

REVISITING THE CONTRACTUAL EFFECT OF THE COMPANY'S CONSTITUTION IN CORPORATE OPERATIONS

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Abstract

The extent to which a company's constitution defines the relationships between the company, its members and officers as such have been a subject of debate. A number of varying judicial decisions and academic opinions have been expressed on these issues. The controversies are embedded in the manner of drafting of the relevant provisions of the regulating instruments with the attendant difficulties in interpretation. In recent times the parliament in some jurisdictions have intervened by enacting laws intended to introduce some level of clarity into the debated issues. The paper examines, by a comparative analysis, the provisions in the Companies Acts of the United Kingdom, Nigeria and South Africa. While a significant improvement seems to have been made in those jurisdictions in redefining the contractual effects of the companies' constitution in their respective extant companies' legislation, the gale of controversy on the enforcement of those contracts are far from settled.

Keywords: Company's Constitution, Contract, Effect, Enforcement, Debate

1. INTRODUCTION

The company as an entity constituted by persons who are its members and officers ordinarily needs regulations to guide its activities. Such regulations are generally referred to as the company's constitution.¹⁷ The company's constitution regulates, among others, the relationships between the company, its members and officers. It bears the status of a contract which does not necessarily arise from the actual consensus of the members.¹⁸ It is a contract created by law and binds persons who are not necessarily parties to it. No member can recile from the provisions of the constitution by relying on any of those general defences such as mistake, misrepresentation, duress or undue influence, that would vitiate the consensus required to constitute ordinary contract. The contract could be altered by a special majority of the members even against the

wishes of the minority of the contracting members, and cannot be rectified on ground of mistake.¹⁹

The consideration of the effect which the contents of the company's constitution, as public document, would have on third parties who are not privy to the making of the constitution, seemingly informs the judicial approach in dealing with this subject matter. In *Evans v Chapman*²⁰ the court was requested to rectify the constitution to correct clerical error, Joyce J in declining to exercise that judicial power, said:

I do not see my way to make the order asked for. No doubt a blunder was made in drafting the articles, but that can be rectified under the provisions of the Companies Act, 1862, s. 50, and is the proper way of doing it [that is, by passing a special resolution to alter the articles]. With reference to the jurisdiction to rectify such a document,... on the materials before me and as at present advised, I am of opinion that the general jurisdiction of the court to rectify instruments has no application to a document of this kind, which has only a statutory effect, and can only be rectified by statutory authority.

This decision received a unanimous approval of the UK Court of Appeal in *Scott v Frank F. Scott*,²¹ where Luxmore LJ drawing a distinction between the rectification of a private contract and the company's constitution, said:

It is quite true that, in the case of the rectification of a document, such as a deed *inter partes*, or a deed poll, the order for rectification does not order an alteration of the document, but merely directs that it be made to accord with the

17 Section 17 of the United Kingdom Companies Act 2006 (UK CA) defines company's constitution as including the company's articles, and any resolutions and agreements to which Chapter 3 applies. The company's constitution is used here specifically as synonymous with the articles. In South Africa, company's constitution is presently referred to as Memorandum of Incorporation, see s 15 of the South African Companies Act 71, 2008 (SA CA). In Nigeria company's constitution is a combination of the memorandum and articles of association, see ss 27 and 33 of the Companies and Allied Matters Act 1990 (CAMA).

18 See Derek French, Stephen W. Mayson and Christopher L. Ryan, Mayson, French and Ryan on Company Law 32 ed (2015) at 81 who described the nature of the contract as 'rational contract' characterised by longevity and incompleteness as it does not specify what is to happen in every possible situation, but merely lays procedural rules for deciding on each question that arises in those relationships as and when it arises. Robin Hollington QC Shareholders' Rights 6 ed (2010) at 20 stated that articles have distinctive features as a result of their status as the basic public constitution of a company to which the members automatically adhere. See also Paul L. Davies QC, Sarah Worthington and Eva Micheler, Gower and Davies Principles of Modern Company Law 9 ed (2012) at 70 on judicial attitude towards the company's constitution.

19 See *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCLC 693 at 698 CA. *Scott v Frank F Scott (London) Ltd* [1940] 3 All ER 508 (CA).

20 (1902) 86 LT 381 at 382.

21 [1940] 3 All ER 508 at 516.

form in which it ought originally to have been executed. This cannot be the case with regard to the memorandum and articles of association of a company, for it is the document in its actual form which is delivered to the registrar and is retained and registered by him, and it is that form, and no other, which constitutes the charter of the company and becomes binding on it and its members.

The essence of this statutory contract is to bridge the gap arising from the transition from companies created by the deed of settlement (which was usually endorsed by all the members) to those created by mere registration which was first witnessed under the UK Joint Stock Companies Act of 1844.²² New members could join companies created by registration by obtaining the company's shares either by a transfer from existing members or from the company itself. Those new members who would not have signed the registered contract contained in the deed of settlement must also be bound by the terms of the contract. This could only be attained by the force of legislation.

Company's constitution featured for the first time as statutory document in the UK Joint Stock Companies Act of 1856. The 1856 Act created two of such documents known as the memorandum and articles of association respectively. Successive UK Companies legislation has continued to adopt that trend until recently when the memorandum started witnessing a diminishing status.²³ South Africa has merged both constitutional documents under the old law and presently refers to them simply as the Memorandum of Incorporation.²⁴ However, in Nigeria, both the memorandum and the articles still enjoy equal importance.²⁵

The determination of the scope and enforceability of the contract contained in the constitution have continued to witness discombobulated judicial and academic opinions. The legislative interventions in the respective jurisdictions have seemingly resulted in a significant shift, bordering on clarity, from the complex and economically worded provisions of the earlier statutes. This might lead to the abatement of some aspects of the debated issues, but the inherent inadequacies in some of the provisions may not guarantee any level of consistency in dealing with some of the issues in the near future.

2. EFFECT OF THE COMPANY'S CONSTITUTION

The legislation on company's constitution in different jurisdictions have consistently, but differently, embodied provisions reflecting the

various relationships among persons involved in the conduct of the company's affairs such as members/shareholders, directors/officers and the company itself. Those relationships are usually generally depicted contractually without laying down rules of enforcement. Thus the debate on the contractual effect of the company's constitution has continued to revolve around the extent and the enforceability of the contract created by the constitution. Successive companies' legislation in jurisdictions under consideration have attempted to narrow down the level of disagreement by introducing different words and phrases to ensure some level of clarity and certainty on the legislative intent. The extent of those innovations or improvements could be appreciated by comparing the expressions employed in the extant provisions with those they immediately replaced. For instance, s 14(1) of the UK Companies Act of 1985 provides as follows:

Subject to the provisions of this Act, the ... articles, when registered, bind the company and its members to the same extent as if they respectively had been *signed and sealed by each member, and contained covenant on the part of each member to observe all the provisions of ... the articles.*²⁶

The first controversy raised by this provision relates to the parties to the contract contained in the constitution. The law says that the articles bind the company and its members, but is silent on the signing and sealing of the articles by the company in the same manner as the members are deemed to have done. This would naturally raise the question as to why the company, a juristic person, should be bound by a contract which it is not deemed to have signed and sealed in the same manner as the members. Hence Mellish LJ in *Re Tavarone Mining Co, Pritchard's case*,²⁷ while pronouncing on the scope of the contract created by the earlier version of that provision as contained in the Joint Stock Companies Act of 1856, stated that "the articles of association are simply a contract as between the shareholders *inter se* in respect of their rights as shareholders." But there is also every reason to doubt whether that is what is intended by the legislature. The constitution is the document of the company and the company is the only constant figure in the making and implementation of the constitution. It would as such be absurd to exclude the company from the effect arising from the application of the constitution. Thus, the courts have, after that initial prevarications, by sheer exhibition of pragmatism, filled the gap in that provision. This was evident in the judgment of Stirling J in *Wood v Odessa Waterworks Co*²⁸ where the judge held that "the articles of association constitute a contract not merely between the shareholders and the company, but between each individual shareholder and every other." Farwell LJ

22 Alan Dignam and John Lowry, *Company Law* 8th ed (2014) at 160.

23 See for instance, ss 6 and 7 UK CA 1948, ss 7 and 10 UK CA 1985, cf ss 8 and 18 UK CA 2006. Sealy and Worthington described the 2006 UK Companies Act provision on memorandum of association as nothing more than a statement from the first members that they intend to form a legal entity, while all the company's constitutional provisions are contained in the articles. See Len Sealy and Sarah Worthington QC, *Sealy's Cases and Materials in Company Law* 9 ed (2010) at 24.

24 See ss 52 and 59 of the SA CA 61 of 1973, cf s 15 of the SA CA 71 of 2008 which bears only one document referred to as the 'Memorandum of Incorporation' a term defined in s 1 of the Act as a document that sets out rights, duties and responsibilities of shareholders and directors and others within and in relation to the company, and contains other matters contemplated in s 15 of the Act.

25 Sections 2 and 8 of the Nigerian Companies Act No 51 of 1968 recognised the memorandum and articles of association as the company's constitution. Similar provisions are now contained in ss 27 and 33 of the Companies and Allied Matters Act 1990 (CAMA).

26 Emphasis supplied. This provision reproduced the much criticised earlier version contained in s 20 of the UK CA 1948. Similar provisions are embodied in s 65(2) of the SA CA 1973 and s 16(1) of the Nigerian CA 1968. 27 (1873) LR 8 Ch App 956 at 960(CA).

28 (1889) 42 ChD 636 at 642(Ch). The same judge, however, adopted a more restrictive approach in *Baring- Gould v Sharpinton Combined Pick and Shovel Syndicate* [1899] 2 Ch 80, 68 LJ Ch 429 where he held that the contract created by that provision was between the company and its members only.

in *Quin and Axtens Ltd v Salmon*²⁹ approved of Stirling J's expatiation of the contractual scope of the constitution as the true statement of the law.³⁰ This aspect of the debate is now fairly addressed under s 33(1) of the UK Companies Act 2006 which provides as follows:

The provisions of a company's constitution bind the company and its members to the same extent as if there were *covenants on the part of the company and of each member* to observe those provisions.³¹

The provision, which enjoys the qualities of precision and brevity, captures the scope of the contract contained in the constitution. It is a contract between the company and its members, and contract between the members *inter se*. The concise statutory restatement of the law eases the burden which the courts have borne over the years in searching for an ideal interpretation of the successive provisions in this regard. The reform in the United Kingdom company's legislation is attributed to the initiative of Lord Wedderburn of Charlton³² whose writings on, and criticisms of, the old law have rattled the judiciary and sparked quality discussions in the academic circle.³³

The UK Companies Act reform did not address other arms of the controversy relating to the capacity in which a member could enforce the contractual rights in the constitution, and the ancillary question as to whether a member *qua* member can enforce every provision of the constitution.³⁴ The courts have in the majority of the cases construed the contractual provisions of the constitution as restricted to those relating to the relationships of members in their capacity as members.³⁵ Any rights conferred on a member in any

other capacity other than that of a member is seen by the courts as 'outsider' rights. Such 'outsider' rights are not enforceable under the statutory contract contained in the constitution. This judicial approach was precisely captured by Astbury J in *Hickman v Kent or Romney Marsh Sheep-Breeders Association*³⁶ as follows:

An outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles treating them as contract between himself and the company to enforce those rights. Those rights are not part of the general regulations of the company applicable alike to all shareholders and can only exist by virtue of some contract between such person and the company, and the subsequent allotment of shares to an outsider in whose favour such an article is inserted does not enable him to sue the company on such an article.³⁷

Lord Wedderburn expressed doubts on the accuracy of some aspects of these decisions. He buttressed his stance with the House of Lords decision in *Quin and Axtens Ltd v Salmon*³⁸ in which Salmon sued as a member to enforce a provision in the constitution of the company which conferred right on him as a director. The House of Lords affirmed the decision of the Court of Appeal granting an injunction against the company and its directors preventing them from acting contrary to the provisions of the constitution. Wedderburn, drawing an inference from that decision, said:

The proposition is that a member can compel the company not to depart from the contract with him under the articles, *even if that means indirectly the enforcement of "outsider" rights vested either in third parties or himself, so long as, but only so long as, he sues qua member and not qua "outsider"*.³⁹

Wedderburn's proposition is at least clear on the fact that a member's right of action lies in his capacity as a member and not as an 'outsider'. This lies in his observation that "Salmon sued as a shareholder to protect a right personal to him, but common to all the members. Hence the representative action."⁴⁰ It is not in dispute that the primary purpose of Salmon's action in that case was not to enforce his 'outsider' right (a right conferred on him as a director) the enforcement of which was merely incidental ('indirectly' as stated by Wedderburn) to the primary cause of action which is the breach of the provisions of the company's

29 [1909] 1 Ch 311 at 318 (CA). See *Hickman v Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch 881 at 897 per Astbury J who stated that "articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively."

30 Cf *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279 per Farewell J at 288.

31 Emphasis supplied. A similar reform appears in s 41(1) of the Nigerian CAMA 1990. See also s 15(6) of the SA CA 2008 for the South African version.

32 See French, Mayson & Ryan op cit note 2 at 81.

33 See KW Wedderburn "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) Cambridge Law Journal 194, KW Wedderburn "Contractual Rights under Articles of Association – An Overlooked Principle Illustrated" (1965) 28 The Modern Law Review 347. Some of the writers that responded to the opinions advanced by Lord Wedderburn include Professor Gower whose views have continued to be reechoed by those who have taken up the baton after him. See LCB Gower, *The Principles of Modern Company Law* 2 ed (1957) at 252. See the most recent edition of that book by Davies, Worthington & Micheler op cit note 2 at 68-77. Other writers who have contributed to this debate include GD Goldberg "The Controversy on the Section 20 Contract Revisited" (1985) 48 The Modern Law Review 158, Roger Gregory "The Section 20 Contract" (1981) 44 The Modern Law Review 526, GN Prentice "The Enforcement of 'Outsider Rights'" (1980) *The Company Lawyer* 179.

34 Hannigan observed that it was emphasised in the UK parliamentary debate that the only purpose of the amended wording of the UK Companies Act provision is to state that the company is a party to the constitution as well as the members. See Branda Hannigan, *Company Law* 4th ed (2016) 112.

35 In *Bisgood v Henderson's Transvaal Estates Ltd* [1908] 1 Ch 743 at 759 (CA) Buckley LJ stated that the purpose of the articles is to define the position of the shareholder as shareholder, and not to bind him in his capacity as an individual. Similarly, in *Beattie v E and F Beattie Ltd* [1938] Ch 708 at 721 Greene MR held that the "contractual force given to the articles of association by the section is limited to such provisions of the articles as apply to the relationship of the members in their capacity as members." In *Browne v La Trinidad* [1887] 37 ChD 1 (CA) the action failed because the relief was sought as director and not as member. In *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873(O) the plaintiff was appointed a director for life, alteration of the articles to subject him to election

like other directors was held not a breach of contract as terms of the article do not constitute a contract between plaintiff and the company. In *Eley v Positive Government Security Life Assurance Co Ltd* (1876) 1 Ex D 88 a claim as solicitor also failed. See also *Gohlke and Schneider and Another v Westies Minerale (Edm) Bpk. And Another* 1970 (2) SA 685 (AD). In *Rayfield v Hands* [1960] Ch 1 the court had to construe the obligation imposed on directors in a quasi-partnership company as an obligation imposed on members who are directors in order to give effect to the provisions of the articles. Similarly, in *Caratti Holding Co Pty Ltd v Zampatti* (1975) 1 ACLR 87 (Western Australian SC) the court construed a provision in the articles of a small company giving powers to life governors as though it was a power given to the class of members who are life governors in order to give contractual effect to the provision as binding between members.

36 [1915] 1 Ch 881 at 897.

37 See also *Globalink Telecommunications Ltd v Wilmbury Ltd* [2002] All ER (D) 158; [2002] EWHC 1988 where Stanley Burnton J held that an article providing for the indemnity of director for liability in the performance of duties is not binding on the company.

38 [1909] 1 Ch 311(CA), affirmed [1909] AC 442 (HL).

39 Wedderburn op cit note 17 at 212-213. Emphasis supplied.

40 *Ibid* at 212.

constitution. But whether a member can, in the light of the modern statutory provisions strengthening the company's right of action and only concessionarily creating room for members through the device of derivative action, successfully maintain such an action is doubtful. An injury which is common to all the members and arising from a breach of the company's constitution, is an injury to the company which only the company could seek redress or a member through the procedure of derivative action.⁴¹

Lord Wedderburn did not, however, address the issue as to the propriety or otherwise of treating the directors as outsiders to a contract statutorily created by the company's constitution. Professor Gower believes that this is an anomaly as in most cases the law treats the directors as "insiders" which members as such are not.⁴² The directors, both individually and collectively, navigate the corporate ship in the exercise of their powers of corporate governance. A good number of them know the company from its origin and played different roles in bringing the company into existence. Some of them were involved as promoters in the preparation of the company's constitution and as such familiar with the company's operation from inception. They are trustees of the company's assets and powers, hence the law imposes on them fiduciary duties and duties of care and skill demanding from them the exhibition of due diligence in the conduct of the company's affairs. Individual members of the company, in their capacity as such, are mere investors whose interests are mostly financial bordering on the expected returns on their investments. They rarely get involved in the company's operations and sparingly attend company's meetings. There is thus a strong case for the directors to be treated as insiders to the statutory contracts. Although there are a few instances in which the courts have alluded to the existence of, and upheld the contractual relationships between the company and the directors under the constitution,⁴³ the fact that the majority of the cases have treated the directors as outsiders is inconsistent with the preeminent position of the directors in the corporate scheme. While the UK parliament failed to address this issue in 2006 Companies Act, Nigeria and South Africa have commendably done so.⁴⁴ The Nigerian Companies and Allied Matters Act 1990 (CAMA) provides in s 41(1) as follows:

Subject to the provisions of this Act, the ... articles, when registered, shall have the effect of a contract under seal between the company and its members and officers and between the members and officers themselves whereby they agree to observe and perform the provisions of the ... articles, as altered from time to time in so far as

they relate to the company, members, or officers as such.

The South African Companies Act of 2008 moved a step further in bringing in more contracting parties within the provision. Section 15(6) of the Act provides as follows:

A company's Memorandum of Incorporation, and any rules of the company, are binding -

- (a) between the company and each shareholder;
- (b) between or among the shareholders of the company; and
- (c) between the company and -
 - (i) each director or prescribed officer of the company; or

(ii) any other person serving the company as a member of the audit committee or as a member of a committee of the board, in the exercise of their respective functions within the company.

The explicitness of the South African provision has not, however, spared it from criticism. The argument is that the absence of the word 'contract' in describing the relationships between the parties as set down in the provision could create some doubts as to the nature of the relationships envisaged by the statute.⁴⁵ Although the inclusion of the word 'contract' would have guaranteed greater clarity of the parliamentary intention, the absence of such word does not, however, seem to have done any harm to the provision. The words 'binding' and 'between' as used in the provision significantly point to the parliamentary intention which is the creation of contractual obligation.

In both Nigeria and South Africa, directors are no longer 'outsiders' to the contract contained in the company's constitution. Thus, they could in their capacity as directors enforce the provisions of the constitution conferring rights on them in that capacity in the same manner as any obligations imposed on them by the constitution could be enforced by the company against them. The reference to 'officer'⁴⁶ in the provisions of both jurisdictions respectively takes the capacity of the contracting parties beyond that of the directors and could include the managers, secretary and even solicitors of the company.⁴⁷ Cases such as *Eley v Positive Government Security Life Assurance Co Ltd*⁴⁸ and *Browne v La Trinidad*⁴⁹ which failed under the old English statute (and are very likely to attain the same result under the present UK Companies Act) because the actions were respectively initiated in capacities other than that of member, would most certainly be decided differently under the present laws of Nigeria and South Africa respectively.

The realisation that the statutory contract embodied in the company's constitution is, among others, a contract between members *inter se*, ordinarily suggests that a member could in that

41 See s 263 UK CA 2006, s 165 SA CA 2008 and s 303 Nigerian CAMA 1990.

42 That view expressed in the second edition of his book and repeated in the successive editions is now re-echoed by Davies, Worthington & Micheler on cit note 17 at 72. See also Hollington QC on cit note 2 at 24.

43 See *Imperial Hydropathic Hotel Co., Blackpool v Hampson* (1882) 23 ChD 1 (CA), *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335 (ChD). In *Pulbrook v Richmond Consolidated Mining Co.* (1878) 9 ChD 610 at 612(CA) Jessel MR held that a director "has a right by constitution of the company to take part in its management, to be present, and to vote at the meetings of the directors."

44 See s 33(1) of the UK CA of 2006.

45 Maleka Femida Cassim 'Formation of Companies and the Company Constitution' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim, Richard Jooste, Joanne Shev and Jacqueline Yeats (eds) *Contemporary Company Law* 2nd ed (2012) at 142.

46 Section 650(1) of the Nigerian CAMA defines "officer" as including a director, manager or secretary. The use of the word 'includes' in that definition suggests that other persons not specifically mentioned but who occupy positions of responsibility in the company could also be regarded as officers.

47 See the dictionary definition of 'officer' as "a person who is in a position of authority in government or a large organisation". AS Hornby, Oxford *Advanced Learner's Dictionary of Current English* 8th ed (2010) at 1019.

48 (1876) 1 Ex D 88.

49 [1887] 37 ChD 1 (CA).

capacity sue every other member to compel compliance with the provisions of the constitution. The judicial position, however, suggests that the right of action by a member should be exercised through the company. Lord Herschell in *Welton v Saffery*⁵⁰ emphasised that the right conferred on a member by the constitution can only be enforced through the company or through the liquidator representing the company. In *Rayfield v Hands*⁵¹ Vaisey J was disposed to allowing a direct personal action by a shareholder against the others but not without a caution where he said:

I am encouraged, not I hope unreasonably, to find in this case a contract similarly formed between a member and member-directors in relation to their holdings of the company's shares in its articles. The conclusion to which I have come may not be of so general an application as to extend to the articles of association of every company, for it is, I think, material to remember that this private company is one of that class of companies which bears a close analogy to a partnership.

The decision was influenced by the size of the company and the perceived personal relationships that prevailed among the members of the company which invokes the intervention of equity where the conduct of some members is seen as being unfair to others. It is thus an exceptional situation restricted to the peculiarities of the case, and may not be applied in a general commercial relationship among members of a company. This judicial approach to the enforcement of the statutory contract by shareholders is rooted in the unwillingness of the courts to interfere in matters of internal management of the company. James LJ in *MacDougall v Gardiner*⁵² said:

Nothing connected with internal disputes between shareholders is to be made the subject of a bill by some one shareholder on behalf of himself and others, unless there be something illegal, oppressive, or fraudulent- unless there is something *ultra vires* on the part of the company *qua* company, or on the part of the majority of the company, so that they are not fit persons to determine it, but that every litigation must be in the name of the company, if the company really desire it.

There is substance in classifying shareholders dispute as internal dispute, but to suggest that such disputes, where they arise, cannot be subject of litigation between shareholders *inter se* defeats the essence of the statutory contract as embodied in the company's constitution. Any dispute between shareholders that borders on illegality, oppression, fraud or *ultra vires* should rightly be litigated through the company, as in those circumstances the company as a juristic person is directly affected. But it is not every dispute between shareholders that bear such characteristics. *Rayfield v Hands*⁵³ is a good example where the dispute borders on the refusal of the directors/members to take a transfer of shares from a member as provided in the company's constitution. There was no illegality, oppression, fraud or *ultra vires* in the refusal to take a transfer of shares but a simple breach of contract. It would be absurd in such an instance to insist that

the right of an aggrieved member could only be vindicated through the company.⁵⁴ In *Union Music Ltd v Watson*⁵⁵ Peter Gibson LJ suggested that the statutory contract which is binding between members *inter se* cannot be treated differently from the shareholders' agreement where he said:

In this context it is to be borne in mind that by section 14(1) of the Act [1985 Companies Act], the memorandum and articles bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and articles. For my part, I have difficulty in seeing how an agreement constituted by the statutory deeming provision is to be treated in any way differently from an express agreement, such as a shareholders' agreement, containing a quorum provision. Both have effect as contractual agreements as between the shareholders.

Lord Davey had in *Welton v Saffery*⁵⁶ accepted that individual shareholders may deal with their own interests by contract in such a way as they may think fit, and that "such contracts, whether made by all or some only of the shareholders, would create personal obligations, *exceptio personalis* against themselves only." In *Russell v Northern Bank Development Corp Ltd and Others*⁵⁷ Lord Jauncey of Tullichettle explained Lord Davey's decision as an acceptance that shareholders may lawfully agree *inter se* to exercise their voting rights in a manner which, if it were dictated by the articles, and were thereby binding on the company, would be unlawful. His Lordship, while according judicial validity to the shareholders' agreement in that case, said: "this agreement is purely personal to the shareholders who executed it and as I have already remarked does not purport to bind future shareholders. It is, in my view, just such a private agreement as was envisaged by Lord Davey in *Welton v Saffery*".⁵⁸

The point made here is that the courts duly recognise the similarity between the shareholders contract as contained in the company's constitution and the shareholders' agreement. They also uphold the enforceability of the latter as between shareholders. Why not accord the same judicial force to the former? The House of Lords' decision in *Russell* indicates that the inclusion of the company in the shareholders' agreement could render such an agreement unenforceable. Insisting therefore that the contract between shareholders *inter se* as contained in the constitution can only be enforced by the shareholders through the company is prejudicial to the shareholders.

3. EXTENT OF A MEMBER'S RIGHT TO ENFORCE THE CONSTITUTION

Lord Wedderburn had in his analysis of the House of Lords decision in *Salmon's case*⁵⁹ suggested that every member of the company can enforce all the

50 [1897] AC 299 at 315.

51 [1958] 2 All ER 194 at 199.

52 (1875) 1 ChD 13 at 21-22.

53 [1958] 2 All ER 194.

54 Davies, Worthington & Micheler op cit note 26 at 69 observed that for the law to insist on action through the company in such circumstances would be merely to promote multiplicity of actions and involve the company in unnecessary litigation.

55 [2003] EWCA Civ 180 para 34.

56 [1897] AC 299 at 331.

57 [1992] 3 All ER 161.

58 *Ibid* at 167.

59 [1909] 1 Ch 311(CA), affirmed [1909] AC 442 [HL].

provisions of the company's constitution so long as the member sues in his capacity as a member. This is borne by the following observation made by Wedderburn:

Salmon sued as a shareholder to protect a right personal to him, but common to all the members. Hence the representative action. What was that right? It could not be a right vested in him *qua* managing director. In such a capacity (as an "outsider") he could not enforce the contract arising from the articles. It is, therefore, obvious that Salmon enforced the right of a member *to have the articles observed* by the company.⁶⁰

Wedderburn strengthened this proposition with the statement of Greene MR in *Beattie v E & F Beattie Ltd*⁶¹ where his Lordship, though finding against Beattie for asserting his membership right under the constitution in a claim brought against him in his capacity as a director, illustrated the nature of a member's rights under the company's constitution as follows:

Let me assume that this article on its true construction entitles any member of the company to say to the company, when it is in dispute with a director: "You, the company, are bound by your contract with me in the articles to refer this dispute to arbitration, and I call upon you so to do." That is the right, and the only right in this respect, which is common to all the members, under this article. If that were the right which the appellant was seeking to exercise, there might be something to be said for that argument.

Wedderburn concluded on the strength of these judicial authorities that every member can call upon (compel) the company to observe the provisions of the constitution even if that amounts to an indirect enforcement of outsider right or a right vested in third parties or himself "so long as, but only so long as, he sues *qua* member and not *qua* "outsider".⁶²

Prior to the House of Lords decision in *Salmon's case*, there was *Eley v Positive Government Security Life Assurance Co Ltd*⁶³ where Lord Cairns observed that the constitution constitutes "an agreement *inter socios* and . . . it becomes a covenant between the parties to it that they will employ the plaintiff... a matter between the directors and shareholders and not between them and the plaintiff." That statement bears the impression that every member of the company (including Eley in his capacity as a member) had membership right to prevent the directors from appointing anyone else as solicitor except Eley.⁶⁴ But Lord Cairns himself had described that manner of construction of the contractual effect of the constitution in that case as being against 'public policy'.⁶⁵ Although the judgment did not expatiate on the concept of 'public policy', that concept could be viewed from both narrow and broad perspectives in the context of that case. The narrow meaning is the restrictive impact which the enforcement of the constitution would have on the power of the company in making a choice as to who should be its solicitor at any time. The broad meaning focuses on the essence of

allowing every member of the company to enforce every provision of the company's constitution against the company under the statutory contract.

Gower disagreed with Wedderburn's suggestion that every provision of the constitution has contractual effect and enforceable by every member. He stated that the "articles have no direct contractual effect in so far as they purport to confer rights or obligations on a member otherwise than in his capacity of a member."⁶⁶ In simple terms, the enforceable contractual provisions in the constitution relate to membership rights and matters dealing with the conduct of the company's affairs.⁶⁷ In *Bratton Seymour Service Co Ltd v Oxborough*⁶⁸ Steyn LJ observed that "if the provisions [of the constitution] are not truly referable to the rights and obligations of members as such, it does not operate as a contract." Milne J, presiding over a South African High Court, in *Rosslare Pty Ltd and another v Registrar of Companies*⁶⁹ explained the legal implication of the expression; 'member in his capacity as such' where he said:

A member of a company has, of course, no separate legal personality "in his capacity as a member" which is distinct from him "in his private capacity." It seems clear, however, that what is meant by a contract with a member "in his capacity as such", is a contract between him and the company which is connected with the holding of shares *and* which confers rights which are "part of the general regulations of the company applicable alike to all share-holders.

This explanation offers some justification to the UK Court Appeal decision in *London Sack & Bag Co Ltd v Dixon & Lugton Ltd*⁷⁰ where Scott LJ held that the statutory contract between members does not confer a right of action on a contract created entirely outside the company relationship, such as transactions between members. "[I]t does not in the least follow that the rule applies to extrinsic purposes such as individual trading."⁷¹

The company's constitution sets out the rights, duties and responsibilities of the shareholders, directors and others within and in relation to the company. A shareholder subscribes to the terms of the constitution and is deemed to be a contracting party within the provisions of the constitution by virtue of his shareholding and membership of the company. The reasonable expectation of every contracting party within the context of the constitution should ordinarily relate to the acquiring of rights and incurring of obligations that fall within the scope of the company's affairs. Extraneous obligations and relationships should not therefore fall within the contractual relationships created by the constitution.⁷²

66 Gower op cit note 17 at 252.

67 Davies, Worthington & Micheler op cit note 17 at 69.

68 [1992] BCC 471 at 475 (CA).

69 [1972] 2 All SA 354 (D) at 359.

70 [1943] 2 All ER 763.

71 Ibid at 766.

72 See Paul L. Davies & DD Prentice, *Gower's Principles of Modern Company Law* 6 ed (1997) at 118 fn 55 where the authors suggested that if the solicitor had slipped into the constitution, to which he and his wife were the subscribers, a provision to the effect that he and his wife should no longer be bound to cohabit, it would be absurd if this were treated as a deed of separation.

60 Wedderburn op cit note 23 at 212.

61 [1938] 3 All ER 214 at 218-219(CA).

62 Wedderburn op cit note 44 at 213.

63 (1876) 1 Ex D 88 (CA) at 90.

64 See French, Mayson & Ryan op cit note 16 at 88.

65 Ibid at 89.

The other arm of the debate lies in the suggestion that a member could enforce a right conferred on another member (third party) under the statutory contract in which all the members are parties. Wedderburn in making that proposition relied again on *Quin & Axtens v Salmon*.⁷³ It is doubtful whether the facts of that case could have supported such an extensive inference. Salmon and Axtens had a veto power conferred on them by the constitution as directors which they could exercise in relation to certain property transactions decided upon by the board of directors. Salmon had exercised the veto in that occasion but was overruled by the vote of a simple majority of the members at an extraordinary general meeting called by other members of the board that supported the transaction. The power exercised by the general meeting amounts to usurping of the power of the board and is contrary to the company's constitution which requires special resolution for the amendment of company's articles. Given these facts, Salmon has an interest to protect, both as a member and as a director in ensuring that the company observes the provisions of its constitution. Although Salmon's capacity as director was not strongly canvassed in that suit, it was not lost on the House of Lords decision. Lord Loreburn LC, in a brief judgment representing a unanimous decision of the court, said:

My Lords, I do not see any solid ground for complaining against the judgment of the Court of Appeal. The bargain made between the shareholders is contained in articles 75 and 80 of the articles of association, and it amounts for the purpose in hand to this, that the directors should manage the business; and the company, therefore, are not to manage the business unless there is provision to that effect. Further the directors cannot manage it in a particular way – that is to say, they cannot do certain things if Mr Salmon or Mr Axtens objects. Now I cannot agree with Mr Upjohn in his contention that the failure of the directors upon the objection of Mr Salmon to grant these leases of itself remitted the matter to the discretion of the company in general meeting. They could still manage the business, but not altogether in the way they desired.⁷⁴

Farwell LJ had at the Court of Appeal in the same case described the company's conduct as "an attempt to alter the terms of the contract between the parties by a simple resolution instead of by a special resolution"⁷⁵ and to this it could be added, which affected Salmon as a member and as a director of the company.⁷⁶ This is what establishes Salmon's interest to maintain the action. Without such interest as is apparent on the face of the pronouncement of the House of Lords, and latent in the decision of Farwell LJ at the Court of Appeal, it is doubtful whether Salmon would have approached the court, and if he did, he would have had to contend with the issue of establishing his *locus standi* to maintain the action. Salmon's action succeeded based on the court's finding that his right

was infringed by the procedure adopted by the majority of the shareholders which deprived him and Axtens of their veto powers. It would be tenuous to pursue the argument that every member of the company could, relying on *Salmon's case*, enforce every provision of the company's constitution, even those bordering on a third party's right.⁷⁷ Any member who adopts such measure would always have the issue of *locus standi* to contend with.

In South Africa, s 15(6) of the Companies Act does not define the extent of a shareholder's right to enforce the provisions of the constitution. Section 161 of the Act could however be of assistance in this regard to the extent that it confers power on the shareholders to approach the court to determine and protect their rights as contained in the constitution. Implicit in that provision is that a shareholder can only enforce those provisions of the constitution the breach of which affects him as a member or in any other capacity within the contemplation of s 15(6) of the Act.

Although the Nigerian Companies Act provision similarly leaves a vacuum in this regard, the Supreme Court of Nigeria has provided a lead in such matters by recognising that the issue of *locus standi* could be a decisive factor in asserting a member's right to enforce the provisions of the company's constitution. In *Globe Fishing Industries Ltd v Coker*⁷⁸ Olatawura JSC adopted the opinion expressed in Pennington's Company Law⁷⁹ that:

The dividing line between personal and corporate rights is very hard to draw, and perhaps the most that can be said is that the court will incline to treat a provision in the Memorandum or Articles as conferring a personal right on a member only if he has interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its Constitution.

A member who is unable to establish, not just that the company's conduct constitutes an infringement of his membership right, but that such an infringement has subjected him to some detriment (injury) over and above that suffered by other members may not be able to maintain a personal action on the strength of the contractual provisions in the constitution. Such a wrong, when it affects the members as a whole, is a wrong done to the company for which only the company could seek redress.

Gower and Wedderburn share a similar view on the power of the majority to ratify matters of internal irregularities.⁸⁰ They agreed that this could constrain a member from enforcing the contractual rights contained in the constitution.⁸¹ Ratification is

77 Hannigan op cit note 18 at 112 stated that not even the new provision under s 171 of the UK Companies Act would guarantee members a right to enforce every provision of the constitution.

78 [1990] 7 NWLR (pt 162) 265 at 280, [1990] NILR 23 para 13(SC).

79 Robert R Pennington Pennington's Company Law 4 ed (1979) at 588.

80 Mellish LJ recognised this power of the company in *MacDougall v Gardner* (1875) 1 Ch D 13 at 25 (CA) where he said: "In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is that a meeting has to be called, and then the majority ultimately gets its wishes." See also *Burland v Earle* [1902] AC 94(PC).

81 See Wedderburn op cit note 46 at 215. See also KW Wedderburn "Contractual Rights Under the Articles of Association – An Overlooked Principle Illustrated" (1965) Vol 28 The Modern Law Review 347 at 350 where the writer reiterated the same position.

73 [1909] AC 442 (HL).

74 Ibid at 443.

75 *Quin & Axtens v Salmon* [1909] 1 Ch 311 at 319(CA).

76 French, Mayson and Ryan stated that Salmon succeeded because he sued as a member of the company to prevent the company acting on a decision which was taken unconstitutionally. *Mayson, French and Ryan on Company Law* op cit note 48 at 89.

an equitable principle evolved at common law to curtail avoidable litigations relating to matters of non-compliance with procedure and formalities in the conduct of the company's affairs. It was reasoned by the courts that where only a mere informality or irregularity is alleged to invalidate management decision, action by a member would not be allowed if it is clear that on going through the right procedure, the decision would be approved or adopted by the majority of the members.⁸² Successive common law courts' decisions have consistently adopted this approach which was restated by Cotton LJ in *Browne v La Trinidad*⁸³ to the effect that "a court of equity refuses to interfere where an irregularity has been committed, if it is within the power of persons who have committed it to at once to correct it by calling a fresh meeting and dealing with the matter with all due formalities".

Statutory interventions in the jurisdictions under consideration have, however, considerably watered down the effectiveness of this principle as a defence to an action by a member to seek redress for wrong done to the company. In the UK, for instance, the possibility of ratification would not prevent an action, but could be taken into consideration by the court in an application by a shareholder seeking leave to commence a derivative action to redress a wrong done to the company.⁸⁴ In Nigeria and South Africa the emphasis is now on actual ratification or approval of the wrongful act and not on mere possibility of the act being ratified by the majority of the members. Such actual ratification would not prevent an action but could be a material consideration by the court in arriving at its judgment or making an order.⁸⁵ Actual ratification however forecloses the right of action under the UK Companies Act provision.⁸⁶

4. CONCLUSION

The statutory provision on the effect of the company's constitution under the UK Companies Act of 2006⁸⁷ has now, in line with the trend in Nigeria,⁸⁸ and lately South Africa,⁸⁹ cleared up the doubt relating to the parties to the contract contained in the company's constitution. This is now explicit – the contract is created between the members *inter se*, and between the members and the company. The UK Companies Act, however, failed in a material respect in this reform in that the Act still treats the directors as 'outsiders' to the contract contained in the constitution. Thus, under the existing provision in the UK statute, the directors are still constrained; they cannot enforce any provisions in the constitution giving them rights in their capacity as directors in the same manner as members could enforce such provisions. The important position occupied by the directors in the corporate operations contradicts the position of the law in treating them as outsiders. On the other, hand the

law recognises the vital role of the directors by imposing on them fiduciary duties and demanding of them extra diligence in the discharge of their responsibilities to the company. Members as such, are investors, interested mainly on the returns on their investments. Their actions in most cases are informed by individual interests. While not suggesting that there is anything wrong in the law that protects members' rights of membership in the company, the exclusion of the directors from enjoying similar protection in the corporate scheme is hard to justify. Nigeria and South Africa have now extended both the benefits and obligations arising from the statutory contracts contained in the constitution to the directors and other officers of the company.⁹⁰

The judicial position which insists that a member can only enforce the contractual rights under the constitution through the company is not in tandem with the members' freedom of contract. The recognition by Peter Gibson LJ in *Union Music Ltd v Watson*⁹¹ that the constitutional contract between members *inter se* bears similarity with the shareholders' agreement, raises the issue as to why the latter should be enforceable by the members *inter se* and not the former. The justification for this judicial attitude which is hinged on the powers of the majority of the shareholders to ratify matters of internal irregularity ought to be restricted to matters affecting the company as a legal entity. Vaisey J's decision in *Rayfield v Hands*⁹² demonstrates that the company is not always equally affected by disputes between members. The caution expressed in that decision by Vaisey J should not have been as members ought to enjoy the right to enforce the provisions of the constitution that affect them as members *inter se* and in the same manner as they could enforce the terms of the shareholders' agreement.

Wedderburn's suggestion that every member of the company could enforce every provision of the company's constitution, even those affecting the rights of a third party, 'so long and only so long as he sues *qua* member',⁹³ stretches the effect of the statutory contract beyond the limits of its elasticity. This suggestion, apart from being unrealistic in the sense that no reasonable member of the company would seek to enforce a contractual obligation which does not affect him in some manner,⁹⁴ is confronted by the judicially established concept of *locus standi* in civil litigation.

The Nigerian Supreme Court has recognised that a shareholder's right to enforce a particular breach of the constitution is predicated on the interest which such shareholder has in the observance of that provision over and above the interest of other shareholders of the company.⁹⁵ Where such overriding interest cannot be established by the shareholder, the wrong could at best be seen as a wrong done to the company which

82 See *Bagshaw v Eastern Union Railway Co* (1849) 7 Hare 114 at 130 per Wigram VC (VC), *Davidson v Tulloch* (1860) 3 Macq 783 at 792 per Lord Campbell LC (HL), *Edwards v Halliwell* [1950] 2 All ER 1064(CA).

83 (1887) 37 ChD 1 at 10 (CA).

84 See s 263(3)(c)(d) of the UK CA 2006.

85 See s 305 of Nigerian CAMA and s 165(14) of the SA CA 2008.

86 See s 263(2)(c)(ii).

87 See s 33(1) UK CA 2006.

88 See s 41(1) Nigerian CAMA 1990.

89 See s 15(6) SA CA 2008.

90 See s 41(1) Nigerian CAMA 1990, s 15(6) SA CA 2008.

91 [2003] EWCA Civ 180 para 34.

92 [1958] 2 All ER 194.

93 Wedderburn op cit note 46 at 215.

94 Except perhaps those described by Mellish LJ in *MacDougall v Gardner* (1875) 1 ChD 13 at 15 (CA) as 'cantankerous members' who would contest every decision of the company.

95 *Globe Fishing Industries Ltd v Coker* [1990] 7 NWLR (pt 162) 265 at 280, [1990] NILR 23 para 13(SC) per Olatawura JSC.

a member could enforce by a derivative, as opposed to a personal, action.

Section 15(6) of the South African Companies Act of 2008, though distinctively recognises the various parties to the contract created by the constitution, does not show the extent of a member's right to enforce such contract as it affects a member. However, a close reading of s 161(1) of the Act which confers power on the shareholders to apply to court for an order determining any rights of the shareholder in terms of the company's constitution, suggests that a member can only in that capacity approach the court to enforce those provisions of the constitution that confer rights on the member. The law does not authorize a member to seek redress for every wrong done to the company as the company remains the proper plaintiff in such cases.

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