

KEITH ALFRED EDWARD MARLOW & ANOTHER

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v.

THE COMMISSIONER OF ESTATE AND GIFT DUTIES, SUVA & OTHERS

[SUPREME COURT—Kermode J.—27 March 1984]

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Civil Jurisdiction

Issue of preference shares—right to share in surplus asset of winding up—referrable to Memorandum and Articles, terms of resolutions passed or other evidence as to terms of issue—voting rights—donor primarily liable for gift duty.

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B. N. Sweetman for Plaintiff

M. J. Scott for 1st Defendant

F. G. Keil for 2nd Defendant

Plaintiff sought a determination of four questions related to preference shares issued by Marlows Limited (formerly Fiji Builders Ltd.) (the Company).

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On 18 October 1943 the late A.H. Marlow entered into a deed of separation with his then wife Geraldine Alice Marlow and created then the Marlow Trust.

The Marlow Trust settled on the wife for her life (inter alia) 3,000 \$2 preference shares in the Company, dividends to be payable to her during her life. The shares had been issued to the husband in 1938 pursuant to a Resolution passed at a General Meeting of the company in the following terms:

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"Preference Shares: Proposed by Mr A. H. Marlow and Seconded by F. W. Bond. That 3000 Shares of the Capital of the Company be made Preference Shares, with the right to a fixed Cumulative Preferential Dividend of 7% per annum on the Capital for the time being paid up thereon, and the right in a winding up to payment off the Capital and arrears of dividend, whether declared or undeclared up to the commencement of the winding up in priority to the Ordinary Shares of the Company."

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On 16 May 1970 the Company at the husband's request and on payment by him of \$10,000 issued a further 5,000 \$2 preference shares pursuant to a Resolution passed similarly recorded in minutes as follows.

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A "Preference Shares It was resolved that 5,000 7% Preference Shares be issued to Marlow Trust at par."

The husband did not make any Gift Duty Statements or pay any duty in respect of the 1970 gift, an omission remedied by a statement filed and dated 5 March 1981.

B The 4 questions submitted to the court were as follows:

C "(1) Whether on the true construction of the Memorandum and Articles of Association of Marlow's Limited the 8,000 preference shares of that company held in the Marlow Trust should be valued as at the 25th day of January, 1980 on the basis that any surplus assets of the Company ought to be distributed on the footing that the preference shareholders were entitled to participate with the ordinary shareholders in such distribution rateably or in some other and what proportion, or upon the footing that the preference shareholders had no right to participate in such distribution?"

D "(2) Which party or person is primarily liable for payment of gift duty (if any) on the gift made by Alfred Henry Marlow deceased to the Marlow Trust on the 16th day of May 1970 comprising a \$10,000.00 credit with Marlow's Limited applied at the request of the said Alfred Henry Marlow in the issue to the Marlow Trust of \$5,000 preference shares of \$2.00 each in Marlow Limited?"

"(3) Whether the preference shares carry voting rights?"

E "(4) Whether the 2nd issue of preference shares are subject to the same conditions as the first issue?"

The questions may now be considered in order.

F The main issue was that raised by the first question namely how the 8,000 preference shares should be valued. That involved deciding whether the holders of those shares would have been entitled on winding up of the company to participate in surplus assets.

The question was a purely hypothetical, there being then no intention of winding up the company.

G The share certificates relating to the separate issues were in identical terms purporting to express the terms on which issued viz.

"The preference shares carry a final Cumulative Preferential Dividend at the rate of 7 per centum per annum and rank as to dividend and capital in parity to the Ordinary Shares but convey no further right to participate in profits or assets."

H The Memorandum and the Articles of the Company did not spell out the rights of different classes of shares but provided reference to terms of any shares issued. (See para. 3(p) of the Memorandum).

Paragraph 6 of the Memorandum also had application viz:

"The capital may from time to time be increased and the present capital or any part thereof and the whole or any part of such increased capital may from time to time be issued as ordinary or deferred shares or at a discount or at a premium or with any preference guarantee privilege or other advantage and upon such terms and conditions as the directors think fit and all or any part of the share capital for the time being of the Company may be issued as fully or partly paid up."

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It was common ground that the two issues of shares were lawfully made in exercise of the powers provided in the Memorandum.

Neither of the resolutions authorising the share issues made mention of rights as to participation in or a sharing of surplus assets, in the sense used in the judgment.

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Article 147 made clear that special rights could be conferred by special resolutions passed by the company. It was argued on behalf of the plaintiff that the 8,000 preference shares were by article 146 given the right to share in a surplus on winding up.

Held: To determine what rights a preference shareholder has, recourse must be had to the Memorandum and/or Articles of the Company or to the terms of resolutions passed by the company in general and special meeting. The share certificates may also be referred to if there is not otherwise evidence as to the terms on which the shares to which such certificate relates were held. The rights of preference shareholders were dependent upon the resolutions creating such shares or by the Articles (amended by any relevant resolution.)

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Since neither the Memorandum nor Articles of the Company had any provision entitling the preference shareholders to share any surplus assets (other than Article 146) the Scottish Corporation case (*supra*) indicated the preference shareholders had only such rights as were conferred by the resolutions of the company at the time of issue.

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All counsel agreed as to the answers to the 2nd and 3rd questions. The terms of issue of the second parcel of shares determined the rights conferred thereon by the Company, being these contained in the relevant resolutions viz a fixed dividend of 7% and the issue of the shares at par.

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The answer to the questions posed therefore are as follows:

1. None of the preference shareholders have a right to distribution in surplus assets as earlier defined on winding up.
2. The Donor was primarily liable.
3. The preference shares do not carry voting rights.
4. The second issue of preference shares was not subject to the same conditions as the first.

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A Cases referred to:

Scottish Insurance Corporation Ltd. & Ors. v. Wilsons & Clyde Coal Co. Ltd. (1949) 1 All E.R. 1068.

White v. Bristol Aeroplane Co. Ltd. (1953) 1 All E.R. 40.

Re. John Dry Steam Tugs Ltd. (1932) 1 Ch. 594

In re. the Isle of Thamer Electricity Supply Co. Ltd (1950) 1 Ch. 161

In re. Espuela Land and Cattle Company (1909) 2 Ch. 187

Dimbula Valley (Ceylon) Tea Co. Ltd. v. Laurie (1961) 1 All ER 769

KERMODE J.

B

Judgment

The plaintiff seeks the determination of the Court of four questions which will be referred to later.

- C Mr E. H. Marlow, one of the second defendants, in his affidavit filed in support of the plaintiff's summons has set out the facts which gave rise to a difference of opinion between the plaintiffs and the first defendant and the second defendants resulting in this application.

- D By a Deed of Settlement (hereinafter called "the Marlow Trust") dated the 18th day of October, 1943 entered into by the late Geraldine Alice Marlow (hereinafter called "the first deceased") and the late Alfred Henry Marlow (hereinafter called "the second deceased") the parties entered into a Deed of Separation and the second deceased created the Marlow Trust.

The Marlow Trust settled on the first deceased for her life (inter alia) 3,000 \$2.00 preference shares in Marlows Limited (then Fiji Builders Limited), (hereinafter called "the Company"), the dividends to be payable to her during her life.

- E The said 3,000 preference shares had been issued to the second deceased in 1938, pursuant to a resolution passed at a general meeting of the Company, in the following terms:

- F "Preference Shares Proposed by Mr A. H. Marlow and Seconded by F. W. Bond. That 3000 Shares of the Capital of the Company be made Preference Shares. with the right to a fixed Cumulative Preferential Dividend of 7% per annum on the Capital for the time being paid up thereon, and the right in a winding up to payment off (sic) the Capital and arrears of dividend, whether declared or undeclared up to the commencement of the winding up in priority to the Ordinary Shares of the Company."

- G On the 16th May, 1970 the Company at the request of the second deceased and on payment by him of \$10,000 issued a further 5,000 \$2.00 preference shares pursuant to a resolution passed at a general meeting. The minutes of that meeting record as follows:

"Preferences Shares It was resolved that 5,000 7% Preference Shares be issued to Marlow Trust at par."

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The share certificate for these 5,000 shares was made out in the names of Keith Alfred Edward Marlow, Ralph Sidney Marlow and Eric Henry Marlow because the

second deceased at the time believed that Ian Eric MacKinnon had retired from the Trust and had been replaced by Messrs. Ralph Sidney and Eric Henry Marlow. There was not however any formal resignation or appointment of any new trustees.

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The said Ralph Sidney Marlow died in 1963 and by Declaration of Trust dated 20th February 1981 Messrs. K. A. E. and E. H. Marlow declared that they held the said 5,000 additional preference shares upon the same trusts as the original 3,000 preference shares are held by the trustees thereof.

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The second deceased did not make any Gift Duty Statement or pay any duty in respect of the 1970 gift of the \$10,000 or the 5,000 preference shares. This omission was remedied by a gift duty statement filed by Mr K. A. E. Marlow dated the 5th day of March, 1981.

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The procedure followed in this case has been of considerable assistance to the Court. All counsel submitted written submissions and at the hearing covered briefly points raised by other counsel or added to their written arguments. The result has been that the Court has had the benefit of three well considered, well written submissions supported by authorities.

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I turn now to consider the four questions. The first question is as follows:

"(1) Whether on the true construction of the Memorandum and Articles of Association of Marlows Limited the 8,000 preference shares of that Company held in the Marlow Trust should be valued as at the 25th day of January, 1980 on the basis that any surplus assets of the Company ought to be distributed on the footing that the preference shareholders were entitled to participate with the ordinary shareholders in such distribution rateably or in some other and what proportion, or upon the footing that the preference shareholders had no right to participate in such distribution?"

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The main issue to be considered is that raised by this first question, namely how the 8,000 preference shares should be valued. That involves deciding whether the holders of those shares would be entitled on a winding up of the Company to participate in surplus assets.

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The question posed is a purely hypothetical one because there is no present intention of winding up the company.

The certificates pertaining to the two separate issues of the preference shares were more specific and went further than the terms of the resolutions which authorised the issue of them.

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Both certificates purport to express the terms on which the shares were issued in identical terms as follows:

"The preference shares carry a final cumulative Preferential Dividend at the rate of 7 per centum per annum and rank as to dividend and capital in parity to

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- A the Ordinary Shares but convey no further right to participate in profits or assets.”

To determine what rights a preference shareholder has recourse must be had to the memorandum and/or articles of the Company or to the terms of resolutions passed by the Company in general and special meeting. In my view the share certificates may also be referred to if there is not otherwise evidence as to the terms on which the shares to which such certificate relates are held. Under section 85 of the Companies Act 1983 the certificate is prima facie evidence of the title of the member to the shares.

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- C The memorandum and articles of association of the company do not spell out the rights of different classes of shares but very full powers are provided therein with regard to the shares that can be issued and the terms on which they may be issued by the company.

Paragraph 3(p) of the memorandum is very full and, since there is reference in it to the rights of a shareholder on distribution of the assets the paragraph is stated in full. It provides as follows:

- D “From time to time to make the shares of the capital of the company original increased or reduced or any part thereof ordinary or preferred or guaranteed or deferred shares and to convert the same into shares of different nominal amount and in any case either of one class and with like privilege or of several classes and with different privileges and of the same or different amounts and respectively with any fixed fluctuating contingent preferential perpetual terminable deferred or other dividend or interest and subject to the payment of calls of such amounts and at such times as the company from time to time thinks fit and with such rights in the distribution of the assets of the company and with a special or without any right of voting and subject to such other conditions and restrictions as may by the company in general meeting be from time to time determined and to issue all or any of such shares at par or at a discount or at a premium or as paid up or partly paid up.”
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Paragraph 6 of the memorandum also has application and is as follows:

- G “The capital may from time to time be increased and the present capital or any part thereof and the whole or any part of such increased capital may from time to time be issued as ordinary or deferred shares or at a discount or at a premium or with any preference guarantee privilege or other advantage and upon such terms and conditions as the directors think fit and all of any part of the share capital for the time being of the company may be issued as fully or partly paid up.”

- H It is not in dispute that the two issues of preference shares were lawfully made in exercise of the very wide powers provided in the memorandum. Articles 10 and 11 also provide for issue of various classes of shares without specifying or limiting the terms on which shares can be re-issued.

Neither of the two resolutions authorising the issues of the two parcels of preference shares makes any mention of any rights as regards participation in a sharing of surplus assets, that is to say, the assets of the company remaining after payment of the debt and liabilities of the company, after payment of any arrears of preference dividends up to the date of the beginning of the winding up, after returning to the members the amounts paid up or credited as paid up on all the shares of the company and after providing for payment of costs.

Paragraph 3(p), which must be read with the articles, envisages that the Company may in general meeting, as regards shares, issue such shares with such rights as the Company may from time to time determine.

If the Articles in dealing with the assets of the Company on a winding up do not indicate that preference shares are to have rights as regards surplus assets, then *prima facie* it would appear that such rights must be conferred pursuant to a resolution of the Company which specifies the terms on which such shares are issued.

Article 147 also makes it clear that special rights are conferred by special resolutions passed by the Company. The Article is in the following terms:

"Subject to the provisions if any in that behalf of the memorandum of association of the company and without prejudice to any special rights previously conferred on the holders of existing shares in the company any share in the company may be issued with such preferred deferred or other special rights or such restrictions whether in regard to dividend voting return of share capital or otherwise as the company may from time to time by special resolution determine."

I ignore the purported terms written on the share certificates where such terms depart from the terms expressed in the resolutions because there is no evidence that the original terms were subsequently varied by any resolution of the Company.

In any event I would agree with Mr Scott that the end result would be the same on the authority of the cases he has quoted.

Mr Sweetman in his submission has referred to paragraph 6 of the memorandum which I have earlier quoted and to Article 146 which is in the following terms:

"If the company shall be wound up the whole amount of the uncalled Capital shall be called up and subsequent distribution shall be made on all shares alike after provision for shares issued on special conditions."

As regards Article 146 Mr Sweetman argues that on the authority of *In re John Dry Steam Tugs Ltd.* [1932] 1 Ch. 594 and *In re The Isle of Thanet Electricity Supply Co. Ltd.* [1950] 1 Ch. 161 the 8,000 issued preference shares were by that article given the right to share in a surplus on a winding up of the Company.

Article 146 does not refer to "surplus assets" but to the situation where shares are not fully paid up or credited as such. To form an equitable basis for sharing the assets of a company on a winding up it is essential that all shares, whether preference or otherwise are fully paid.

Article 146 does provide that uncalled capital, after provision is made for shares issued on special conditions is distributed to *all* shareholders. *All* shareholders would include preference shareholders. The article would, however, only cover a

- A possible surplus of the called up capital and to this extent a preference shareholder would share in any such surplus.

Article 146 also makes no mention of the debts or liabilities of the Company which have to be paid before there can be distribution on the shares.

- B Article 147 which I earlier quoted indicates that it was believed at the time that preference shareholders had a right on a winding up to share with ordinary shareholders in any surplus assets. The article includes in the restrictions which the Company can impose "return of share capital or otherwise" which would seem to indicate that exclusion from participation in a sharing of surplus assets would have to be specifically stated.

- C The Company memorandum and articles of association are dated the 24th March, 1938. That date provides a clue as to why special mention is made about a possible surplus when uncalled capital is called up when there is no specific provision regarding the overall surplus of assets on a winding up.

- D In 1938 it was believed in most legal circles that preference shareholders on a winding up shared any surplus assets with ordinary shareholders. This could account for no specific provision being made regarding the overall surplus assets in the Company's memorandum and articles. In the instant case it appears that it was thought necessary at the time to deal specifically with uncalled capital which is called up on a winding up resulting in Article 146 which indicates that any surplus of such capital is to be distributed on *all* shares. That is consistent with what was believed at the time to be the legal situation.

- E In *re John Dry Steam Tugs Limited* [1932] 1 Ch. 594 it was held "that there being nothing in the articles to modify or exclude the normal right of the preference shareholders to share in the distribution of the surplus assets, they were entitled to rank *pari passu* with the ordinary shareholders in such distribution".

In that Company, unlike the Company in this case, the articles of association spelled out the rights of the preference shareholders but made no specific mention of surplus assets.

- F Eve J. in that case followed (inter alia) *In re Espuela Land and Cattle Company* [1909] 2 Ch. 187 where both the memorandum and articles had similar provisions regarding preference shares but were silent as to surplus assets on winding up.

- G Until 1949 there was some conflict of legal opinion on the issue as to whether preference shareholders had a right to share in surplus assets. That conflict was laid to rest by the House of Lords in *Scottish Insurance Corporation Ltd. & Ors. v. Wilsons & Clyde Coal Co. Ltd.* [1949] 1 All E. R. 1068. In that case two articles of the Company governed the rights of the ordinary and preference shareholders but there was no mention of surplus assets.

Lord Simonds said at p.1077:

- H "Reading these articles as a whole with such familiarity with the topic as the years have brought, I would not hesitate to say, first that the last thing a preference shareholder would expect to get (I do not speak here of legal rights) would be a share of surplus assets . . ."

At p.1078 Lord Simonds also said:

"It is clear from the authorities, and would be clear without them, that, subject to any relevant provisions of the general law, the rights *inter se* of preference and ordinary shareholders must depend on the terms of the instrument which contains the bargain that they have made with the company and each other. This means that there is a question of construction to be determined and, undesirable though it may be that fine distinctions should be drawn in commercial documents such as articles of association of a company, your Lordships cannot decide that the articles here under review have a particular meaning, because to somewhat similar articles in such cases as *Re William Metcalfe & Sons, Ltd.*⁽³⁾ that meaning has been judicially attributed."

(3) [1933] Ch. 142.

Lord Simonds gave very cogent reasons why the rights of preference shareholders were dependent on the express terms of their shares. He also said at p.1078 as follows:

"If there are 'surplus assets', it is because the ordinary stockholders have contrived that it should be so, and, though this is not decisive, in determining what the parties meant by their bargain it is of some weight that it should be in the power of one class so to act that there will or will not be surplus assets. There is another somewhat general consideration which also, I think, deserves attention. If the contrary view of articles 159 and 160 is the right one and the preference stockholders are entitled to a share in surplus assets, the question will still arise what those surplus assets are. For the profits, though undrawn, belong, subject to the payment of the preference dividend, to the ordinary stockholders, and, in so far as surplus assets are attributable to undrawn profits, the preference stockholders have no right to them. This appears to follow from the decision of the Court of Appeal in *Re Bridgewater Navigation Co.*⁽¹⁾, in which the judgment of the House of Lords in *Birch v. Cropper*⁽²⁾ is worked out. This again is not decisive, but I am unwilling to suppose that the parties intended a bargain which would involve an investigation of an artificial and elaborate character into the nature and origin of surplus assets."

(1) [1891] 2 Ch. 317. (2) 14 App. Cas. 525

Romer L. J. in *White v. Bristol Aeroplane Co. Ltd* [1953] 1 All. E.R. 40 at p.48 said:

"The rights attached to a class of shares within the meaning of such an article as this remains attached by the resolutions creating such shares or by the Articles of Association of the Company as amended from time to time by any relevant resolution, and accordingly, one has to look to such resolutions and to the constitution of the Company to find out what the rights of the preference shareholders are."

In *Dimbula Valley (Ceylon) Tea Co. Ltd. v. Laurie* [1961] 1 All E.R. 769 Article 5 of the Articles of Association of the Company specifically stated what rights were conferred in respect of the 10,000 preference shares in the Original Capital of the Company. Buckley J. had no difficulty in holding that the preference shareholders were entitled to participate in the surplus assets after receiving their entitlement because the article so provided.

As I have pointed out earlier in this judgment neither the memorandum nor the articles of the Company have any provision entitling the preference shareholders to share in any surplus assets other than Article 146 which I referred to earlier.

- A Since the *Scottish Corporation* Case the law is clear. It matters not that the memorandum and articles of the Company were framed in the belief that all shareholders shared in any surplus assets and it was thought there was no need to spell out that belief except for Article 146 which does envisage a possible surplus. The memorandum and articles are silent as to any right that a preference shareholder may have to a general surplus of assets on a winding up. The preference shareholders in my view only have such rights as were conferred by the resolutions of the Company at the time they were issued.

B My answer to the first question is that none of the preference shareholders have a right to distribution in the surplus assets as earlier defined in this judgment on the winding up of the Company. In saying this I have not ignored Article 146. There could conceivably be a surplus resulting from called up capital but that could only be determined on an actual winding up. That possibility must be ignored on a valuation of the shares in the instant case since there is no prospect of the company being wound up in the foreseeable future.

C The question is as follows:

- D "(2) Which party or person is primarily liable for payment of gift duty (if any) on the gift made by Alfred Henry Marlow deceased to the Marlow Trust on the 16th day of May 1970 comprising a \$10,000.00 credit with Marlow's Limited applied at the request of the said Alfred Henry Marlow in the issue to the Marlow Trust of \$5,000 preference shares of \$2.00 each in Marlow's Limited?"

E As regards this question all counsel agree that the law is clear. Sections 44 and 45 of the Estate and Gift Duties Act make the donor of the gift primarily liable for any gift duty payable on the gift of the 5,000 preference shares. The second defendants as trustees of the late Alfred Henry Marlow are the persons primarily liable.

The third question is as follows:

- "(3) Whether the preference shares carry voting rights?"

F All counsel agree that the preference shares do not carry voting rights. I agree with them and do not consider it necessary to set out the reasons for such agreement. Mr Scott has presented a very interesting argument that it could be held that the shares did carry voting rights.

G In view of Article 72 which provides (inter alia) that "every question submitted to a General Meeting shall be determined by *show of hands of the ordinary shareholders present in person*....(emphasis added) preference shareholders have no right to vote unless such right is conferred by resolution of the Company when issuing the shares.

The answer to the third question is that the preference shares do *not* carry voting rights.

The fourth question is as follows:

- H "(4) Whether the second issue of preference shares are subject to the same conditions as the first issue?"

Both Mr Sweetman and Mr Scott agree that the second issue of shares are subject to the same conditions as the first issue although they have different reasons for arriving at that conclusion.

Mr Keil on the other hand sticks to the letter of the law as propounded by the *Scottish Insurance Corporation Case*. He considers the rights attached to the second issue by resolution are exhaustive. He does not specifically state that the answer to the former question is in the negative but that clearly is his view. A

I hold the same view as Mr Keil and in coming to that view I have ignored what is written on the certificates. The certificates were issued in respect of the first issue some 32 years after issue of the shares and in respect of the second issue ten years later. If the certificates do in fact reflect later resolutions, as to which there is no evidence, then the answer to the question would be different. B

Mr Sweetman's argument is that there is nothing to suggest that by the second issue it was intended to create a separate class of preference shares. That is correct but the Company has very full powers to create different classes of preference shares. C

The only rights conferred on the second issue shareholders are those contained in the resolutions namely a fixed dividend of 7% and issue of the shares at par. The only rights they now enjoy is a fixed dividend of 7%. C

Mr Scott recognised the problem and endeavoured to get around it by invoking Article 12 which is in the following terms:

"Except as far as otherwise provided for by the conditions of issue or by these presents any capital raised by the creation of new shares shall be considered as part of the original capital and shall be subject to the same provisions in all respects so far as applicable and also to the provisions hereinafter contained relative to the payment of calls and the forfeiture of shares on the non-payment of calls and otherwise." D

The Company's original capital was 25,000 \$2.00 shares. There is no mention of any preference shares and "shares" in the context of the original capital of the Company must be held to be ordinary shares. E

Mr Scott argued that Article 12 required the terms of the "second resolution" be enlarged to the extent specified in the "first resolution".

It is an ingenious attempt to solve the problem and no doubt was consonant with the Company's intention but it ignores the legal situation that the terms of issue (i.e. the resolution) in the instant case determines the rights conferred by the Company. F

My answer to the fourth and last question is in the negative—the second issue of preference shares are not subject to the same conditions as the first issue.

Each party will pay their own costs. G