From the investor's point of view it is desirable that mutual funds should come under the purview of this Act. This is more than evident from the fact that it stipulates that the manager must make the fullest possible disclosure to both investors and the trustee. The trustee is given the power to intervene in the interests of the investors, e.g. it can veto management decisions.[74] The Act applies the prospectus-advertising provisions of the Companies Act 1955 to "unit trusts". Furthermore it stipulates that a copy of the trust deed must be registered with the Companies Office[75] as well as to some extent the contents of the deed. The duties placed on managers are set out and implied in every deed.[76] The liability on managers is that incumbent on trustees[77] and they must give a $40,000 bond to secure the discharge of their obligations[78] and file audited accounts annually. The Supreme Court has power to make orders concerning the trust's management. Finally, the trust deed cannot purport to exempt the trustee, manager, directors or any officers of either body from liability for failure to observe the same duty of care, diligence and honesty as rests on any other trustee.[79] It is not surprising that Merriman,[80] having looked extensively at unit trusts and mutual funds in 25 different countries, should classify the New Zealand Unit Trust Act's requirements as "stringent" in comparison with some of the controls exercised elsewhere. But while they may be strict, they provide a form of statutory uniformity of regulation and disclosure which has a sound basis of investor protection.

Conclusion:

(1) These funds are at present regulated only by the Land and Income Tax Act and then only so far as to the requirements for a

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74 Section 12 of the Unit Trusts Act 1960, cf. Northey, *Introduction to Company Law* (7th ed. 1971), 377-378.
75 Unit Trusts Act 1960, s. 9.
76 Ibid., s. 12.
77 Ibid., s. 22 and s. 26.
78 Ibid., s. 3(2) (c) and s. 4.
79 Ibid., s. 24 — however the Trustee is exempt by s. 7 from liability for any mis-statement by the manager in the prospectus.
80 Merriman, *Mutual Funds and Unit Trusts — A Global View*, Pitman, p. 355.

permissible superannuation fund. The aim of that Act is to ensure that such a fund is not merely a disguised tax free savings fund or device to avoid taxation. Its primary aim is the protection of the public revenue and consequently any protection which accrues to investors through its operation is really incidental. Leaving aside the question of the advantage that this gives mutual funds over companies, Unit Trusts, Building and Friendly Societies, and after enactment of the Syndication bill, partnerships, all of which compete for public subscription, it is suggested that the lack of regulation of the funds is a disadvantage for investors. It is desirable that investors in these funds be assured of the substantial protection that the relevant statutes give to investors in those other institutions mentioned above.

No suggestion whatsoever is made or is it in any way to be implied that any malpractice, misappropriation or mismanagement has taken place or is taking place in or in connection with any existing mutual fund. But it is trite that in the past, history has evidenced a need for public regulation where public subscription is involved. In relation to mutual funds three main points of criticism arise, that do not arise under the enactments mentioned above. *First,* at present, the accountability of the management of the funds is uncertain.

The discussion of *Bath's case* shows that where the trustee has an absolute discretion, then while he is clearly in a strict fiduciary position to the cestui que trust, persons employed by him will not be in such a relationship, at least not directly. Their duty will be to the trustee and will turn on their contract or their relationship to him. If perchance any mismanagement were to occur, the fundholder would have to rely on the trustee to recover any loss. Because of the contract he may be unable or unwilling to do so. Unlike the company situation where, if the directors are unwilling to act, the shareholder at least has the possibility of bringing a representative or derivative action in certain instances, such would not seem to be the case here. Furthermore, the trustee himself in such a situation would presumably be exempted from liability for the acts of his agents by the provisions of the Trustee Act. Thus leaving aside the suggested availability of a direct action under the rule expounded in the *Fawcett* case, there would seem to be no action at equity available to the fundholders.

Likewise it is doubtful whether they would have any redress at common law on contractual grounds; the reason for this is that at least some of the funds, by way of their trust deeds, purport in effect totally to exempt from liability not only the First Trustee but also its officers, employees and agents. Despite his tenacity, Lord Denning has not yet managed to inflict so mortal a wound as to destroy the possibly all pervading effect of the wide and inequitable exclusion clause. Thus the fundholder having signed the trust deed may fall within the rule in *L'Estrange* v. *Graucob Ltd.*[81] The fundholder's position is at least sufficiently uncertain at equity and common law

81 [1934] 2 K.B. 394.

to warrant comment. This uncertainty does not generally arise in the company, unit trust or building society situation for two reasons. First, because their governing statutes preclude the directors, trustees or managers from excluding either themselves, their officers, employees or agents from liability and secondly, and perhaps the major point to be emphasised in this regard, is that either those institutions per se, or their governing enactments provide their contributors with the means to call the directors to act and to account. The company shareholder has the annual general meeting, the minority protection provisions and the derivative action. The unit trust holder has his right provided by sections 18 and 20(1)(b) and (2) of that Act. Section 18 relates to the provision of meetings and s. 20 states that one-tenth in number of the unit holders or the holders of not less than one-tenth of the value of interests in the unit trust may summon a meeting . . .

The mutual fund holder is provided with no such mechanism whereby he can question or check the operation and management of the fund.

This leads to the second main point of criticism which relates to disclosure: (a) accounting disclosure and (b) advertising disclosure.

(a) At present these funds would seem to be under no obligation whatsoever to provide their contributors with an annual report or account and if they do then there is nothing which dictates the content of these documents.

In the writer's opinion it seems that while the funds have found it expedient to issue their fundholders with a report, they have presented their accounts in a way which, while convenient to them, may not be the most satisfactory from the investor's point of view.

(b) In relation to advertising the question of disclosure is rather more vexed. It is true that these funds depend on advertising for their successful operation. It is not suggested that their advertising be curtailed to the extent that company investment advertising has been. But it seems clear that while they should be permitted to advertise in the normal way using the mass media as service and commodity suppliers do, yet their brochures and those of their agents and salesmen and especially one which contains an application form, or any application form itself, should fall within provisions similar to the prospectus requirements of the Companies Act. There is no justification for the present situation where brochures containing application forms with inadequate information are circulated publicly. The requirements in this respect made of companies and unit trusts are far more satisfactory.

In relation to this whole question of disclosure in reports, accounts and advertising, Weinberg,[82] Berle and Means,[83] Pennington[84] and

82 Weinberg, *Takeovers & Amalgamations* (2nd ed.), p. 267.
83 Berle & Means, *The Modern Corporation and Private Property,* Macmillan 1933.
84 Pennington, *The Investor and the Law,* Macgibbon & Kee, 1968, pp. 558-9.

Gower[85] agree that the greatest real protection an investor can get lies not, for example, in prohibitions placed on directors or managers or increasing their duties but "in imposing rules requiring disclosure by the (institutions) of all material facts tending to change open-market appraisals . . ." This applies equally to mutual fund investors. For them there is a need for greater disclosure before they become committed to the fund because, once in, they cannot (unlike shareholders) freely extract their investment. This is a major reason for the suggestions that the requirements of the Unit Trust Act present an admirable model of the type of regulation that should govern mutual funds. The unit trust manager *must* provide potential investors with a statement or prospectus which not only is to reproduce or summarise many of the provisions of the trust deed but which is also to contain the information specified in the Schedule to the Act, which information the Legislature has deemed "would be likely to interest an informed investor and influence his decision to invest".[86] It should be noted that such a statement is also deemed to be a prospectus within ss. 2, 55 and 457(a) of the Companies Act 1955 so that the provisions of that Act and all other enactments and rules of law relating to prospectuses will apply as if the interest in the unit trust were shares. The assessment of the information supplied is left to the investor.[87] This leads to the third main criticism of the funds. It turns on a combination of points already made and concerns the question of the regulation of remuneration paid to management.

As things stand, at least one fund deed gives the First Trustee an absolute, unfettered discretion to pay whomsoever, howsoever and whatsoever the directors of the First Trustee feel like paying.[88] This wide discretion includes the power to decide what they themselves are to be paid.[89] This is far from satisfactory when one compared with the company situation. In a company, the directors as such are not servants of but managers of the company's affairs. Thus they have no claim for payment for their services unless, as is usual, there is a provision for payment in the articles.[90] Article 76 of Table A of

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85 See Gower *Modern Company Law* (3rd ed. 1970), pp. 444 and 446-7.

86 Farrands, *Company Law in New Zealand,* Sweet & Maxwell (N.Z.) Ltd., 1970, p. 530.

87 *Allied Investors' Trusts Ltd.* v. *Board of Trade* (1956) Ch. 232; *Re Electrical & Industrial Devel. Trust* [1956] 1 All E.R. 162.

88 "The expenses of managing the Fund including the fee [etc.] payable to any person [etc.] employed to recruit new contributors, the fee of the management agency . . . the remuneration of Directors, Secretary and other officers of the First Trustee, members of the Advisory Panel, the Second Trustee *and any other person* [etc.] *providing services for the First Trustee* and . . . Fund generally, *shall be charged equitably against the contributions or moneys paid to the First Trustee in such manner as the First Trustee may from time to time determine.*" (Emphasis added.)

89 The auditors of one Fund now test the calculation and debiting of management expenses and certify that in their opinion these were fair and equitably made between contributors. This is not the best solution to protect the investor-contributor.

90 *Woolfe* v. *East Nigel Co.* (1905) 21 T.L.R. 660.

the Companies Act provides that remuneration of the directors shall from time to time be determined by *the company in general meeting* . . . If there is no such or similar provision then the remuneration is at *the gift of the annual general meeting* of members — it is a gratuity and not an expense and the directors have no legal cause of action to recover it.[91] Suffice to reiterate at this point that mutual fundholders do not have these rules or means available to them to exercise some control over the amount of remuneration paid out of the fund to the directors, the managers and their agents. In the above instance the wide discretion conferred on the First Trustee was conferred on itself by itself; the fundholders had no say in the matter nor do they get an opportunity to alter or amend it. A further adverse comparison can be made with unit trusts; clause 14 in the Schedule to the Unit Trust Act states that full information regarding the remuneration of the trustee and the manager must be made to the investor in the prospectus "together with the provision (if any) of the trust deed governing the manner in which provision is made for their remuneration and the charges (if any) that are made (regarding it) on the sale of or subscription for or purchase of an interest in the unit trust and upon the distribution of income and capital under the trust deed."

The Jenkins Committee's recommendation in relation to charges which was mentioned above cannot be too strongly reiterated and endorsed. It is suggested that the maximum charges should be disclosed as a percentage of the unit and of the fund values in the prospectus which *must* accompany every publicly circulated application form.[92]

These are the three major areas of concern and criticism of the situation which exists at the present time. Other anomalies arise but they concern points which are not common to every fund; some examples follow.

At least one fund does not make it clear who revalues the properties annually. One, without explanation, revalued only a few of its properties in a particular year.

In the chairman's report of one fund the fundholders were told that the fund "showed a small loss". However, if management fees and commissions are treated as an expense or overhead or deducted from the net income of the fund then the loss amounted to approximately 10% of the capital value of the fund at balance date.

The advertising brochure of one of the funds contained photographs of modern high rise buildings without information as to where the buildings were situated and whether the fund had any interest in them. The subsequent disclosure of properties owned by it in its report indicated that it did not own any of the buildings depicted in

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91 *Putaruru Pine and Pulp Co.* v. *MacCulloch* [1934] N.Z.L.R. 639.
92 Jenkins Report, para. 319.

its brochure. If those photographs were included simply as examples of the types of property it was hoped that eventually the fund would own, this should have been stated.

While no suggestion is made or inferred that any impropriety has occurred or is occurring, these matters strengthen the arguments for some form of statutory regulation in order to obtain uniformity, to deter possible irregularities, to disclose the state of the funds and to provide fundholders with some democratic means of checking and controlling those who are entrusted with their investment.

It is recommended therefore that the superannuation type mutual funds should be brought within the provisions of the Unit Trust legislation although some exemption may be needed with regard to normal advertising in the media and perhaps also in relation to utilisation of salesmen, although both these aspects should not be completely unregulated.

POSTSCRIPT — THE SYNDICATES BILL

This article was completed just prior to the introduction of the Syndicates Bill to Parliament. The suggestion has been made that this Bill as it stands will (if enacted) apply to mutual superannuation funds. If this is so, many of the areas of criticisms discussed above will have to be rectified expeditiously by the funds if they are to comply with the requirements of the Bill. This could mean some drastic changes in the structure and operation of the funds.

Briefly the Bill regulates invitations made to the public to acquire interests in "syndicates". It states that such invitations must be made in the form of a prospectus containing all the particulars stipulated in a Schedule to the Bill. It imposes liability and penalties for mis-statements in a prospectus; it restricts advertising and curtails door-to-door invitations or sales. Before a prospectus is issued a statutory trustee (i.e. one of the trustee companies, etc.) must be appointed and all moneys subsequently subscribed before the deed of syndication comes into effect must be held on trust by the syndicate's statutory trustee. The Bill increases the degree of disclosure to investors by stipulation as to the content of the prospectus and the deed. It imposes duties on trustees and managers which cannot be avoided and prohibits attempts to exempt them from liability. It requires separate, annualy audited accounts for each syndicate and an annual report to members. An annual general meeting of members must be convened. Provision is made for those instances where the promoters or any other person undertakes in the prospectus to purchase any of the syndicate's assets at a future date and a right to apply for the dissolution of the syndicate is given to its members. In brief, this Bill makes mandatory the provision of many "devices" to regulate and control the management and administration of the organisations in question. As they stand at present, mutual superannuation funds do not comply with and do not provide many of the items outlined

above, e.g. their members are not entitled to an annual general meeting.

The question is whether these funds do come within the ambit of this proposed legislation. The protagonists of the affirmative view are provided with what appears to be a very wide definition in the Bill on which to rely. However, the situation is not so easily settled. In opposition to that view several arguments can be raised which place the funds outside the scope of the Bill.

The heart of the question lies in the Bill's definition of a "syndicate" as:

> "Any partnership, special partnership, joint venture or *other unincorporated association of persons* established . . . to undertake for profit or gain any financial or business scheme . . . " (emphasis supplied).

On the one hand no express mention of mutual funds is made anywhere in the Bill. On the other, the only exemption from the application of the Bill is given in relation to professional "syndicates" where the occupation or business is legally performable only by qualified persons. Thus while in everyday language one would not normally refer to a mutual superannuation fund as a syndicate, the definition clause in the Bill is arguably wide enough to deem them to be syndicates for its purposes.

Arguments *against* the inclusion of the funds within the scope of the definition are:

(1) That the whole tenor of the Bill indicates that it is not intended to apply to such large institutions as the funds. All the terms therein: syndicate, partnership, joint venture, tend to indicate that the Legislature had in mind small groups of up to 25 members. Mutual funds however can at present have an unlimited number of "members" without becoming subject to any of the existing regulatory legislation. The use of the word "other" before the words "unincorporated associations" in the definition could be said to limit the otherwise wide scope of those words to groups consisting of not more than 25 members as imposed on partnerships and other such trading groups by s. 456 Companies Act 1955. Also the purpose of the Bill or the mischief in society which it seeks to remedy has no connection with mutual funds but relates to or stems solely from the recent collapse of JBL Ltd and the adverse effect for investors involved in the numerous small syndicates managed by it. In brief, the Bill is not intended to apply to mutual funds just as it was not intended to apply to their comparable institution, the unit trust.

(2) Some of the provisions of the Bill either have no application to the funds or could be applied only at the expense of their taxation exemption. For example, cl. 43 of the Bill gives *any member* the right to apply to the Court for the dissolution of a syndicate. The Court can order this as if the syndicate were a partnership to which s. 38 of the Partnership Act 1908 applies. This provision, if applicable,

would defeat the superannuation nature of the present mutual fund schemes. In effect it would mean that they could become tax free savings schemes at the whim of the "members". Also cl. 45, which stipulates that a trustee must be appointed where an undertaking to purchase assets from a syndicate at a future date has been made, to ensure that it can be performed, seems to be of doubtful relevance to the existing mutual funds.

(3) The strongest argument against their inclusion is based on the words used in the definition. Clearly a mutual fund cannot be classed as a "partnership or special partnership". "Joint venture" indicates a *combined* embarkation by investors in the initial stage, which is not what occurs in so far as the contributors to a fund are concerned. On the question whether it is a joint venture or "association . . . for profit or gain . . ." one must bear in mind the utilisation by these funds of the trust concept.

The leading case — *Smith* v. *Anderson*[93] established that the forerunners of the modern unit trust and similar institutions based on the trust did not fall within the ambit of the equivalent of s. 456 of the Companies Act 1955. That section uses slightly different words:

> No company, association or partnership consisting of more than 25 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain (by it or its members) unless it is registered . . .

Back in the 1870's the deed of settlement companies and management trusts operated with more than 25 "members" and yet were unregistered. For this reason they were held illegal in *Sykes* v. *Beadon*[94] but this was reversed in *Smith* v. *Anderson.* The reasons for the latter decision have a bearing on the scope of the definition in the Syndicates Bill. The Court of Appeal held that —

(i) There was *no* "association" between the "certificate holders" (unitholders or fundholders) between whom no mutual rights or obligations had been created and who could not be said to become "associated" merely because they had an interest as beneficiaries in something which was to be divided among them.

(ii) The "certificate holders" were not "carrying on business" themselves because they had no greater control over the venture than the beneficiaries under an ordinary trust, and they were not carrying on business through their agents (the trustees) because the trustees had the property, and management of it, vested in themselves. When they dealt with it the trustees did so as the owners, holding themselves out as personally liable and those with whom they dealt had no recourse against the "certificate holders" in that instance, nor the "certificate holders" against them.

93 (1880) 15 Ch. D. 247.
94 (1879) 11 Ch. D. 170.

On these grounds the forerunners of the modern unit trust and mutual superannuation fund were exempt from registration under the Companies Act.

(4) A final point is that a number of cases including *Smith* v. *Anderson* have held that in relation to the word "gain" in s. 456 of the Companies Act the profit or gain must result from a "business". The case *Armour* v. *Liverpool Corporation*[95] has held that the operation of a superannuation fund does not involve the carrying on of a "business". Despite the slightly different wording of the definition in the Syndicates Bill this would still seem to be applicable. It reads:

> . . . or (an) association . . . to undertake for profit or gain any financial or business scheme, venture or enterprise.

Relying on *Armour's* case, it could be said that a superannuation scheme is not a "business scheme" and whether there is any distinction between that and a "financial scheme" is doubtful. Even if the funds were clearly caught by this part of the definition it by no means negatives the other arguments excluding them from the ambit of the Bill.

Because of the points in (3) and (4) above, mutual superannuation funds were exempt from registration under the Companies Act. All of the points in (1)-(4) in varying degrees, but especially the first reason for the decision in *Smith* v. *Anderson* (which seems to preclude them from being classified as "associations") place these funds outside the scope of the proposed syndicates enactment as well. As has been suggested earlier, in the writer's opinion, mutual funds should be regulated by statute. However, if they are to be brought within any existing Bill or Act, it should be the Unit Trust Act 1960, although exemptions such as cl. 11 of the Syndicates Bill (permitting certain types of advertising) could be allowed to them.

C. L. RYAN*

95 [1939] Ch. 422.

* LL.M., Lecturer in Commercial Law, Commerce Faculty, Victoria University of Wellington.