

Funds Management & Financial Services Alert

Judicial advice: dealing with competing unitholder interests

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Introduction

The recent Supreme Court of New South Wales case of *Re Real Estate Capital Partners Managed Investments Limited as Responsible Entity of the Real Estate Capital Partners USA Property Trust [2013] NSWSC 190* highlights the potential benefits of a responsible entity (**RE**) obtaining judicial advice where it finds itself in the midst of competing interests of unitholders.

Facts

Real Estate Capital Partners Managed Investments Limited (**ReCap**) was likely to be replaced as the RE of the Real Estate Capital Partners USA Property Trust (**Trust**). The unitholders had resolved to sell the majority of the Trust assets to another entity, but had voted against the distribution of the Trust's net assets after the sale. Before the meeting to decide ReCap's replacement as RE, unitholders representing approximately 20% of the units in the Trust requested that their units be redeemed.

ReCap wrote to unitholders noting that it was, in the best interests of all unitholders, going to accept the redemption requests and also to offer all of the Trust's unitholders the opportunity to submit redemption requests.

Unitholders holding approximately 45% of the units opposed the relief sought by ReCap, namely that the Court determine that ReCap had the power under the Constitution of the Trust to redeem units the subject of discretionary redemption requests.

Why would ReCap seek the Court's advice?

ReCap was able to seek the Court's advice under s 63 of the *Trustee Act 1925* (NSW). Once such advice is obtained, if the RE acts in accordance with the advice, the RE shall be deemed to have discharged its duty and its

actions cannot be claimed to be beyond its powers by disaffected unitholders.

In circumstances where ReCap obviously found itself caught between competing sets of unitholders – those who wanted to redeem their units (**redemption unitholders**) and those who wanted all the Trust's assets to be reinvested, effectively opposing the redemptions and seeking to replace the RE (**opposing unitholders**) – ReCap was wise to seek the Court's direction as to the exercise of its powers under the Constitution.

If ReCap had proceeded with the redemption requests without such direction from the Court, it could have opened itself up to potential challenge by the opposing unitholders and to a claim for damages (not to mention the cost and time of the potential litigation) by the opposing unitholders and any other affected unitholders.

What did the Court consider?

The Court looked closely at the Constitution of the Trust, as well as the provisions of the *Corporations Act 2001* (**Corporations Act**) in relation to the proposed exercise of ReCap's powers.

The Court also considered the main submissions of counsel for the opposing unitholders. The most interesting of these is the argument that the redemptions could not proceed because giving effect to the redemption requests would contravene the takeover laws in the Corporations Act. The takeover laws are intended to apply to listed schemes as if they were companies.

Under these takeover provisions, an entity is prohibited from acquiring a 'relevant interest' in units in a listed scheme if the voting power of a person in the entity will increase to 20% or more, or from a starting point of between 20% and 90% as a result of that acquisition. The opposing unitholders alleged that by accepting redemption requests from 20% or more of the unitholders,

and the subsequent reduction of units on issue, consequentially the voting power of one unitholder and its associate (both opposing unitholders) would increase above the permitted threshold.

The decision

The Court found that giving effect to a redemption request will not be a breach of the takeover provisions of the Corporations Act by an RE because in any scheme with withdrawal provisions, the RE has a 'relevant interest' in those units from the point of their issue (although this may depend on the drafting of the withdrawal provisions). There is, in effect, no acquisition of a relevant interest when a redemption request is made or satisfied. Despite the increase in voting power by the relevant unitholder and its associate due to the redemptions, if there was no acquisition of a 'relevant interest', there was no breach of the takeover provisions.

The Court also found that the takeover provisions could not be seamlessly applied to a listed scheme as if it were a company because of the different constituent rights of each legal structure, particularly in the case of redemptions. A company is only entitled to redeem its shares under the buy-back provisions of the Corporations Act whereas a scheme can determine its own capital reduction procedures when it is liquid.

The Court also held that ReCap was not bound by the previous resolution of the Trust unitholders not to distribute its net assets. It said that a trustee is not required (again, depending on the terms of the Constitution) to act in accordance with the views of the majority of beneficiaries, or even the views of all the beneficiaries, except where the beneficiaries are entitled to call for a transfer of the trust property to terminate the trust.

The outcome

The meeting to replace ReCap as RE of the Trust never took place as claims about misleading and deceptive conduct by ReCap made by the opposing unitholders agitating for ReCap's removal were settled. Using the permission granted to it by the Court, approximately 90% of unitholders redeemed their units in the Trust.

Important points for REs from the decision:

- It may be appropriate and beneficial at certain times for REs to seek judicial advice before proceeding on a course of conduct, particularly where there appear to be conflicting interests of unitholders.
- The takeover provisions of the Corporations Act are unlikely to be activated by the redemption of units in listed managed investment schemes in most cases.
- REs are not bound to act in accordance with the views of the majority of beneficiaries, except in limited circumstances. They must always act in the best interests of unitholders as a whole.

If you would like any further information about the case or you would like to discuss when to consider seeking judicial advice, then please contact Sonya Parsons.

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