THE COMPANY CONSTITUTION AS A CONTRACT WITH EMPHASIS ON THE OUTSIDER RULE

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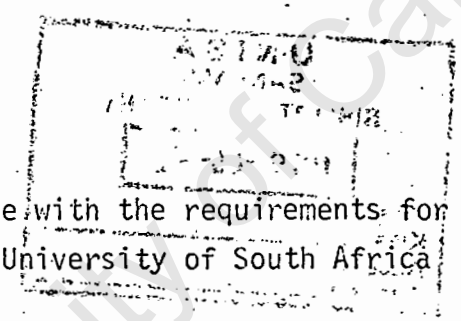

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C O N T E N T S

SUMMARY

The concept of the company constitution as a contract will be examined in three parts.

The first part is devoted to the legal nature of the constitution. It will examine the role of the two sources of its nature and sanction, namely the contractual and the statutory. It will also identify the parties to the constitution and accordingly the contracts to be found therein. Then consideration will be given to the possibility in law of altering the company constitution by the unanimous consent of all its members, without complying with the formalities for such alteration as are prescribed by statute. In addition, attention will be given to the problem of rectifying mistakes in the constitution once it is registered. These topics serve to cast light on the legal nature of the company constitution.

The second part is concerned with aspects of the enforcement of rights arising from the contract embodied in the constitution. One such aspect is the proposition that continued membership of a company is a barrier to an action for damages against that company.

Another aspect is the ultra vires doctrine under the common law in terms of which acts beyond the capacity and powers of a company are void. Since the memorandum and articles

constitute a contract, the members rights in relation to such an act will be considered.

The important changes to this common law doctrine wrought by s36 of the Companies Act, 1973 will also receive detailed attention.

Another aspect is the rule in Foss v Harbottle, which circumscribes the rights of a member to take action to enforce rights arising from the constitution, firstly in regard to a wrong done to the company, and secondly, in matters of internal management, where the irregularity is capable of ratification by a simple majority. Consequential difficulties in the definition and the enforcement of the member's personal rights will also receive attention.

The third part is devoted to another major topic to which special attention will be given, namely the outsider rule. It declares that rights purporting to be given by an article in a capacity other than that of a member, cannot be enforced against the company. Its effect in limiting the scope of the contract embodied in the constitution, and, therefore, its role as an obstacle to the enforcement of contractual rights embodied in the constitution, will occupy the remaining chapters of this dissertation.

Abbreviations of law reports are set out in full at xi below

(a) South African cases

(b) English cases

Addlestone Linoleum Co Ltd Re (1887) 37 ChD 191 CA
Allen v Gold Reefs of West Africa Ltd [1900] 1 ChD 656
Appleyard ex parte (1881) 18 ChD 587
Ashbury Railway Carriage and Iron Co v Riche (1875) LR 7 HL 653
Bailey Hay and Co Ltd Re [1971] 3 ALL ER 693 ChD
Bamford v Bamford [1968] 2 ALL ER 655 ChD; [1969] 1 ALL ER 969 CA
Baring-Gould v Sharpington Combined Pick and Shovel Syndicate [1899] 2 ChD 80 CA
Baroness Wenlock v River Dee Co (1887) 36 ChD 674
Beattie v E and F Beattie [1938] 3 ALL ER 214 CA
Bell Houses Ltd v City Wall Properties Ltd [1965] 3 ALL ER 427 QBD
Bisgood v Henderson's Transvaal Estates Ltd [1908] 1 ChD 743
Borland's Trustee v Steel Bros [1901] 1 ChD 279
Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339
Bradford Banking Co v Briggs (1886) 12 AppCas 29
Browne v La Trinidad (1887) 37 ChD 1
Buchanan (Peter) v McVey [1955] AC 516
Burland v Earle [1902] AC 83 PC
Bushell v Faith [1969] 1 ALL ER 1002 CA; [1970] 1 ALL ER 53 HL
Carlill v Carbolic Smoke Ball Co [1893] 1 QB 256 CA
Central Railway Company of Venezuela v Joseph Kisch (1867) LR 2 HL 99
Dale and Plant Ltd Re (1889) 61 LT 206
Dale and Plant Ltd Re (1889) 43 ChD 255
Dean v Prince [1953] 2 ALL ER 636 ChD; [1954] 1 All ER 749 CA
Drive Yourself Car Hire Co (London) Ltd v Strutt [1953] 2 All ER 1475 CA
Dunlop Pneumatic Tyre Co Ltd v Selfridge and Co Ltd [1915] AC 847 HL
Duomatic Ltd Re [1969] 1 All ER 161 ChD
Edwards v Halliwell [1950] 2 All ER 1064 CA
Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88
Evans v Chapman [1902] 86 LT 381
Express Engineering Works Re [1920] 1 ChD 466 CA
Foss v Harbottle (1843) 2 Hare 461
Greene (deceased) Re Greene v Greene [1949] 1 All ER 167 ChD
Harmer (HR) Ltd Re [1958] 3 All ER 689 CA
Hayes v Bristol Plant Hire Ltd [1957] 1 ALL ER 685 ChD
Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881

Hogg v Cramphorn Ltd [1966] 3 ALL ER 420 ChD
Ho Tung v Man On Insurance Co Ltd [1902] AC 232 PC
Houldsworth v City of Glasgow Bank (1880) 5 AC 317 HL
Imperial Hydropathic Hotel Co Blackpool v Hampson (1882) 23 ChD 1
Johnson v Lyttle's Iron Agency (1877) 5 ChD 687
Kelner v Baxter (1866) LR 2 CP 174
Leicester Club and Country Racecourse Co Re (1885) 30 ChD 629
London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 ALL ER 763 CA
Lundie Bros Ltd Re [1965] 2 ALL ER 692 ChD
MacDougall v Gardiner (1875) 1 ChD 13
Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503; 43 LJCP 253
Mozley v Alston (1847) 1 Ph 790
New British Iron Co Re; Ex Parte Beckwith [1898] 1 ChD 324
Newman (George) and Co Re [1895] 1 ChD 674 CA
Oxted Motor Co Re [1921] 3 KB 32
Pender v Lushington (1877) 6 ChD 70
Percival v Wright [1902] 2 ChD 421
Parker and Cooper Ltd v Reading [1926] ChD 975
Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610
Quin and Axtens Ltd v Salmon [1909] AC 442 HL
Rayfield v Hands [1958] 2 ALL ER 194 ChD
Richmond Gate Property Co Ltd Re [1964] 3 ALL ER 936 ChD
Royal British Bank v Turquand (1856) 6 E and B 327; 119 ER 886
Salmon v Quin and Axtens Ltd [1909] 1 ChD 311
Salomon v Salomon and Co Ltd [1897] AC 22 HL
Scott v Scott (Frank J) (London) Ltd [1940] 3 ALL ER 508 CA
Scruttons Ltd v Midland Silicones Ltd [1962] 1 ALL ER 1 HL
Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956
Welton v Saffery [1897] AC 299 HL
Wheal Buller Consols Re (1888) 38 ChD 42
Wood v Odessa Waterworks Co (1889) 42 ChD 636

(c) An Australian case

Australian Coal and Shale Employees Federation v Smith (1937) 38 SR NSW 48

B I B L I O G R A P H Y

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Buckley : On the Companies Act (Sixth Edition London 1891)

Cheshire and Fifoot's Law of Contract :(Ninth Edition by M P Furmston London 1976)

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Craies : On Statute Law (Seventh Edition by S G G Edgar 1971)

De Villiers and Macintosh : The Law of Agency in South Africa (Second Edition by D B Knight Cape Town 1956)

De Wet J C : Die Ontwikkeling van die Ooreenkoms ten behoewe van 'n Derde (Leiden 1940)

De Wet J C and Yeats J P : Kontraktereg en Handelsreg (Derde Uitgawe Durban 1964)

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Palmer : Company Law (Fourth Edition by Sir Francis Beaufort Palmer London 1902)

- Company Law (Seventeenth Edition by Judge Topham London 1942)

- Company Law (Twenty-second Edition by C M Schmitthoff London 1976)

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Pyemont : Company Law of South Africa (Sixth Edition by Diemont M A Cape Town 1953)

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Bastin N A : The Enforcement of a Member's Rights The Journal of Business Law January 1977 17

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- The Principle of Unanimous Assent (1974) 91 South African Law Journal 2

Getz L : Contracts for the Benefit of Third Parties (1962) Acta Juridica 38

Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 Modern Law Review 362

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- Rayfield v Hands - A Postscript and a Drop of Scotch (1958) 21 Modern Law Review 657

- Some Contrasts between British and American Corporation Law (1956) 69 Harvard Law Review 1369

- Notes on Cases (1950) 13 Modern Law Review 367

Honore A M : Degrees of Invalidity (1958) 75 South African Law Journal 30

Hornby J A : Houldsworth v City of Glasgow Bank (1956) 19 Modern Law Review 54

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- Henochsberg on the Companies Act (1976) 39 Tydskrif vir Hedendaagse Romeins-Hollandse Reg 95

Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) Cambridge Law Journal 194

continued (1958) Cambridge Law Journal 93

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- Oppression of Minority (1959) Cambridge Law Journal 37

- Going the whole Hogg v Cramphorn? (1968) 31 Modern Law Review 688

- Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 Modern Law Review 347

c) Supplementary bibliographical information

Bibliographical information is also furnished in the footnotes.

The following is the bibliographical information in respect of books and journals and law reports which are often referred to and accordingly are cited in the following abbreviated form :-

(i) Books

Cheshire and Fifoot	:	Cheshire and Fifoot's Law of Contract (Ninth Edition by M P Furmston 1976)
Cilliers Benade De Villiers	:	Company Law (Third Edition 1977)
Craies	:	On Statute Law (Seventh Edition by S G G Edgar 1971)

De Villiers and Macintosh	:	The Law of Agency in South Africa (Second Edition by D B Knight 1956)
De Wet and Yeats	:	Kontraktereg en Handelsreg (Derde Uitgawe 1964)
Gibson	:	South African Mercantile and Company Law (Second Edition 1966)
Gore-Browne	:	On Companies (Forty Second Edition by Boyle and Sykes 1972)
Gower	:	The Principles of Modern Company Law (Third Edition 1969)
Hahlo	:	Company Law through the Cases (Third Edition 1977)
Halsbury	:	Laws of England (Fourth Edition by Lord Hailsham 1973)
Henochsberg	:	On the Companies Act (Third Edition 1975)
Naude	:	Die Regsposisie van die Maatskappy-direkteur (1970)
Palmer	:	Company Law (Twenty-second Edition by C M Schmitthoff 1976)
Pennington	:	Company Law (Third Edition 1973)
Pyemont	:	Company Law of South Africa (Sixth Edition by Diemont 1953)
Steyn	:	Die Uitleg van Wette (Fourth Edition 1974
Van Wyk de Vries Commission	:	Commission of Enquiry into the Companies Act Main Report RP 45/1970

(ii) Journals

CLJ	:	Cambridge Law Journal
HLR	:	Harvard Law Review
LQR	:	Law Quarterly Review
MLR	:	Modern Law Review
NLJ	:	New Law Journal
SALJ	:	South African Law Journal
THRHR	:	Tydskrif vir Hedendaagse Romeins-Hollandse Reg

(iii) Law reports

South African

AD	-	Appellate Division
SA	-	South African Law Reports
TPD	-	Transvaal Provincial Division
TS	-	Transvaal Supreme Court
WLD	-	Witwatersrand local Division

English

AC	-	Appeal Court
All ER	-	All England Law Reports
AppCas	-	Appeal cases, House of Lords
ChApp	-	Chancery Appeals
ChD	-	Chancery Division
E and B	-	Ellis and Blackburn's Queen's Bench Reports
ER	-	English Reports
ExD	-	Exchequer Division Reports
Hare	-	Hare's Vice-chancellors' Reports
KB	-	King's Bench
LR	-	Law Reports
LT	-	Law Times
QB	-	Queen's Bench

Australian

NSW	-	New South Wales Law Reports

CHAPTER 1 - AN OUTLINE

The subject-matter of this dissertation is the concept of the company constitution as a contract, with special emphasis on the outsider rule.

Several facets of this complex subject will be examined, and have been selected because each contributes to a comprehension of the contractual nature of the company constitution.

The first broad aspect to receive treatment is the legal nature of the constitution. Its contractual nature may be traced to its antecedent, the constitution of the joint stock association. On the other hand, a company which is registered under the relevant companies legislation derives its sanction from this statute. The role of these two sources in determining the legal nature of the constitution is evaluated.

The contractual nature of the company constitution presupposes that there are parties to the contract embodied in the constitution. The identification of these parties, or, to put the matter another way, of the contracts which are to be found in the company constitution, will also be examined.

A unique aspect of the contract embodied in the company constitution is that it may be altered by the consent of a prescribed majority of the members of the company, following the statutory formalities. As a result, alterations to its constitution do not require the unanimous assent of all the members of a company. The resultant possibility that such alterations may occur by the unanimous assent of all the members, while dispensing with the formalities prescribed by statute, will, therefore, be examined.

The possibility of rectifying mistakes in the memorandum and articles of the company, once they are registered, and the obstacles thereto, also have to be dealt with.

The second major element of this enquiry is the enforcement of rights arising from the contract embodied in the constitution, as this also contributes to an understanding of the nature of the company constitution. In this regard, the following matters, inter alia, will receive attention.

The first matter is the right of the parties thereto to recover damages arising out of a breach of the contract in the constitution, in the light of the proposition that continued membership of a company is a barrier to an action for damages against that company.

The second is the ultra vires doctrine, in terms of which acts beyond the capacity and powers of a company are void. Since the memorandum and articles constitute a contract, the members' rights in relation to such an act need to be examined. The important changes to this common law doctrine wrought by s 36 of the Companies Act, 1973, will also receive detailed attention.

The third is the rule in Foss v Harbottle, which circumscribes the right of a member to take action to enforce rights arising from the constitution, in regard to a wrong done to the company, where the irregularity is capable of ratification by a simple majority. Consequential difficulties in the definition and the enforcement of members' personal rights will also receive attention.

The remainder of this dissertation is devoted to another major topic, to which special attention will be given, namely the outsider rule. This rule declares that rights purporting to be given by an article in a capacity other than that of a member, cannot be enforced against the company. Its effect in limiting the scope of the contract embodied in the constitution, and, therefore, its role as an obstacle to the enforcement of contractual rights embodied in the constitution, will occupy the remaining chapters of this dissertation.

PART I

THE LEGAL NATURE OF THE CONSTITUTION OF A COMPANY

CHAPTER 2 - THE LEGAL NATURE OF THE CONSTITUTION OF A COMPANY

1. Introduction

"It is generally accepted today that the memorandum and articles constitute a contract between the company and its members to the extent that the provisions thereof affect the members in their capacity as members."[1]

That the legal nature of the constitution of a company is contractual, is not a controversial proposition. What has occasioned difficulty has been the meaning of s 20(1) of the English Companies Act, 1948 and its predecessors as far back as the Joint Stock Companies Act, 1862.[2] This section corresponds to s 65(2) of the South African Companies Act, 61 of 1973.[3] Considerable difficulty has also arisen in regard to the parties to the company constitution.

It is proposed in this chapter to deal with the legal nature of the company constitution, and the meaning and import of the section.

In the first place, the matter will be dealt with in English law. The reason for this is that the incorporated company of our law is modelled after its English counterpart.[4] Many of the rules of the English common law of companies apply in South African law with little or no modification. Thus the English view on the legal nature of the company constitution has been accepted into our law. On the other hand, certain aspects of the English common law conflict with distinctive rules of South African law, for example, the rules relating to a stipulatio alteri. In such cases the South African law is applied.[5]

In the second place, therefore, the position in South African law will then be set out. In this way the interaction of the English common law and our legal principles, will be observed in the subject under discussion.

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1. Cilliers Benade De Villiers 35. The words underlined are italicised in the reference. The phrase "in their capacity as members" refers to the outsider rule, to which much attention will be given below. See Chapters 8-12 below.
2. S 16 thereof. Ss VII and X of the Joint Stock Companies Act, 1956, which corresponds thereto, is slightly different in form.
3. Hereinafter referred to as "the Act".
4. Cilliers Benade De Villiers 11.
5. Ibidem.

2. The English law

2.1 Introduction

The company is historically descended from the joint stock association, a type of large partnership whose formation was brought about entirely by the agreement of its members acting under the common law. This agreement was known at the time as a "deed of settlement".[1] Under the Joint Stock Companies Act, 1844 this was required to contain a covenant by all the members binding themselves to one another and to trustees for the company, to conform to the deed of settlement.[2]

This Act, the earliest English companies legislation, adopted the existing method of forming an unincorporated joint stock company by agreement, and, as Gower says, "merely superimposed incorporation on registration".[3] However, in doing so, it effected a radical departure from the past, in that the company became a separate legal entity apart from its members.[4]

2.2 The legal nature of the constitution

What, therefore, is the nature of the company's constitution? Is it statutory or is is contractual? In the leading case of Hickman v. Kent or Romney Marsh Sheepbreeders' Association, Astbury J pointed out that a company cannot in the ordinary course be bound otherwise than by statute or contract.[5]

The matter had arisen for judicial comment prior to Hickman's case. In a number of cases, the contractual nature of the company constitution had been taken for granted.[6]

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1. Gower 33 et seq.
2. Par VII thereof.
3. Gower 261.
4. Ashbury Railway Carriage and Iron Co v Riche (1875) LR 7 HL 653.
5. [1915] 1 ChD 881 at 897.
6. Tavarone Mining Co Re, Pritchard's case (1873) 8 ChApp 956; see Chapter 3 at 33 and Chapter 8 at 179-180; Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88; see Chapter 8 at 181-182; Browne v La Trinidad (1887) 37 ChD 1; see Chapter 3 at 33 and Chapter 8 at 182-184.

In the leading case of Wood v Odessa Waterworks Company it was held that the constitution of a company is a contract.[1] However, in Bisgood v Henderson's Transvaal Estates Ltd, Buckley L J said that the purpose of the memorandum and articles was to define the position of the shareholder, and not to bind him in his personal capacity as an individual.[2] Consequently, it followed that an article could not validly increase a shareholder's liability above the amount stated in the memorandum nor bind him in respect of his share of its assets on a winding-up. Although these words seem to deal with the contractual nature of a company's constitution, it seems clear that Buckley L J was in fact referring to the subordinate position of the constitution of a company in relation to the statute, and that his words were not intended to be a new definition of the nature of a company's constitution. In Salmon v Quin and Axtens Ltd the articles were described as equivalent to a contract.[3] However, in the same matter, reported as Quin and Axtens Ltd v Salmon, the House of Lords approved of the view expressed in Wood's case namely that the constitution of a company is a contract.[4] In Hickman's case, Astbury J, in answer to the question whether the constitution of a company was statutory or contractual in character, expressed the view that it was in the relevant section that its obligation must be found.[5] He, having considered the authorities as they then stood, described the constitution as a statutory agreement.[6]

In one case after Hickman's case, it was said of s 20 that it may well be that it adjusts the relations of ordinary members inter se in the same way as a contract would if signed by all.[7] In another it was described simply as a contract.[8] In the case of Beattie v E and F Beattie Ltd it was said that s 20 gives to articles of association a contractual force.[9]

The views of leading English academic writers, on the question of the contractual nature of the company constitution, are, briefly, as follows:

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1. (1889) 42 ChD 636 at 642; see Chapter 3 at 34.
2. [1908] 1 ChD 743 at 758.
3. [1909] 1 ChD 311 at 318. The case is also reported in the Appeal Court as Quin and Axtens Ltd v Salmon [1909] AC 442 HL.
4. [1909] AC 442 HL 443.
5. Hickman's case supra 897.
6. Ibid 903.
7. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G
8. Greene (deceased) Re, Greene v Greene [1949] 1 All ER 167 ChD 170A-D.
9. [1938] 3 All ER 214 CA 217F-G.

In Gower's view it is clearly established that the memorandum and articles constitute a contract.[1]

Pennington is of the same opinion.[2] Read literally, s 20 appeared to create a contract between the company and its members to observe all the provisions of the memorandum and articles.

Halsbury, on the other hand, states that the question how far the memorandum and articles constitute a binding contract between a company and its members on the one hand and on the other hand between its members inter se, was one of great difficulty and was not altogether clear.[3] However, the learned author then proceeded to state that the articles are a contract between the company and its members in their capacity as such.[4] On the other hand, Halsbury's view is that, while the articles regulate the rights of members inter se, they did not constitute a contract between the members inter se but only a contract between the company and its members.[5]

Gore-Browne's view is that the effect of s 20(1) is to create an obligation binding alike on the members and the company.[6] A shareholder was not bound in his personal capacity. The purpose of the memorandum and articles was to define the position of the shareholder as shareholder, not to bind him in his personal capacity as an individual.[7]

Wedderburn said of s 20 and its predecessors, that "this section makes the articles into a contract between the company and each member 'in respect of their rights and duties as members'".[8] The existence of some such contract was clear law in spite of the fact that the section did not read "by each member and the company." The unsolved problem had been whether the articles were also a contract between the members inter se.

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1. Gower 261.
2. Pennington 55.
3. Halsbury 71 par 117.
4. Ibid 71 par 118.
5. Ibid 72 par 119.
6. Gore-Browne 51.
7. Ibidem.
8. Wedderburn K W : Company law - Effect of Articles as a contract - remedy against directors (1958) CLJ 148. On the question of the contract between the members inter se, see Chapter 3 at 32 et seq.

Each of these learned authors have qualified their remarks with reference to the outsider rule.[1] Thus, Gower stated that s 20 gives the memorandum and articles contractual effect only in so far as they confer rights or obligations on the member in his capacity as a member.[2]

Having regard both to the judicial statements and the views of English academic writers, set out above, there can be no doubt, it is submitted, that the company constitution is universally regarded in English law as contractual in nature. The difficult problem has always been the role of s 20(1) of the English Companies Act, 1948, and its predecessors. It is to this question that attention will now be given.

2.3 The role of the section in the creation of legal relationships through the company constitution

The first English companies legislation was the Joint Stock Companies Act, 1844. It simply adopted the existing method of forming an unincorporated joint stock company by deed of settlement. This deed, of course, constituted a contract between the members who were party to it.[3] It also provided that the constitution should contain undertakings by every shareholder with a trustee on behalf of the company to pay for his shares and "to perform the several engagements in the Deed on the part of the shareholders."[4] This Act did not lay down the nature of these engagements. It did, however, provide that on the complete registration and incorporation of the company, any covenants between the shareholders and the trustee could be enforced in all respects as if they had been made or entered into with the company after incorporation thereof.[5] This seems to indicate a clear recognition that, in terms of English common law, the company, which would be incorporated in

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1. Gower 263; Pennington 55-56; Halsbury 71 par 117; Gore-Browne 51. This question will receive detailed attention under the heading of the outsider rule in Chapters 8-12.
2. Gower 261.
3. Joint Stock Companies Act supra par VII.
4. Ibid par XXV.
5. Ibidem.

terms of this Act, would be precluded from being bound by the contract embodied in its constitution, for the reason that this agreement was concluded prior to its own coming into existence.[1] The Act therefore provided a statutory exception to this common law rule to enable the company, after its incorporation, to be so bound. This, it is submitted, is the reason for the agreement between the shareholder and the trustee for the company to be formed and the statutory provision that such agreement could be enforced in all respects as if entered into by the company after its incorporation.[2]

This Act was repealed and replaced by the Joint Stock Companies Act, 1856. This Act replaced the deed of settlement with a memorandum and articles of association, and introduced a provision along the lines of the the present s 20 of the English Companies Act, 1948. This section has been retained intact in all subsequent company legislation.

The Act of 1856 was repealed and replaced by the Companies Act, 1862. Under this and under all subsequent English Companies Acts, the procedure of the Joint Stock Companies Act, 1844, for the incorporation of companies was no longer followed. Instead, the procedure is as follows:

Any seven or more persons, or, in the case of a private company, any two or more persons associated for any lawful purpose, may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of the act in respect of registration, form and incorporate a company.[3]

Under this section, the incorporators, as in the 1844 Act, subscribe their names to the memorandum prior to the formation of the company. By so doing they contract with each other, and with the company prior to its incorporation, purporting to bind the company to its own constitution, which of course is impossible under English common law.[4]

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1. The question of the constitution as a pre-incorporation contract will receive detailed attention below at 26 et seq.
2. Joint Stock Companies Act, 1844 par XXV.
3. S 1 of the English Companies Act, 1948.
4. See below at 13 et seq.

There is no equivalent to the provision in the Joint Stock Companies Act, 1844, declaring this to be an agreement between the shareholders and a trustee for the company to be formed, and enabling it to be enforced as if entered into by the company after its incorporation.[1] Instead there is s 20(1) of the Companies Act, 1948 and its predecessors. This section embodies the statutory sanction for the legal nature of the company's constitution in English law. It reads as follows:

> "Subject to the provisions of this Act, the memorandum and articles, shall, when registered, bind the company and the members thereof 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 of the articles."

This section, and its predecessors in successive English Companies Acts, has always occasioned difficulties in interpretation, despite the optimism of Lindley L J which he expressed in 1887 in Browne v La Trinidad.[2] He thought that the difficulties in construing the corresponding s 16 of the English Companies Act of 1862 had been removed by the authorities. However, in 1915, Astbury J in Hickman's case said that the exact nature of the covenant referred to in the section had given rise to considerable discussion and was even then very difficult to define.[3] Furthermore, in 1958 Gower confessed that the exact effect of the section had long been one of the most baffling questions in company law.[4] He also commented on a provision in the 1856 Act on the lines of the present s 20 as follows: "Unhappily, full account was not taken of the vital new factor, namely, the fact that the incorporated company was a separate legal entity, and the words 'as if ... signed and sealed by each member' did not have added to them 'and by the company'. This oddity has survived into the modern Acts."[5]

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1. Joint Stock Companies Act, 1844 par XXV.
2. 37 ChD 1 at 15.
3. Hickman's case supra 890 and 897.
4. Gower L C B: The Contractual Effect of Articles of Association (1958) 21 MLR 401.
5. Gower 261. The provision in the 1856 act is set out in ss VII and X thereof; see 3 above at footnote 2.

Pennington says of the section that, although it states that the company shall be bound by the memorandum and articles, it is not deemed to have executed them as the members are deemed to have done.[1] This, he says, is the result of an oversight in translating the covenant in the old deed of settlement (which could not be entered into by the company because it was unincorporated) into the terms of modern incorporated companies. Nevertheless it had been held that the company was bound by the memorandum and articles as much as its members. In support of this view he relied on Hickman's case.[2]

This section is undoubtedly obscure. It says that it binds the company but it does not say that the company is bound to the members. Nor does it say whether the company is bound in contract or by statute. It says that the company is bound, but not "as if" it had signed the memorandum and articles.

This submission is made because the word "they" in the section refers to the memorandum and articles. The word "respectively" means that both the memorandum and the articles are deemed to have been signed, but not by the company. The section says that the company is bound as if the memorandum and the articles had each been signed by the members. It is submitted that this was not an oversight, as suggested by Pennington, but recognition that the company could not sign because, at the time, it was not in existence.[3] It also obviates the necessity for the company to sign the constitution every time a new member is admitted.

The section then says that the company is bound, as if the constitution contained covenants by the members. It is submitted that the company ought to be bound because the constitution contains covenants by itself. If that is not the case, or if such covenants by itself are not binding because they are pre-incorporation covenants, it becomes bound because in terms of the section, the company is deemed to have made covenants with the members.

As far as the members are concerned, it says that they are bound, but it does not say that they are bound to the company or to each other, inter se. It says that they are bound as if the memorandum and articles had been signed by each member. However, in terms of s 1(1) of the English Companies Act, 1948, the subscribers are obliged to subscribe their names to the memorandum of association as part of the mode of forming an incorporated

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1. Pennington 55.
2. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 897.
3. Pennington 55.

company. The subscribers are, in terms of s 26(1) deemed to have agreed to become members of the company. In the case of subscribers, s 20(1) would appear to be redundant, since they sign the constitution in terms of s 1(1). This would be so, were it not for the fact that the constitution is a pre-incorporation contract as far as the company is concerned. Their signatures would, therefore not be sufficient to create a binding contract between them and the company, were it not for s 20(1).

Other members are not obliged to sign the constitution. However, their agreement to become members is a requirement of membership in terms of s 26(2), as is the entry of their names in the register of members. Such agreement, it might be argued, carries as a necessary implication, the undertaking to be bound to the contract embodied in the constitution. Yet s 20(1) declares that they are bound to the constitution as if they had signed it. The section goes further. It says that the company and the members are bound as if the memorandum and articles contained covenants on the part of each member. This signifies that the articles do not contain such covenants, whereas the essence of the concept of the constitution as a contract is that it contains such covenants. Nevertheless, the members and the company are deemed to be bound to such covenants "by the members". In other words the section contemplates that there are, in fact, no such covenants. It is submitted that this could mean that there are no binding covenants because the company was not in existence when they were made, or because the necessary consensus ad idem to form a contract is missing in regard to members who become such after incorporation.

It may be argued, therefore, that the section is a deeming provision in the sense that a state of affairs is considered to exist, although in fact it may not exist.[1] The state of affairs is the existence of an agreement in the constitution. In this sense, despite the universal opinion that the constitution is a contract, it could, it is submitted, be accurately described as the equivalent of a contract, as was done in Salmon v Quin and Axtens Ltd.[2] It is also accurate to describe it, as Astbury J did in Hickman's case, as a statutory agreement between the members "as such" and the company as well as between themselves inter se.[3] In Beattie's case it was said that s 20 gives to the articles a contractual force.[4]

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1. Palmer 129 par 14-10.
2. [1909] 1 ChD 311 CA 318.
3. Hickman's case supra 903.
4. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 217F-G.

The significance of this creation by statute of a contract may not be fully apparent in the case of a small company having a handful of shareholders. In this case the contract contained in the constitution may have been concluded as a fact. The subscribers may indeed have signed and sealed the memorandum. There may have been an agreement outside the constitution, signed by the company and the members, adopting the constitution and confirming it as the contract between the parties.

On the other hand, the likelihood of finding all these facts in a public company, with thousands of members, is remote, to say the least of it. In the absence of a contract in fact, the section has, by a fiction, created a contract between the company and the members, brought about by the same acts by which persons become members of the company.

The question may, therefore, be asked whether the section is essential for the purpose of preserving or creating the contractual nature of the company constitution.

Astbury J in Hickman's case raised the issue in the following way.[1] Having stated that the section was difficult to construe or understand, he said: "A company cannot in the ordinary course be bound otherwise than by statute or contract and it is in this section that its obligation must be found." He also said: "Much of the difficulty is removed if the company be regarded, as the framers of the section may very well have so regarded it, as being treated in law as a party to its own memorandum and articles."[2]

The matter can be tested by enquiring whether, in the absence of the section, the company and its members would be bound to each other under the constitution.

As far as the initial subscribers and the promoters are concerned, there is, it is submitted, no legal obstacle to their agreeing with each other to form an association and to incorporate the company. The agreement between these members, inter se, is not dependent on the section.

After the incorporation of the company, the introduction of new members would require the signature by all members, old and new, and by the company,

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1. Hickman's case supra 897.
2. Ibidem.

of agreements to abide by the constitution, to admit the new members and to release old members. It is submitted that the section enables new members to enter into agreements with the company and with the existing members without such signature, since the section provides that the memorandum and articles bind the company and the members to the same extent as if they respectively had been signed and sealed by each member. This facility is not available to the subscribers, who are required to subscribe their names to the memorandum of association, as part of the process of incorporating the company.[1]

The position of the company, it is submitted, is quite different, in that the company could not be a party to its own constitution, but for the section, for the reason that the constitution is an agreement concluded prior to its incorporation, that is to say, before it came into existence.

It is proposed to investigate in detail this aspect of the matter.

In general, only the parties to an agreement are bound by it, in the sense that they can sue or be sued on it.[2] Since the company was not in existence at the time that the agreement in the constitution was concluded by the subscribers, it was therefore not a party to it and therefore could not be bound by it.

It might, however, be contended that the subscribers were agents for the company about to be formed, or alternatively, that they were acting as principals, intending that the company could,after its incorporation, accept the benefits of this contract.

Under s 11 of the English Companies Act, 1948 the memorandum of association is required to be in accordance with the forms set out. These forms, with unimportant variations, require the subscribers to record that they desire to be formed into a company and agree to take the number of

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1. S 1(1) of the Companies Act, 1948.

2. Scruttons Ltd v Midland Silicones Ltd [1962] 1 All ER 1 HL 6.
This is the position in English law according to the doctrine of privity of contract.

shares stated.[1] In none of these forms does the company appear as a party to the constitution or to the contract therein contained. Furthermore, if one looks at the memorandum prescribed in this Act, there is no suggestion in the words used, of an agency for the company, or of a contract between two principals for its benefit as a third party thereto.

However, if the wording of an agreement for the benefit of, or on behalf of a company entered into prior to its incorporation could be found in the constitution, or even outside it, then the further question arises, whether this would bind the company and the members to the contract embodied in the constitution. Pennington says: "A company cannot enter into a contract before it is incorporated, because it does not yet exist as a legal person."[2]

It is proposed to examine this proposition in two parts. The first is in respect of the agreement by an agent for the company prior to its incorporation, that is to say, by an agent for a non-existent principal. The second is the contract for the benefit of a third, entered into by two principals.

As to the first, the position is as follows. An agent may make a contract for his principal which has the same consequence as if the latter had made it himself. To this extent, therefore, the fundamental rule that a person cannot be affected, either beneficially or adversely, by a contract to which he is not a party, is considerably diminished in its area of operation.

Where an agent purports to enter into a contract on behalf of his principal without in fact having been authorised to do so, in general the principal may ratify or adopt the contract with retrospective effect.[3]

However, a company cannot sue or be sued upon a contract made by an alleged agent on its behalf prior to its incorporation. This is the principle in Kelner v Baxter.[4] In this case the promoters of a proposed

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1. In the English Companies Act, 1948 this form is set out in Tables B, C, D and E in the First Schedule to the Act.

   Slightly different forms are prescribed for public companies, private companies and companies limited by guarantee. For the present purpose the differences are of no consequence.

2. Pennington 87.

3. Cheshire and Fifoot 458 et seq.

4. (1866) LR 2 CP 174.

company purported to enter into a contract on its behalf, and the company, when formed, purported to ratify the contract. The company was wound up, being unable to pay its debts. The promoters were held personally liable on the ground that the company could not possibly ratify as a principal what was done for it, by an alleged agent, before it was legally in existence. Therefore the agents were personally liable, since they had contracted for a non-existent principal.

In Melhado v Porto Alegre Rail Co the articles of association of the company provided that the directors were authorised, at their discretion, to pay certain pre-incorporation expenses.[1] The plaintiffs claimed these expenses, having disbursed same in the course of promoting and establishing the company. The court held, inter alia, that if there was such a contract among the promoters before the company came into being, purporting to bind it, the company could not ratify it.[2]

Pennington says that just as a company cannot enter into an agreement before it is incorporated, because it does not yet exist as a legal person, so for the same reason, it is not bound by contracts made by agents purporting to act on its behalf before its incorporation.[3] Pennington goes further: "By a strict application of this rule, it has been held that a company may not after its incorporation ratify such a contract made on its behalf before it was incorporated."[4] As far as the second type of contract is concerned, that is to say, contracts for the benefit of a third person, concluded by two principals, it is settled law that rights cannot be conferred on a stranger to a contract as of right to enforce the contract in personam.[5]

It is submitted that these principles apply with equal force to the contract contained in the constitution, so that, in either situation, the company cannot, at common law, be or become a party to its own constitution, since it was concluded before its incorporation. Nor can it adopt or ratify this contract.

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1. (1874) LR 9 CP 503; 43 LJCP 253.
2. Ibid 505.
3. Pennington 87.
4. Ibidem.
5. Dunlop Pneumatic Tyre Co Ltd v Selfridge and Co Ltd [1915] AC 847 HL; see also Getz L : Contracts for the Benefit of Third Parties (1962) Acta Juridica 38 at 53-54.

It is against this common law background that s 20(1) is to be considered. It provides that, subject to the provisions of the act, the memorandum and articles shall, when registered, bind the company and the members thereof 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 of the articles.

Whatever else it conveys, the section clearly binds the company and the members to all the provisions of the memorandum and articles.

It is submitted, therefore, that one purpose of s 20(1) of the English Companies Act, 1948 and of its predecessors as far back as the Joint Stock Companies Act, 1856, is to provide a statutory exception to the common law rule against contracts for a non-existent principal, whether by an agent on its behalf, or by two principals for its benefit.

Another purpose is to dispense with the need for the company itself, or new members from time to time, to sign the memorandum or the articles.

A further purpose is to obviate the necessity to seek a consensual contract in the constitution. The section is a deeming provision, creating a contract in the constitution even if there be none in fact.

This explanation gives meaning to the view of Astbury J expressed in Hickman's case, and mentioned above, that much of the difficulty of construing or understanding the section is removed, if the company be regarded, as the framers of the section may have regarded it, as being treated in law as a party to its own memorandum and articles.[1]

It also, it is submitted, offers an answer to Gower's criticism that the framers of the section failed to take into account the vital new factor, namely, that the company had become a separate legal entity.[2] In fact the section can be explained, as has been attempted above, on the basis that it assumes that the company is a separate persona, and on the further basis that it recognises that this new entity cannot, under the common law, be a party to its own constitution, since it was agreed on prior to the company's existence.

In passing, it is to be noted that, under the same common law rule, the subscribers to the memorandum would not be able to demand that the

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1. Hickman's case supra 897. See above at 10.
2. Gower 261.

company, on its formation, acknowledge their membership, since it cannot be bound to this undertaking, embodied in the pre-incorporation agreement, namely the constitution. It is submitted that this explains s 20(1) which lays down that the subscribers to the memorandum of a company shall be deemed to have agreed to become members of the company upon its incorporation, and shall forthwith be entered as members in its register of members. It would, on the other hand, not accord with the common law, and the historical precedent of the joint stock association, to explain this section on the basis that it is a deeming provision, binding the subscribers to a contract to which they were not a party.

It would appear that the constitution is the only pre-incorporation agreement which is deemed to be binding on the company. The statute does not permit the company to adopt or ratify any other contract entered into on its behalf with a third party before it was incorporated.[1]

2.4 Conclusion on the English law

Firstly, the company constitution is without doubt contractual in character. This proposition leads to further enquiries, more particularly who are the parties to the contract, the method of altering and of enforcing the contract, and the scope of the contract, that is to say, whether it is limited to those provisions conferring rights and obligations on the member in his capacity as a member. These enquiries will occupy the remaining chapters hereof.

Secondly, the source of the rights and obligations contained in the contract in the constitution is both the agreement of the members and the sanction of s 20(1). The purpose of the section, it has been submitted, is threefold. Firstly, it provides a statutory exception to the common law rules against contracts by an agent for a non-existent principal, and against the stipulatio alteri. Secondly, it facilitates changes of membership after incorporation, by dispensing with the need for signature by new members, and by the company. Thirdly, it is a deeming provision, imposing a contract

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1. Pennington 81.

on the company and its members, even if consensus cannot be established.

It is now proposed to deal with the same subject in South African law.

3. South African law

3.1 Introduction

South African company law is, of course, independent of English law, being governed by the Act. On the other hand the English common law is part of our company law, to the extent that it is not inconsistent with the South African common law.[1] However, where sections of the Act have obviously been taken over from the English companies legislation, our courts will, as a rule, follow the meaning as laid down in an English court.[2] This is frequently the case where the terms are identical.[3] It is not, however, inevitable.[4]

Until the advent of the Act, South African company legislation was modelled for the most part on the English Companies Acts in force from time to time.[5] The South African Companies Act 46 of 1926 repealed various provincial ordinances and remained the law with numerous amendments until the promulgation of the Act in 1973. The South African equivalent of s 20(1) of the English Companies Act, 1948 was s 16 of the Companies Act, 1926, which became s 65(2) of the Act. This reads as follows:

> "The memorandum and articles shall bind the company and the members therof to the same extent as if they respectively had been signed by each member, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act."

This section is identical to s 20(1) of the English Companies Act, 1948 except for the phrase "and contained covenants on the part of each member" which appears in the English Act. This phrase also appeared in the Transvaal Companies Act.[6] It was however, inexplicably left out of the Companies Act, 1926 and out of the Act.

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1. Cilliers Benade De Villiers 11; see 1 above.
2. Estate Wege v Strauss 1932 AD 76 at 81.
3. Buckingham v Combined Holdings and Industries Ltd 1961 (1) SA 326 (E) 331D-E.
4. See, for example, Albert v Papenfus 1964 (2) SA 713 (EC) 721.
5. Cilliers Benade De Villiers 12.
6. S 16(1) of Act 31 of 1909 of the Transvaal.

Pyemont expressed the view that the omission may weaken the intended effect of the section, namely to create rights and obligations, binding alike on the members and the company, and between the members inter se.[1] However, s 65(2) of the Act has been construed by the Appellate Division as having the same meaning as s 20(1) of the English Companies Act, 1948.[2]

Consequently, it is submitted that the decisions of English courts on the meaning of s 20(1) of the English Act are of great importance in ascertaining the meaning of s 65(2) of the Act. On the other hand the English courts have had great difficulty in interpreting s 20(1). Innes C J in Ross and Co v Coleman spoke of the many English cases on the matter, "not all of them harmonious".[3]

As a result, their judicial interpretations are by no means authoritative, nor are these supported by long lines of cases.[4] On the other hand, the history of s 20(1) and its predecessors as far back as the English Companies Acts of 1844 and 1856, serves to explain the meaning of s 65(2) of the Act, because s 65(2) has been modelled on the English section.

Having regard to these principles, it is proposed to set out the views of South African judges on the contractual nature of the company constitution in South African law and on the meaning of s 65(2) of the Act and then to outline the views of South African academic writers on the same subject..

3.2 South African cases

The first comment on the nature of the company's constitution in the South African cases, is to be found in Ross and Co v Coleman.[5] There was no doubt in the mind of Innes C J that the articles are an agreement.[6] However, the court was construing the articles of a company which was registered under the Ordinance of the Orange Free State 24 of 1904. In terms of this Ordinance

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1. Pyemont 36.
2. Gohlke and Schneider v Westies Minerale (Edms)Bpk 1970(2) SA 685 (A) 692D-E.
3. 1920 AD 408 at 417.
4. Osaka Mercantile Steamship Co Ltd v South African Railways and Harbours 1938 AD 146 at 173-174.
5. 1920 AD 408 at 418.
6. Ibidem. What he actually said was that the articles in themselves are merely an agreement between the shareholders inter se. This statement - to the extent that it excludes the company as a party to the constitution - is not good law today. See Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) 692E-H and Chapter 3 hereof at 57 and Chapter 4 at 78 et seq.

a company requires a memorandum. The Ordinance is silent about articles, and has no section equivalent to s 65(2) of the Act. To this extent, therefore, the importance of the case is diminished.

The matter arose again in Ko-operatiewe Wynbouers Vereeniging van ZA Bpkt v Botha.[1] A wine farmer became a member of a co-operative society, registered under the Companies Act, 1892. The articles of the society bound members, for an indefinite period, to sell their wine only to persons authorised by the society and only at prices fixed by the company. In an action by the company for an interdict restraining a member from selling wine to persons not authorised by the company, the main defence was that this clause was illegal as constituting an unlawful restraint of trade.[2]

The court, in deciding this issue, clearly viewed the articles as a contract. The judge, in fact, said that in deciding on the validity of a restraint of trade clause, it can make no difference whether the contract containing such a clause, is between two individuals or between an individual and a corporation of which he is a member, whether it is contained in a document expressly styled a contract or whether the contract arises out of articles of association.[3]

One of the leading cases on the nature of the company constitution is De Villiers v Jacobsdal Saltworks[4]. Its main import arises in regard to the outsider rule, and considerable attention will be given to it under that heading. Nevertheless, it is authority for the contractual nature of the constitution.

Botha J P relied on two English cases, namely Hickman's case[5], and Beattie's case,[6] to support his view that, while in terms of s 16 of the Companies Act, 46 of 1926, a company's articles of association bind the company and the members thereof to the same extent as if they had been signed by each member, no right given to a person in a capacity other than as a member could be enforced against the company.

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1. 1923 CPD 429.
2. Ibid 434.
3. Ibid 435.
4. 1959 (3) SA 873 (O). See Chapter 12 hereof at 263.
5. Hickman v Kent or Romney Marsh Sheep Breeders' Association [1915] 1 ChD 881.
6. Beattie v Beattie E and F Ltd [1938] 3 All ER 214 CA.
7. De Villiers' case supra 873-874A.

Potgieter J relied on Eley's case,[1] Browne v La Trinidad,[2] Hickman's case,[3] and Beattie's case.[4] It was clear from these decisions that "the articles of association do not create a contract between the company and a member except in his capacity as a member". "The articles", he said, "constitute a contract between the members inter se and between the company and the members but only in their capacity as members."[5]

In the case of Isaacs, Geshen and Co (Pty) Ltd v Ellis, Caney J stated that every member was bound to observe all the provisions of the articles, in terms of s 16 of Act 46 of 1926 and was entitled to enforce the provisions and restrain breaches of them, as against the company whose shares they owned.[6] Although he did not spell out the contractual nature of the constitution, the learned judge relied on Hickman's case for this proposition. Nevertheless, it is submitted that he did support this view of the constitution, since he explained that a stranger to the articles could not rely on them merely because, in terms of the articles, the parties to them had made an agreement between themselves relating to him.[7] He relied for this view on Hickman's case[8] and on Beattie's case[9], although he questioned this view in our law, "having regard to the rule that a stipulatio alteri may be accepted by him for whose benefit it is made."[10]

The Appellate Division reaffirmed, in Gohlke and Schneider v Westies Minerale (Edms) Bpk, the fact that the articles have the same force as a contract.[11] Trollip J A said of s 16 of the Companies Ordinance of South West Africa, that in substance it is the same as the corresponding section of our Act and in the

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1. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88.
2. (1887) 37 ChD 1.
3. Hickman's case supra.
4. Beattie's case supra.
5. De Villiers v Jacobsdal Saltworks supra 876H-877A.
6. 1964 (2) PH A59 293 at 298. See Chapter 3 at 58 ; Chapter 12 at 271.
7. Ibidem.
8. Hickman's case supra.
9. Beattie's case supra.
10. Isaacs, Geshen and Co (Pty) Ltd v Ellis supra 298.
11. 1970(2) SA 685 (A) 692F-G.

successive English Companies Acts. He said that the section does not render the articles absolutely binding on the company and its members as though they were statutory enactments. The company and its members, he said, are bound only to the same extent as if the articles had been signed by each member, that is, as if they had contracted in terms of the articles. "The articles, therefore, merely have the same force as a contract between the company and each and every member as such to observe their provisions." There was therefore no reason why, as with any other contract, it could not be departed from by a bona fide agreement concluded between the company and all its members to do something contrary to the articles.[1]

The judgment of Milne J in the case of Rosslare(Pty) Ltd v Registrar of Companies also rested on the assumption that the company constitution is contractual in nature.[2] In this case, the judgment dealt with the outsider rule. However, in approaching the problems associated with the outsider rule, Milne J dealt firstly with the submission before the court that it was the fact that the amended articles gave the shareholders rights to the company's property in their capacity as members which rendered the article objectionable.[3] First of all, Milne J quoted the words of Potgieter J in De Villiers v Jacobsdal Salt Works that the articles constitute a contract between the members inter se and between the company and the members, but only in their capacity as members.[4] He also noted that this passage was approved by the Appellate Division in Gohlke's case where Trollip J A said that "the articles therefore merely have the same force as a contract between the company and each and every member as such to observe their provisions".[5]

Milne J then proceeded to deal with the outsider rule, to which a return will be made below.

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1. Ibid at 692E-H. The learned judge also said that, of course, to bind new members and to affect outsiders, the agreement would probably have to be incorporated into the articles by a special resolution duly registered (692H).
2. 1972(2) SA 524 (D) 528A-D. This case receives detailed attention below. See Chapter 12 at 272 et seq. There is, therefore, it is submitted, no need to traverse the judgment in detail at this juncture.
3. The words underlined are italicised in the judgment (528A).
4. De Villiers v Jacobsdal Saltworks supra 876-7.
5. Gohlke and Schneider v Westies Minerale (Edms) Bpk supra 692F-G.

In the case of Oranje Benefit Society v Central Merchant Bank Ltd reference was made to s 16 of the English Winding-up Act, 1862 which provided that the articles of association shall bind every member as if he had subscribed and sealed same and had covenanted to conform to all the articles thereof.[1] The respondent claimed from the appellant damages caused by the fraudulent conduct of two of the appellant's servants in the course of carrying out their duties on its behalf.[2] The fraud complained of was that these servants "designedly refrained" from informing the other party that certain suretyship was ultra vires and of no force or effect.[3] The defence pleaded was that the other party was deemed in law to know that the contract of suretyship was ultra vires and invalid, and that therefore was not induced to enter into the contract by the said fraud.[4]

Holmes J A referred to the case of Central Railway Company of Venezuela v Joseph Kisch.[5] In that case the same defence was raised to a claim of damages for fraud, and received short shrift in the House of Lords. Holmes J A, in following that judgment, noted the import of s 16 of the Winding-up Act, 1862 and the fact that any one who had without fraud taken shares could not allege ignorance of the memorandum and articles merely because he had not signed or sealed them, but if he never actually signed or sealed them, nor had notice of what they contained, the statute could not be taken to impute to him knowledge of the contents so as to protect those who by a fraud had induced him to do that which, in the absence of fraud, would have precluded him from saying he was ignorant of their contents.[6]

"In other words", said Holmes J A, "a statutory deeming was held not to apply to a person who had been induced to take shares by fraudulent misrepresentation or concealment".[7]

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1. 1976 (4) SA 659 (A) 673H - 674A.
2. Ibid 667F-G.
3. Ibid 671D-E.
4. Ibid 672C.
5. [1867] LR 2 HL 99 at 123.
6. Oranje Benefit Society v Central Merchant Bank Ltd supra 673D-674C.
7. Ibid 674B-C.

It is submitted that these words in s 16 of the English Winding-up Act, 1862 are very similar to those of s 65(2) of the Act, and that the description thereof by Holmes J A as a "statutory deeming" applies equally to the following words in s 65(2), namely that the memorandum and articles shall bind the company and the members thereof to the same extent as if they had respectively been signed by each member. It is submitted, therefore, that s 65(2) may well be described as a deeming provision, in the sense that a state of affairs is considered to exist, even if it does not. The state of affairs in question is the existence of a contract in the constitution even if it did not exist.

Having set out the cases which deal with the contractual nature of the constitution and on the meaning of s 65(2) of the Act, it is now proposed to outline the views of South African academic writers on the subject.

3.3 South African academic writers

Cilliers Benade De Villiers, relying on Hickman's case, state that it is generally accepted today that the memorandum and articles constitute a contract between the company and its members to the extent that the provisions thereof affect the members in their capacity as members.[1]

Henochsberg deals with s 65(2) of the Act, in particular the words "shall bind the company and the members to the same extent as if".[2] With reference to provisions in the articles purporting to confer rights on persons otherwise than in their capacity as members, Henochsberg quotes in extenso, and, it is submitted, with approval from De Villiers' case[3] and from Gohlke's case.[4] Then Henochsberg proceeded as follows. The English cases were, however, far from consistent as regards the effect of the articles as a contract binding the members inter se.[5] In "the valuable judgment of Vaisey J in Rayfield v Hands"[6] he had clearly and correctly favoured the view that the articles did constitute a contract between the members as such inter se. The language of the statute seemed clear enough, since it expressly said that the memorandum and articles were binding on the members to the same extent as if they had respectively been signed by each member, subject only to the provisions of the Act.

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1. Cilliers Benade De Villiers 35.
2. Henochsberg 120.
3. De Villiers v Jacobsdal Saltworks 1959(3) SA 873(O). See above at 20.
4. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970(2) SA 685 (A) 692E-H. see above at 21 ; see Henochsberg 121-122.
5. Ibid 122.
6. [1958] 2 All ER 194 ChD.

It is submitted that Henochsberg has brought together several concepts, treating them as one, whereas they should be dealt with separately, the one concept leading to the next. These are, the contractual nature of the constitution, the role of s 65(2), the parties to the contract contained in the constitution, the enforcement of that contract, and the outsider rule.

Naude states that the historically determined contractual character of the articles was imposed on the company constitution in the first English Companies Act, and this character has remained to this day, embodied in s 16 of Act 46 of 1926.[1] This section was the point of departure whenever the courts were required to give judgment on the binding effect of the articles. In none of the decisions in which this matter arose, was the character of the constitution viewed as anything but contractual. There had been differences of opinion as to the interpretation of the articles, but these differences never turned on the contractual nature of the articles, but rather on the question of the parties to the constitution.[2]

Beuthin has commented on the words of Trollip J A in Gohlke's case, namely, that "the articles merely had the same force as a contract between the company and each and every member as such to observe their provisions."[3] In Beuthin's view, the description of the articles of association as merely having the same force as a contract did very little to solve the difficulties involved in determining the exact nature of the contractual relations established by the articles, both as between the company and the members, and as between the members inter se.[3]

Hahlo says of the memorandum and articles, that, on the authority of s 65(2), once registered, they bound the company and its members, including further members, as if they had been signed by each member.[4] They constituted a contract between the company and its members, and regulated the rights of members inter se; non-members acquired no rights under the articles, and even a member could not enforce provisions which did not concern him as a member.[5]

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1. Naude 57. S 16 of Act 46 of 1926 is, of course, the predecessor of s 65(2).
2. Ibidem.
3. Beuthin R C : Appointment of Directors and Legal Effect of Articles (1970) 87 SALJ 395 at 397 referring to Gohlke and Schneider v Westies Minerale (Edms)Bpk 1970 (2) SA 685 (A) 692E-H. See above at 21.
4. Hahlo 68.
5. Ibid 89 and 92.

3.4 An assessment

Firstly, it is submitted that in the cases and the academic writings referred to, the contractual nature of the constitution has been upheld and affirmed.

Secondly, the influence of the English cases, particularly Hickman's case, and Beattie's case is beyond question.

Thirdly, running through all these judgments is the influence of the outsider rule, and also the question of the parties to the agreement embodied in the constitution.

Fourthly, the sanction for the legal nature of the constitution is acknowledged to be s 65(2) of the Act, and its predecessor, s 16 of Act 46 of 1926. Its role as a deeming provision has not been extensively considered, although there is a reference to similar words in another context as a deeming provision.[1]

The meaning and import of s 20(1) of the English Companies Act, 1948 was considered in the first section of this chapter. Three propositions were advanced in respect thereof. The first is that it provides an exception to the English common law rule against contracts for a non-existent principal, whether by an agent on its behalf, or by two principals for its benefit. The second is that the section dispenses with the need for the company itself, or new members from time to time, to sign the memorandum and articles. The third is that it is a deeming provision, obviating the necessity to seek a consensus ad idem between the parties to the contract contained in the constitution.

It is proposed to consider these propositions in South African law. In doing so, it is necessary to repeat the fact that English company law is part of our common law, subject to any distinctive rules of South African common law which prevent the reception of a particular rule of English law.[2] It is also important to note that s 65(2) of the Act is identical to s 20(1) of the English Companies Act, 1948, except for the phrase "and contained covenants on the part of each member" which appears in the English Act, but not in the Act. However, s 65(2) of the Act has been construed by the Appellate Division as having the same meaning as s 20(1) of the English Act.[3] It is, therefore,

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1. Oranje Benefit Society v Central Merchant Bank Ltd 1976 (4) SA 659 (A) 674B-C.
2. Cilliers Benade De Villiers 11.
3. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) 692B-E.

proposed, in dealing with the three propositions outlined above, to consider only whether there are any distinctive rules of South African law which alter the conclusions arrived at in regard to English law. This obviates the necessity to traverse the same ground again.

The first question, therefore, is whether s 65(2) provides a statutory exception to a South African common law rule against contracts for a non-existent person.

The South African common law divides all agreements for the benefit of or on behalf of a third party into two classes: those made by agents purporting to act on behalf of principals; and those made by principals for the benefit of a third party.

In regard to the former, the South African common law, in common with the law of England, upholds the rule that there can be no ratification by a principal of a contract made by a person purporting to be his agent if the contract was concluded at a time when the principal was not in existence.[1]

However, unlike English law, it is possible, in South African law, to contract independently for the benefit of a third person. Such a contract, when duly accepted by the person for whose benefit it was made, may be enforced by him even if he was not in existence at the time of the contract.[2] Accordingly, it is possible for a company to become a party to the contract embodied in the constitution, although it was concluded before the company came into existence provided that this contract was concluded by principals acting independently and with the clear intention to provide a benefit for the company still to be formed.

However, in the absence of clear proof that a stipulatio alteri was intended, the company could not accept the benefit of such a contract.[3] Furthermore, a person who, as agent for a company not yet formed, concludes a contract with another, cannot also be a principal contracting independently for a stipulation for the benefit of a third.[4]

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1. Lecomte v W and B Syndicate of Madagascar 1905 TS 696 at 706.
2. McCulloch v Fernwood Estates Ltd 1920 AD 204.
3. Baikie v Pretoria Municipality 1921 TPD 376 at 379.
4. Sentrale Kunsmis Korporasie v NKP Kunsmis Versspreiders (Edms) Bpk 1970 (3) SA 367 (A) 394H and 403G-H. It is submitted that he could be principal or agent in the alternative, provided he states this clearly.

There is some difficulty in ascertaining whether a particular transaction falls under one class or the other, especially where the third person was not in being at the date of the agreement.[1]

The South African common law position is, therefore, that it is impossible for a company to be a party to its own constitution, since it was agreed upon prior to its incorporation. Nor can it adopt or ratify the constitution in the event that it was entered into on its behalf by an agent prior to its incorporation. It could,however, adopt a constitution concluded by two principals before or after its incorporation provided it was clearly intended as a stipulatio alteri. It could, of course adopt its constitution after its incorporation, by agreement with its members.

In order to apply these principles to the constitution of a company, it is necessary to bear in mind that the procedure for registration of a company in South African law is the same as in English law, with the exception that in South Africa it is possible under the Act to form a one-man company.[2] Any single person may form a company by following the same procedure. Naturally its constitution cannot be a contract between the incorporators since there is only one. At most it is a declaration by him, or else it is a contract between him and the company prior to its formation. This, too, is an impossibility, since the company is not in existence. It is equally impossible that such a declaration could be a stipulatio alteri, since this can only arise from a contract between two persons and not from a unilateral declaration. Since all the acts leading to the incorporation of a one-man company take place prior to the company's incorporation,it is submitted that it is only the provisions of s 65(2) which make it possible for the company after incorporation to accept an offer by the single incorporator so as to create a binding contract between him and the company.

Once the procedure for registration is the same in South African law as in English law, and once the effect of the South African common law is to preclude the possibility of an agreement for a non-existent person, except on the narrow

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1. McCullogh v Fernwood Estates Ltd supra.
2. S 1 of the English Companies Act, 1948 corresponds to s 32 of the Act.

facts required for a stipulatio alteri, it is submitted that the arguments put forward regarding the meaning and import of s 20(1) of the English Act, apply equally to s 65(2) of the Act.[1] It is submitted, therefore, that s 65(2) does in fact provide an exception to this South African common law rule.

The second submission, that the section dispenses with the need for the company itself, or new members from time to time, to sign the memorandum and articles, is, it is submitted, equally valid in South African law.

The position is the same in regard to the third submission, namely that the section is a deeming provision, obviating the necessity for actual agreement between the company and the members. One argument advanced in regard to this submission in English law, cannot be put forward in South African law, namely the fact that the section states that the company and the members are bound as if the memorandum and articles contained covenants on the part of each member. These words are not to be found in s 65(2) of the Act.

Nevertheless, the view that s 65(2) is a deeming provision finds support in the comments of Holmes J A in Oranje Benefit Society v Central Merchant Bank Ltd.[2] He there described words similar to those found in s 65(2), particularly the words "the articles shall bind every member as if he had subscribed same" as a statutory deeming. In other words, the constitution is a contract, although in fact there may be no consensus between the company and the members. The contract may have been actually concluded, but if it was not,it was created by a statutory fiction. This, it is submitted, is the meaning of the words of Trollip J A in Gohlke's case that the articles "merely have the same force as a contract."[3] These words do, in fact, help to solve the difficulties involved in determining the contractual relations established by the articles, despite the criticism by Beuthin of these words.[4] They illustrate that the contract between the parties may in fact exist, but if it does not, the statutory fiction deems it to exist.

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1. See above at 4 et seq.
2. 1976 (4) SA 659 (A) 674B-C.
3. Gohlke and Schneider v Westies Minerale(Edms) Bpk 1970 (2) SA 685 (A) 692F-G.
4. Beuthin R C : Appointment of Directors and Legal Effect of Articles (1970) 87 SALJ 395 at 397.

3.5 Conclusion on the South African law

Notwithstanding the distinctive South African rules on the *stipulatio alteri*, it is submitted that the conclusions on the English law in regard to the legal nature of the company constitution, are equally valid in South African law.

4. General conclusion

The contractual nature of the company constitution is, it is submitted, beyond question. This contract originates partly in the agreement of the parties, and partly from the operation of the section in question. It may be said, therefore, that the company constitution is contractual in character and statutory in origin.

It is now proposed to examine, in the next chapter, the contracts embodied in the constitution.

CHAPTER 3 - THE CONTRACTS EMBODIED IN THE CONSTITUTION

1. Introduction

Having concluded that a company's constitution is statutory in origin and contractual in nature, it now becomes necessary to deal with the contracts contained in the constitution.

S 65(2) of the Act clearly says that the company and the members are bound by the memorandum and articles to the same extent as if they had been signed by each member. Arising from this section, therefore, there are contracts embodied in the constitution between the members inter se, and between the company and its members.[1] These contracts are universally recognised today.[2] However, the road to this recognition has been strewn with uncertainty and confusion.

It is proposed to trace the evolution of this recognition in two parts: firstly, the contract between the members inter se and secondly, the contract between the company and its members.[3] In doing so, it is proposed in each case to commence with the English law and thereafter to state the position in South African law. This sequence is dictated by the strong influence of English law on South African company law.[4] It is also convenient, thereafter, to consider the validity of a contract for the benefit of a third, which is found in the constitution.

In the next chapter consideration will be given to the alteration of these contracts, and the problem of their rectification.

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1. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) 692F-G. Although no authority is available on the point, it is assumed that each member has a separate contract with the company and with each of the other members, and further, that the members do not contract collectively with the company, as would a partnership or an association.
2. Cilliers Benade De Villiers 35-37.
3. Mention will also be made, in this chapter of the possibility in South African law of including, in the company's constitution, a contract for the benefit of a third. See below at 62 et seq.
4. See Chapter 1.

2. The contract between the members inter se

2.1 English law

S 20(1) of the English Companies Act, 1948, obscure as it is, states quite clearly that the constitution contains covenants on the part of each member.[1] Nevertheless, it was not until 1958 that the question as to whether these covenants are binding between the members inter se, was answered, in Rayfield v Hands, in the affirmative.[2]

Gower considers that the question, whether the memorandum constitutes a contract between the members inter se, had previously been completely uncertain.[3] He had, prior thereto, argued for the view that s 20 does establish a contract between the members inter se so that a direct right of action between the members should be permitted.[4] Wedderburn was of the same opinion.[5] The unsolved problem, he said, arising from section 20 of the Companies Act, 1948, had been whether the articles were, in addition to being a contract between the company and the members, also a contract between the members inter se. Both these learned writers therefore welcomed the decision in Rayfield v Hands,[6] which in their respective views answered the question in the affirmative.[7]

Firstly, however, the way in which the question had been dealt with previously will be set out together with the reasons why it had remained unanswered.

The joint stock association, which preceded the incorporated company was created solely by an agreement between the members inter se. Company legislation in English law merely superimposed on this contract between the members inter se, a company, separate and apart from its members, which was incorporated by registration.[8] The contract between the members inter se remained the basis of the company.

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1. Which section corresponds to s 65(2) of the Act.
2. [1958] 2 All ER 194 ChD.
3. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401.
4. Gower L C B : The Principles of Modern Company Law (Second Edition London 1967 253-254.
5. Wedderburn K W: Effect of Articles as a Contract - remedy against Directors (1958) CLJ 148.
6. [1958] 2 All ER 194 ChD.
7. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401; Wedderburn's article supra.
8. Gower 261.

The cases have passed through three stages. Firstly, the constitution was regarded as solely a contract between the members inter se. Then this was denied and the constitution was regarded solely as a contract between the company and the members. Today it is regarded as both a contract between the company and its members and between the members inter se.

The earliest view is reflected in cases in the nineteenth century which construed the articles, not as a contract between the members and the company, but only as a contract between the members inter se.

Thus in Tavarone Mining Co Re, Pritchard's Case the articles contained a clause requiring the company to purchase a mine from the promoters, who were also the subscribers, who were to be paid by the allotment of fully paid shares.[1] The articles were the only agreement of allotment. When the company was wound up, an attempt was made to place one of the allottees on the list of contributories in respect of the shares allotted to him and not paid up. It was held that the articles were not a written contract between the vendor and the company since articles are only a contract between the members inter se.[2] Consequently the shares were held not to be paid up in terms of s 25 of the Companies Act, 1867. As a result the allottee was placed on the list of contributories.

In Eley v Positive Government Security Life Assurance Co the plaintiff claimed relief arising out of a breach of the contract between himself and the company appointing him as its solicitor.[3] The agreement, said the plaintiff, was embodied in the articles. It was, however, held by the Court of Appeal that the articles did not in themselves constitute a contract between the company and third parties, but only between the members inter se.[4]

In Browne v La Trinidad a member who became a director was removed from office.[5] The member challenged his removal, contending that an agreement had been adopted by the company as part of its articles and that this agreement

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1. (1873) 8 ChApp 956.
2. Ibid 960.
3. (1876) ExD 20 and 88.
4. Ibid 89.
5. (1887) 37 ChD 1.

provided that he would be a director and that he would not be removed until a certain date, which had not yet arrived. It was however held, rejecting his claim, that inter alia the articles were not a contract between the member and the company but only between the members inter se.[1]

It is apparent from these cases that the earliest view was that the articles are undoubtedly a contract between the members inter se. The question was whether the constitution was also a contract between the members and the company. In answering the latter in the affirmative, the courts also affirmed the view that the constitution is a contract between the members inter se.

This was clearly stated in the leading case of Wood v Odessa Waterworks Co.[2] The company carried on business as a waterworks and in doing so made a substantial profit which was applied in extending the company's water mains. As a result, although the profits were available for the declaration of a dividend, there was no cash with which to pay it. The directors proposed to declare a dividend of £1 per share but, instead of paying it, to convert the dividends into debenture bonds bearing interest and redeemable over a period of thirty years. The company passed a resolution declaring a dividend and offering members debenture bonds bearing interest and redeemable at annual drawings over thirty years. The plaintiff, a member, sought an injunction restraining the company from acting on this resolution as it contravened the articles. One of the articles permitted the directors, with the sanction of the company, to declare a dividend. The directors were also authorised to set aside reserves from the profits of the company for contingencies.

In support of the injunction it was argued that the directors were obliged to pay the dividends which had been declared and that there was no contract with the shareholders to pay them a dividend in shares or bonds. The proposal of the directors was, it was argued, a compulsory loan by way of a dividend at present but payable at an uncertain period in the future.

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1. Ibid 13.
2. (1889) 42 ChD 636 at 641-642.

According to the judgment of Stirling J, although there were profits with which to pay the dividends, the question simply was whether it was in the power of the majority of the shareholders to insist, against the will of the minority, that the profits which had actually been earned be divided, not by the payment of cash, but by the issue of debenture bonds.[1]

The rights of the shareholders in respect of a division of the profits of the company, said the judge, were governed by the articles which in turn were governed by s 16 of the Companies Act, 1862.[2] The articles, he said, constituted a contract not merely between the shareholders and the company, but between each individual shareholder and every other.[3] Therefore the question regarding the manner of disposing of dividends, not by paying same, but by issuing debenture bonds, would be answered in the negative, if there was in the articles a contract between the shareholders as to the division of the profits and the provisions of that contract had not been followed. Stirling J then went on to analyse the articles, and concluded that these provided for payment of dividends in cash and that the proposed debenture bonds were not payments in cash; they were merely promises to pay. The company, he said, had overlooked the fact that the articles constituted an agreement between the members inter se.[4] As the proposals did not accord with the articles, as they stood, the plaintiff was entitled to an injunction relating to the manner of payment of the dividends.[5]

The proposition of Stirling J, that the articles are a contract between the members inter se and between the company and its members, was quoted with approval in the Chancery Division in Salmon v Quin and Axtens Ltd.[6] The matter is reported both in the court of first instance and in the House of Lords, in the name of Quin and Axtens Ltd v Salmon.[7] The management of the

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1. Supra 641.
2. The predecessor of s 20 of The Companies Act, 1948 and corresponding to s 65(2) of the Act.
3. Supra 641-642.
4. Ibidem.
5. Ibid 646.
6. [1909] 1 ChD 311 at 318.
7. [1909] AC 442 HL. See Chapter 8 at 190-191.

company was entrusted to its directors, which included two of the major shareholders who were its managing directors, who had certain powers of veto. When Salmon vetoed a directors' resolution this was referred to a members' meeting and was passed by a simple majority. It was contended that members' resolutions have a higher authority than those of directors. In reply the House of Lords said that "the bargain of the shareholders contained in the articles" laid down a method of managing the business - the directors could not do certain things if Salmon objected.[1] It was therefore held that the members' resolutions were inconsistent with the articles, and that the company be restrained from acting on them.

On this line of cases, culminating in a decision of the House of Lords, there can be no doubt that the articles are considered, in English law, to be a contract between the members inter se.

Why, therefore, has it remained uncertain whether the constitution is or is not a contract between the members inter se?

It is submitted that the answer is to be found in the dissenting judgment of Lord Hershell in Welton v Saffery.[2] This case introduces the second line of cases, namely those which regarded the constitution as being a contract solely between the company and the members, and not between the members inter se.

In this case it was held to be ultra vires for a company to issue shares at a discount even if authorised to do so by the articles. Nevertheless the holders of shares so issued were not thereby relieved from liability in a winding-up, for the amounts unpaid on their shares for the adjustment of the rights of contributories inter se and the company's debts and the costs of winding-up.

Lord Hershell dealt with the validity of the issue of these shares at a discount. In doing so, he considered the rule that although such an issue was invalid it did not prevent the holder of such shares from being liable to contribute to the full amount of the shares for the purpose of paying the

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1. Ibid 443.
2. [1897] AC 299 HL 315 et seq.

creditors of the company. This rule, he said, did not determine the effect of such an issue as regards the shareholders inter se on a winding-up.[1] In his view the Companies Act, 1962 did not hamper the members inter se in regard to their interests in a company, nor did it require them to contribute equally to the funds of the company or share alike in the distribution of its surplus assets.[2] Lord Hershell then considered the provisions of s 16 of the Companies Act, 1862, namely, that the articles bound the company and the members as if each member had signed them and there were in such articles a covenant by each member to conform thereto. The articles thus became in effect a contract by each member and regulated his rights.

He concluded that the statute did not purport to settle the rights of the members inter se, which were only regulated through the company.[3] There was no contract between the individual members of the company; but the articles did not any the less regulate their rights inter se. Such rights could only be enforced by or against a member through the company, but no member had, as between himself and another member, any right beyond that which the contract with the company gave.[4] There was nothing in the statute to prevent the articles of a company providing for different rights attaching to different classes of shares, in respect of either dividends or a distribution of assets on a winding-up.[5] Consequently over and above what was necessary to pay the debts of the company and the expenses of winding-up, there was no need for members to contribute an equal sum to the funds of the company in order to adjust their rights.[6]

To sum up his views, Lord Hershell interpreted s 16 as creating a contract in the articles between the members and the company, but not between the members inter se. Their rights and obligations inter se derive from the contract with the company and can only be enforced through the company.

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1. Ibid 311.
2. Ibid 313.
3. Ibid 315.
4. Ibid 315.
5. Ibid 316.
6. Ibidem.

It is submitted that Lord Hershell erred in his views for the following reasons:

Firstly, he ignored the historical antecedent of the company, namely the joint stock association, which was founded by an agreement between the members inter se.

Secondly, he did not refer to those cases, quoted above, which clearly held that the constitution is a contract between the members inter se.[1]

Thirdly, he erred in saying that s 16 of the Companies Act, 1862 did not purport to settle the rights of the members inter se.[2] It did refer to covenants by the members, although it did not say with whom these covenants are concluded. Nor did it state positively that the constitution was a contract between the members inter se. However, it certainly did not exclude its existence. Having regard to its purpose, it is submitted that the section did not have to create a contract between the members inter se. It has been argued that the purpose of the section is to enable the company to be a party to contracts concluded prior to the company's existence.[3]

Consequently there is no need to state that contracts between the members inter se embodied in the constitution, are binding on them. They are binding under the common law.

The effect of Lord Hershell's view has been, not only to limit the enforceability of rights between the members inter se to actions through the medium of the company, but also to challenge the very existence of a contract between them. Lord Hershell's views have had a considerable impact. They have been quoted in Halsbury.[4] They have also been referred to with approval in two English cases.[5] It is now proposed to deal with these cases in order to indicate the influence of Lord Hershell's views on the concept of the constitution as a contract between the members inter se.

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1. Tavarone Mining Co Re, Pritchard's case (1873) 8 ChApp 956; Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88; Wood v Odessa Waterworks Co (1889) 42 ChD 636 at 642.
2. This section is the predecessor of s 20 of the English Companies Act, 1948, which corresponds to s 65(2) of the Act.
3. As set out in Chapter 2 at 7 et seq.
4. Vol 7 par 119.
5. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA; Greene (deceased) Re, Greene v Greene [1949] 1 All ER 167 ChD.

In the case of London Sack and Bag Co Ltd v Dixon and Lugton Ltd[1] the facts were as follows. Two companies were engaged in a dispute arising out of a contract for the sale of 5000 used cotton flour bags. One of them brought an action against the other, in reply to which the latter sought a stay of action under the Arbitration Act, 1889, s 4. The latter contended that there was a written submission within this act by virtue of the following: both companies were members of another company whose rules were binding on its members; one of these rules provided that all disputes arising out of transactions connected with the trade shall be referred to arbitration; s 20(1)of the Companies Act, 1929 provides for covenants on the part of each member to observe all the provisions of the memorandum and of the articles; both the parties were members of the association; the rule in question, although not included in the articles, was made pursuant to the articles and was thus binding on both the parties. Thus the rule constituted a written submission to arbitration.[2]

These contentions were rejected by the court, on the basis that there can be no written agreement to arbitrate unless the written contract between the parties refers to and incorporates the arbitration clause.[3]

For the contention that s 20 creates a contract between the members of a company inter se, counsel for the appellants relied on Welton v Saffery and other cases.[4] Scott L J,one of the judges in the case, was not satisfied that counsel had interpreted these decisions correctly. "It may well be," said the judge, "even as between ordinary members of a company who are also in a nominal way shareholders, that section 20 adjusts their legal relations inter se in the same way as a contract in a single document would if signed by all; and yet the statutory result may not be to constitute a contract between them about rights of action created entirely outside the company relationship, such as trading transactions between members."[5]

In support of this view the judge quoted Halsbury, to the effect that while articles regulate the rights of the members inter se, they do not

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1. [1943] 2 All ER 763 CA.
2. Ibid 764-765.
3. Ibid 765D-E.
4. [1897] AC 299 HL. The other cases relied on were Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881; Wood v Odessa Waterworks Co (1889) 42 ChD 636; Borland's Trustee v Steel Bros [1901] 1 ChD 279.
5. London Sack and Bag's case supra 765F-G.

constitute a contract between the members, inter se, but only a contract between the company and its members and, therefore, the rights and liabilities of members under the articles can only be enforced by or against the members through the company. Consequently the judge held that any doubt about the written submission being clearly established is a sufficient reason for a judge exercising his discretion against a stay.[1]

The case clearly illustrates the influence of Lord Hershell's view, namely, that there is no contract between the members, whose rights inter se only exist via the contract between each of them and the company and can only be enforced inter se through the medium of the company.[2]

However the judgment went further, stressing that even if, as between shareholding members, there is a written contract for "what may be called the purposes of company law", it does not follow that the rule applies to extrinsic purposes such as individual trading.[3] As to the relevance of this, it will be recalled that it was contended in argument that the written submission was to be found in a rule promulgated in terms of the articles, in terms of which all disputes, arising out of transactions connected with the trade were to be submitted to arbitration.[4]

The judgment concluded by finding that the parties were not ordinary members of the company at all, since they held no shares. Accordingly, even if it were accurately contended that the articles constitute a contract between the members inter se, this principle could not be extended to the parties in this matter. The action for a stay therefore failed.[5]

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1. London Sack and Bag's case supra 765H.
2. Welton v Saffery [1897] AC 299 HL 315.
3. London Sack and Bag's case supra 765H-777.
4. Ibid 764F-G.
5. The judgment suggests that there is a distinction in principle between articles intended to be for company law purposes and others having extrinsic purposes. Such a distinction is novel and is by no means elucidated in the judgment. See Chapter 11 at 260.

   This distinction is not unlike that in the outsider rule between rights given qua members and rights given qua outsiders. See Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900. It will therefore be considered together with the outsider rule. See Chapter 8 at 185-186 and Chapter 11 at 260.

In Greene (deceased) Re, Greene v Greene the facts were as follows.[1] An article providing pre-emption rights to members inter se was amended by special resolution with the result that it did not apply to the case of a director leaving a widow and with the further result that the shares of such a director were deemed to pass on his death to his wife. One of these directors died intestate, leaving a widow and children. The board of directors of the company resolved that the widow be registered as the holder of the shares and registration was made accordingly. The executor of the deceased director disputed this registration, claiming that the shares fell into the deceased estate of the director in question, to be divided equally on intestacy between the widow and the children of the deceased. In an action by the executor testing the validity of the registration the court held that the article in question as amended was contrary to s 63 of the Companies Act, 1929, (now s 75 of the Companies Act, 1948). This section prohibits the registration of a transfer of shares unless a proper instrument of transfer has been delivered to the company. As there was no such instrument of transfer the registration was invalid.[2]

It was further contended on behalf of the widow that as between herself and the other beneficiaries on intestacy that there had been a donation to her by the deceased of these shares or alternatively that a trust had been created in her favour by the resolution amending the article in question. Both these contentions were rejected by the court.[3]

The widow also sought to rest her claim on a contract. She relied for this on s 20 of the Companies Act, 1920 whereby the articles constitute a contract between the members. "The answer to this", said the judge, "is that such a contract could only be enforced by or through the company: Welton v Saffery [1897] AC 315; and an article which is, as I have held, ultra vires the company clearly cannot be so enforced."[4]

Then the widow argued that there was a contract between the deceased and the other directors that each of them would, in consideration of a reciprocal promise by the others of them, dispose of his shares in favour of his widow.

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1. [1949] 1 All ER 167 ChD.
2. Ibid 169.
3. Ibid 170A.
4. Ibid 170C-D.

The court held that there was no such contract, and that the widow who was no party to it, could not enforce it, had it existed.[1]

The cases under review reveal a divergence of opinion on the existence and enforceability of a contract between the members inter se. On the one hand is a line of cases, consisting of Welton v Saffery;[2] London Sack and Bag Co Ltd v Dixon and Lugton Ltd;[3] and Greene(deceased) Re, Greene v Greene.[4] These cases deny the existence of this contract. They consider that members' rights and obligations inter se derive only from the contract with the company and can only be enforced through the medium of the company.

On the other hand is another line of cases, consisting of Pritchard's Case[5]; Eley's case;[6] Browne v La Trinidad;[7] Wood v Odessa Waterworks Co;[8] and Quin and Axtens Ltd v Salmon.[9] In these cases the courts, particularly the House of Lords in the last-mentioned case, held that the constitution is a contract between the members inter se.

This, then, is the background to Rayfield v Hands.[10] It is the third stage of the cases, restoring the notion that the constitution is a contract between the members inter se. In Rayfield v Hands the plaintiff was the registered holder and beneficial owner of fully paid ordinary shares in the capital of a company. The defendants were also members of the company and were at all material times its sole directors.[11] One of the articles of the company provided that every member who intended to transfer shares "shall inform the directors who will take the shares equally between them at a fair value."[12] The plaintiff informed the defendants in writing as the directors of the company of his intention to transfer his shares to them in terms of the articles. The defendants contended that they were not liable to take and pay for the plaintiff's shares.[13]

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1. Ibid 170D-E.
2. Supra.
3. Supra.
4. [1949] 1 All ER 167 ChD.
5. Tavarone Mining Co Re, Pritchard's Case [1873] 8 ChApp 956.
6. Eley v Positive Government Security Life Assurance Co [1876]1 ExD 20 and 88.
7. [1887] 37 ChD 1.
8. [1889] 42 ChD 636.
9. [1909] AC 442 HL.
10. [1958] 2 ALL ER 194 ChD.
11. Supra 195D-E.
12. Ibid 195I.
13. Ibid 196B-D.

Gower has set out two of the arguments advanced for the plaintiff.[1]

The most difficult part of plaintiff's case, says Gower, was to persuade the judge that an article of association which provided that directors should purchase a member's shares imposed obligations on the directors, not qua directors, but qua members. Counsel argued that qua directors it was immaterial to them who owned the shares, but qua members they were precisely the particular members whom one would expect to be the buyers of shares in a private company, for they alone had access to the books, could assess prospects and determine policy. The article was, therefore, selecting a particular category of members as purchasers, viz. those members who were directors, just as it might have designated male members or those who held ordinary shares.

Counsel's second problem, says Gower, was to persuade the judge that, notwithstanding the dictum of Lord Hershell in Welton v Saffery, an article could constitute a contract directly enforceable by one member against another. Counsel relied for this purpose on s 56 of the Law of Property Act, 1925, saying that Lord Hershell's opinion had been outmoded by statute. He also argued that the article in question might found a contract quite independently of s 20 of the Companies Act. The directors, he argued, relying on Carlill v Carbolic Smokeball Co,[2] made a continuing offer to the other members for the time being to purchase any shares tendered for sale by those members, an offer which could be turned into a binding contract by acceptance. Hence, ran the argument, the member-directors had undertaken to purchase in accordance with the articles by which all members were bound on joining the company.

Vaisey J, the judge in the case, having set out the facts, first of all dealt with the defence of the directors, namely that the article in question

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1. Gower L C B : Rayfield v Hands - A Postscript and a Drop of Scotch (1958) 21 MLR 657. This method of dealing with this case is adopted in order to seek some clarity and order in the judge's line of reasoning, that is, by relating it to the submissions made to him. Comments on the judgment will be added in footnotes, but only in the nature of very tentative indications of his reasoning. However, when all is said and done, one can only deal seriatim with the erratic road followed in the judgment to what was in fact a sound conclusion.

2. [1893] 1 QB 256 CA.

imposed no enforceable liability on them. They contended that the words "the directors will take the shares", suggested an option on the part of the directors - a contention which the court rejected. The article, said the judge, imposed a mutual obligation, one on the member to give notice to the directors of his intention to transfer the shares, the other on the directors to buy them.[1] The article ought to be construed so as to validate it and in that spirit it created an enforceable obligation.

Vaisey J then dealt with the further point taken by the defendants, that the articles, and this article in particular, did not create a contractual relationship between the plaintiff as shareholder and vendor and the defendants as directors and purchasers.[2] This point depended on s 20(1) of the Companies Act, 1948. The judgment noted that there had been a number of apparently conflicting judicial decisions, as to the exact nature of the contractual relations established by the articles, both as between the company and the members and as between the members inter se. It also noted that there were decisions and dicta to the effect that the articles did, and also that they did not, constitute a contract between the members inter se. It also noted the statement of Lord Hershell in Welton v Saffery that there was no contract in terms between the individual members of the company; but that the articles did not any the less regulate their rights inter se.[3] This statement was considered by Vaisey J to be "somewhat cryptic".

The question, said the judge, was whether the article related to the rights of the members inter se, or whether the relationship was between a member as such and directors as such.[4] In his view, this relationship was one between the plaintiff as a member and the defendants, not as directors, but as members. In support of this conclusion the judgment quoted Leicester Club and Country Racecourse Co Re,[5] where the court had held that the directors continued to be members and that they were unable to divest themselves of their character as members of the company. Vaisey J said that he was of the

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1. Rayfield v Hands [1958] 2 All ER 194 ChD 196C-F.
2. Ibid 197B.
3. [1897] AC 299 HL 315.
4. Rayfield v Hands supra 198A.
5. (1885) 30 ChD 629.

opinion therefore that the contract before him was a contract or quasi-contract between members, and not between members and directors.[1]

The judge then indicated that he proposed to deal with the point that the articles create a contract between the company on the one hand and the members on the other, so that no relief can be obtained in the absence of the company as a party to the suit.[2] Presumably the relief referred to was as between the members. This brought Vaisey J face to face with the obstacle created by Lord Hershell's judgment in Welton v Saffery.[3] It also led him to deal with two arguments raised by plaintiff's counsel on the point. The first of these arguments, already mentioned, was that Lord Hershell's views had been rendered outmoded by s 56 of the Law of Property Act, 1925.

Vaisey J dealt with this argument by saying that the defendant's case was met by two cases.[4] These cases, he said, laid down the principle that where a covenant had been made, not by or with, but for the benefit of the plaintiff he could, therefore, sue without the intervention of the covenantee. It would appear that Vaisey J was prepared to accept Lord Denning's view that it is possible, in the light of the section referred to, to allow a stipulatio alteri despite the clear English law prohibition.[5]

This would presumably, enable the contract between the company and the member to contain a stipulation for the benefit of a third, namely the other member. The latter could, therefore, by accepting the benefit of same, enter into a contract with the first member.

The second argument for plaintiff, also in relation to Welton v Saffery was that the article might found a contract quite independently of s 20 of the Companies Act, a contract formed by a general offer to all members to purchase their shares, an offer which stood open for acceptance by any member

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1. Rayfield v Hands supra 198C.
In other words the plaintiff's first contention, (or was it the defendant's) was upheld. Vaisey J then proceeded to deal with the second contention for the plaintiff, namely that despite Welton v Saffery the article was a contract between the members inter se, directly enforceable without the intervention of the company.
2. Supra 198C-D.
3. [1897] AC 299 HL.
4. Smith v River Douglas Catchment Board [1949] 2 All ER 179 CA and Drive Yourself Car Hire Co (London) v Strutt [1953] 2 All ER 1475 CA.
5. The English law on the stipulatio alteri is set out below at 63 et seq. Lord Denning's view on the subject were not accepted by the House of Lords. Scruttons Ltd v Midland Silicones Ltd [1962] 1 All ER 1 HL 16.

at any time. The judge said of this argument, that it rested on the well-known decision of Carlill v Carbolic Smoke Ball Company.[1] He dealt with this argument by saying that he need not refer to the case except to say that it seemed to him to be relevant.[2]

Although Vaisey J apparently decided to circumvent Welton v Saffery in this way, that is by means of a stipulatio alteri, it seems that counsel also persuaded him to adopt a conclusion directly opposed to Lord Hershell's views. This appears to be the case because Vaisey J then said that he had considered Lord Hershell's dissentient speech in Welton v Saffery[3] and the comprehensive review of the earlier authorities by Astbury J in Hickman v Kent or Romney Marsh Sheepbreeders' Association[4] and that among the numerous dicta cited in the latter judgment one of the most helpful and convincing was that of Mellish L J in Pritchard's Case.[5] He then quoted from the latter case as follows : "... the articles of association are simply a contract between the members inter se in respect of their rights as shareholders. They are the deed of partnership by which the shareholders agree inter se." This quotation contains the principle in Rayfield v Hands. All the rest is commentary.

Then the judgment referred to the facts in Dean v Prince,[6] a case in which no reference was made to s 20. Vaisey J noted that there a dispute arose out of a valuation of shares arising out of an article which provided that a deceased director's shares should be purchased by the surviving directors at an auditor's valuation. There was, said Vaisey J, a close similarity between the two cases and although the point under s 20 was not taken in Dean v Prince it was not overlooked since the decision was one of the Court of Appeal.

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1. [1893] 1 QB 256 CA.
2. Rayfield v Hands [1958] 2 All ER 194 ChD 198E-F.
3. [1897] AC 299 HL 315 (thereby continuing to deal with plaintiff's second point).
4. [1915] 1 ChD 881
5. Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956.
6. [1954] 1 All ER 749 CA (It seems that the reference to the case may have been a continued reference to plaintiff's second contention, taking the facts to be analogous and the conclusion to be similar.)

Vaisey J then referred "in passing" to Borland's Trustee v Steel Bros where a provision in the articles compelled a shareholder to transfer his shares at any time to particular persons at a particular price.[1] Vaisey J noted that Farwell J had observed in that case that the articles were a contract between the shareholders under s 16 of the Companies Act, 1862.[2]

Vaisey J then repeated the view that the proper way to construe the constitution was as a commercial or business document which should be validated if possible. He also noted that in the case of Dean v Prince[3] none of the judges showed any signs of shock or surprise in the assumption being made of a contract between directors being formed by the terms of a company's articles.[4] He therefore felt encouraged to find in the present case a contract similarly formed between a member and member-directors in relation to their holding of the company's shares in its articles.

Then the judge said that his conclusion might not be of so general an application as to extend to the articles of association of every company since this was a private company bearing a close analogy to a partnership.[5] In the result the directors were held to be obliged, in their capacity as members, to purchase the shares offered to them by the plaintiff members.

Wedderburn has written on Rayfield's case.[6] Gower too, has commented on it.[7] Both have welcomed the decision and the conclusion that s 20 makes a contract between the members inter se, enforceable without the intervention

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1. [1901] 1 ChD 279.
2. This section corresponded at that date with s 20 of the English Companies Act, 1948 and s 65(2) of the Act. The case of Borland's Trustee, supra, was of course highly relevant to plaintiff's second contention and in strong support of it. In fact it offered a better avenue to circumvent Welton v Saffery than either s 56 or the general offer of Carbolic Smoke Ball's case. It therefore deserved more than a passing reference. This was in fact its proper place in the judgment. Vaisey J seems to have concluded his observations of plaintiff's second contention at this point. The next point he makes, in fact, harks back to the plaintiff's first contention.
3. [1954] 1 All ER 749 CA.
4. Rayfield v Hands [1958] 2 All ER 194 ChD 198H.
5. Ibid 199I.
6. Wedderburn K W : Effect of Articles as a Contract - remedy against Directors (1958) CLJ 148.
7. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 (This will be referred to as "the first note").
   ——— Rayfield v Hands - a postscript and a drop of Scotch (1958) 21 MLR 657 (This will be referred to as "the second note").

of the company. Both considered this conclusion to have been unsupported by the cases quoted, to have been arrived at by a devious route, and by arguments which are not wholly convincing.

The major criticism expressed by Wedderburn is that the obligation rested on the directors, qua directors, and not qua members and was therefore unenforceable under the outsider rule.[1]

Gower, in his first note, agreed with this criticism. He said there that the only way to reconcile the decisions with the earlier cases was to formulate the test, not in terms of the capacity of those on whom it purported to confer rights or duties, but on whether its exercise affected them as members.[2] He also suggested that the earlier authorities could be distinguished on the basis that they referred to non-members qua non-members and not qua members. However, in the second note Gower changed his mind, having had access to council's arguments: the article, he said, selected a category of members, namely, those who were directors; this could not be the answer where the directors did not have to be members; nor did it follow that every director would hold the necessary share qualification at the appropriate time; nor would this argument be as strong in a public company where the directors were not the obvious buyers.[3]

Both Wedderburn and Gower reject the proposition of Vaisey J that his conclusion might not apply to every company since the case concerned only a private company analogous to a partnership. If this means, they say, that this article was only likely to be found in private companies, there would be no quarrel with this. If, however, it meant that s 20 differed in its effect as between public and private companies, there was nothing in the section which supported such a conclusion.

Both writers consider that reliance by Vaisey J on Leicester Club's case was unfortunate.[4] To equate directors with a sub-species of members was,

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1. The outsider rule is to be found in Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881. Much of this thesis is devoted to the outsider rule, which need not be canvassed at this stage. It will be submitted that Rayfield v Hands had nothing to do with the outsider rule. See Chapter 9 at 223.
2. First note supra 402.
3. Second note supra 658.
4. Leicester Club and Country Racecourse Co Re (1885) 30 ChD 629 at 633.

false. Directors were not merely working members. They need not be members at all. However, Gower, in the second note, changed his view on this aspect as well. The case was merely quoted to illustrate that a reference to directors in the article in question need not necessarily refer to them in that capacity.

The manner in which Vaisey J sought to find that an article may constitute a contract enforceable by one member against another, notwithstanding the dictum of Lord Hershell in Welton v Saffery, is also criticised by both writers. The reference to s 56 of the Law of Property Act, 1925 and Lord Denning's dicta thereon, which suggest that the section had destroyed privity of contract, is rejected by Wedderburn on the ground that the section suggested no such reform and that this was no way to solve a company law problem. It is also submitted that s 56 of the Law of Property Act was not intended to amend s 20 of the Companies Act, 1948.

The notion that Carbolic Smoke Ball's case could be used to found a contract independently of s 20 was also rejected.[1] Both writers consider the remarks of Vaisey J, that this case was relevant, to be unclear. Gower presumes that it meant that this provision in the articles was a general offer by each member to every other member which was accepted either by joining the company or offering the shares for sale. This, he says, begged the whole question, which was whether the offer was deemed to be made by the company or by the members, or both.

Gower considers that the reference to Dean v Prince was the frailest straw of all.[2] It was far fetched to suggest that this could be regarded as any authority for the proposition that the article constituted a contract which one member could enforce against the other, since neither party had argued that he was not bound by the article and the case turned only on a question of fair value of the shares in question.

These writers nevertheless welcome the conclusion in Rayfield v Hands and the end to the uncertainty on the point. As Gower says, it was a conclusion which was supported by the wording of s 20, construed in the light of its history, and on dicta not quoted in the judgment, rather than the arguments adduced by the learned judge.

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1. Carlill v Carbolic Smoke Ball Co [1893] 1 QB 256 CA.
2. The learned writer's view is to be found in Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 at 403. The case referred to by him is Dean v Prince [1954] 1 All ER 749 CA.

The criticisms of these two eminent writers are, of course, well founded. Vaisey J undoubtedly touched on irrelevant topics which had been raised in argument before him such as the article as a general offer; or s 56 of the Law of Property Act, 1925. In addition, his judgment is both disjointed and obscure. Furthermore, he failed to deal with the problem as a matter of principle with due regard to the authorities. The problem, he correctly observed, was whether the article created a contract between the plaintiff as shareholder, and the defendants as directors and purchasers, a problem to be resolved in terms of s 20(1) of the Companies Act, 1948.[1] The solution could have been arrived at through the following reasoning.

The first step is to note that, historically, the constitution had always been a contract between the members inter se, to which, by the process of registration, the company was grafted as a separate legal entity. This conclusion is well supported by authority, more particularly Pritchard's Case[2] and Borland's case[3], (both of which Vaisey J quoted), Eley's case[4], Browne v La Trinidad[5], Wood v Odessa Waterworks Co,[6] and most important of all, the decision of the House of Lords in Quin and Axtens Ltd v Salmon.[7]

The second step is that, on incorporation of the company, in terms of s 20, its constitution is a contract both between the members inter se and also between the company and its members.

The third step is to note the apparently conflicting judicial decisions in regard to the problem, in particular Lord Hershell's judgment in Welton v Saffery.[8] Then the reasoning in the latter case is to be rejected, on the grounds set out previously in this chapter,[9] in favour of the high authority of Quin and Axtens v Salmon.[7]

The fourth step (which was taken by Vaisey J) was of course, to construe the article as binding on the directors qua members, and not qua directors. But for this, the case would have fallen for consideration under the outsider rule.

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1. This is the English equivalent of s 65(2) of the Act.
2. Tavarone Mining Co Re, Pritchard's case (1873) 8 ChApp 956.
3. Borland's Trustee v Steel Bros [1901] 1 ChD 279.
4. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88.
5. (1887) 37 ChD 1.
6. (1889) 42 ChD 636.
7. [1909] AC 442 H.
8. [1897] AC 299 HL.
9. See 38 above.

Vaisey J qualified his conclusion that the articles were a contract between the members inter se by observing that it may not extend generally to all companies since this was a private company analogous to a partnership. Both Wedderburn and Gower rejected this, saying that if it meant that s 20 differs in its effect as between public and private companies, there was nothing in the section which supports this conclusion.

There is no doubt that this criticism is valid. It has previously been observed that the contracts contained in the constitution are created by a statutory fiction.[1] In the case of a small private company it may be possible to find a consensual contract, actually concluded. In the large public company, with thousands of members, this is most unlikely. Nevertheless the statutory fiction applies in both situations so that even in the latter, a contract is presumed to exist between the members inter se, although there may be no meeting of their minds and although the membership may be constantly changing.

In English law there is no doubt, today, that the constitution is a contract between the members inter se which is directly enforceable by the members without the intervention of the company.

2.2 South African law

It is now proposed to trace the South African cases and company law text-books on the question whether the constitution is, or is not, a contract between the members inter se. Regard will be had to the English authorities and the extent to which they agree with, or differ from, the South African viewpoint, with particular reference to any South African reaction to Welton v Saffery[2] and to Rayfield v Hands.[3]

In South African law Ross and Co v Coleman contains the first comment on the parties to the contract in the articles.[4] The facts were as follows. The plaintiff was one of three directors nominated as such in terms of an

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1. Chapter 2 at 11 and 17.
2. [1897] AC 299 HL. See 36 above et seq.
3. [1958] 2 All ER 194 ChD. See 42 above et seq.
4. 1920 AD 407 at 408 and 418.

article and entitled under that article to retain office for five years. The articles also provided for remuneration for the directors. As a result of tension between some of the directors, a special general meeting of members passed a special resolution in terms of which the remuneration of directors was henceforth to be settled by the company from time to time at its annual general meeting. The plaintiff, a director who had received an annual salary as a full-time director, protested and voted against this resolution and thereafter resigned as director and brought an action for damages for wrongful dismissal.

Innes C J considered whether the plaintiff was entitled to any relief under the circumstances. The first question he considered was whether the alteration was valid in itself. The company was registered under the Ordinance of the Orange Free State, 24 of 1904, which required a memorandum of association but said nothing about articles.[1] However, the articles themselves provided for alteration by special resolution.

The second question was whether such an alteration was an infringement of the plaintiff's rights. Such an alteration would not justify a breach of the company's obligations. In other words, was there any contract between the plaintiff and the company and, if so, had the plaintiff acquired a vested right to remuneration as a director in the future? An agreement between the plaintiff and the company was admitted by the parties. The dispute was as to its terms and scope. Innes C J indicated that he did not propose to discuss in detail the English cases, which were not all harmonious. Furthermore, the position was not complicated by any obscure statutory provision.[2] This was, no doubt, a reference to s 16 of the English Companies Act, 1906, and to the fact that the matter was governed by the Ordinance of the Orange Free State, 24 of 1904, which required a memorandum but said nothing of articles.

"Articles of association", he said, "are, in themselves, merely an agreement between the shareholders inter se."[3]

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1. Ibid 416.
2. Ibid 417.
3. Ibid 418.

These articles were subject to amendment at the will of a specified majority, expressed in the prescribed manner. What is more, they were incorporated by implication into the contract between the company and the director. This contract was subject to the amendment of the articles, save where the amendment amounted to a breach of contract. In the instant case an amendment did not amount to a breach. The contract was accordingly altered by the amendment thereby depriving the plaintiff of his right to future remuneration.[1] In the result the action for damages failed. Furthermore the plaintiff's claim for services rendered prior to the alteration also failed because under the articles prior to the amendment, the directors alone had the right to decide what the plaintiff should receive. No such decision had been made when the amendment was passed, depriving the directors of this right.[2]

The relevance of the case for the present purposes lies in the statement of Innes C J that the articles are merely an agreement between the members inter se.[3] The importance of the case is considerably diminished by the fact that the company in question was incorporated under the Ordinance of the Orange Free State, 24 of 1904, which contained no statutory provision akin to s 65(2) of the Act.[4] Nor did it make provision for articles of association.

There are no other reported cases on this question prior to 1958.[5] However the company law text-books in South Africa cast some light on the prevailing opinion on the point prior to Rayfield v Hands.

Pyemont, in dealing with s 16 of Act 46 of 1926, said that the intended effect of this section is to create an obligation binding alike on the members in their dealings with the company, on the company in its dealings with the members as members, and on the members in their dealings with one another as members.[6] As authority for the latter proposition he quoted Eley's case.[7]

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1. Ibid 418-419.
2. Ibid 420.
3. Ibid 418.
4. Ibid 417.
5. This was the year in which Rayfield v Hands was decided.
6. Pyemont 36. This section is the predecessor of s 65(2) of the Act. Pyemont has consistently held this view through several editions since 1926.
7. Ibidem.

On the other hand, the shareholder was not bound in his personal capacity and furthermore the purpose of the memorandum and articles was to define the position of the shareholder as shareholder, not to bind him in his capacity as an individual.[1] For this proposition he relied on Bisgood v Henderson's Transvaal Estates Ltd.[2] He also quoted in support thereof Hickman v Kent or Romney Marsh Sheepbreeders' Association.[3]

Henochsberg stated that the question as to how far the memorandum and articles constitute a binding contract between a company and its members on the one hand and between its members inter se on the other hand, is one of great difficulty and is not altogether clear.[4] Henochsberg quoted in support thereof from both Hickman's case and Eley's case.[5] Furthermore he said, while the articles are a contract between the company and its members they did not constitute a contract between the members inter se although they did regulate their rights inter se. For this proposition he relied, inter alia, on Welton v Saffery.[6]

Hahlo's view at that stage was that the memorandum and articles constituted a contract between the company and its members and also regulated the rights of members inter se.[7]

None of these writers referred at all to Ross and Co v Coleman.[8] Both Henochsberg and Hahlo took for granted the proposition in Welton v Saffery[9] that there is no contract between the members inter se whose relationship is nevertheless regulated by the memorandum and articles, to be enforced

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1. Ibidem.
2. [1908] 1 ChD 743 at 759.
3. [1915] 1 ChD 881.
4. Henochsberg E S : On the Companies Act (First Edition Durban 1953) 47.
5. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881; Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88.
6. [1897] AC 299 HL.
7. Hahlo H R : Company Law through the Cases (First Edition Cape Town 1958) 43.
8. 1920 AD 408.
9. Supra.

through the medium of the company.

Despite the views of these authors the judgment of Potgieter J in De Villiers v Jacobsdal Saltworks stated clearly that the articles constitute a contract between the company and its members, and between the members inter se, but only in their capacity as members.[1] In this case, the nature of the pleadings and of counsel's arguments appears from the judgment of Potgieter J.[2] It is, therefore, convenient to deal first with his judgment and then with that of Botha J.

The matter was heard as an exception taken against the plaintiff's declaration as disclosing no cause of action. The plaintiff's claim was for damages arising out of a breach of contract between himself and the defendant company. According to the declaration the plaintiff was in terms of the articles a director of the defendant company. Under the articles the original directors were entitled to be directors as long as they each held 25 per cent of the issued shares of the company and on the death of each of them the eldest son would take the place of his father as long as 25 per cent of the shares were held by various persons.[3] It is not certain whether the plaintiff was one of such persons, an important and unanswered question, important, because it leaves the question of the plaintiff's membership an open one. No allegation of his membership was made.

It was then alleged in the declaration that, pursuant to the provisions of the articles and in terms thereof, the plaintiff was appointed a director, his appointment being governed by and subject to the conditions contained in the said articles, which formed the basis of the contract by which he was appointed a director. At all relevant times he remained qualified to be a director.[4]

By a special resolution the articles were superseded by new articles, which were duly registered, as a result of which the plaintiff ceased to be a director on the terms of his initial appointment and was in fact no longer a director.[5] As Potgieter J summed up the matter, the original articles were superseded by new articles the effect whereof was that the plaintiff

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1. 1959(3) SA 873 (O) 876H. See also Chapter 12 at 263-264.
2. Ibid 875 et seq.
3. Ibid 875D-G. The various persons were the wife, trustee, heirs or legatees of the deceased original director.
4. Ibid H.
5. Ibid 876A.

was no longer a director for life but was subject to election like all the other directors.[1]

In reply to a request for further particulars the plaintiff averred that the contract referred to in the declaration was his appointment as a director, which appointment was subject to the terms and conditions contained in the articles of association.[2]

In arguing the exception, the defendant's counsel made two submissions. Firstly, the articles had no contractual effect in so far as they purported to confer rights or obligations on a member otherwise than in his capacity as such.[3] This proposition was conceded by counsel for the plaintiff.[4]

Potgieter J, in dealing with this point referred to Eley's case,[5] Browne v La Trinidad,[6] Hickman's case,[7] and Beattie's case.[8] It was clear from these decisions that the articles of association of a company did not create a contract between the company and a member except in his capacity as a member. "The articles constitute a contract between the members inter se and between the company and the members but only in their capacity as members. They do not for instance constitute a contract between the company and a director in his capacity as such."[9]

The second submission for the defendant was that in the absence of a contract outside the articles, whatever contract might be embodied in the articles was subject to alteration by an alteration of the articles, for the contract derived its force and effect only from the articles.[10] Plaintiff's counsel agreed with this contention, but urged that the declaration alleged a contract which consisted of plaintiff's appointment as director pursuant to the articles, the said appointment being governed by and subject to the conditions contained in the articles. That contract might be capable of the construction that the parties also agreed that no subsequent alteration of the articles would affect the terms of plaintiff's appointment as director.[11]

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1. Ibidem.
2. Ibid 876C-D.
3. Ibid D.
4. Ibid 877D.
5. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88.
6. (1887) 37 ChD 1.
7. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881.
8. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA.
9. De Villiers' case supra 877A.
10. Ibid 876E-F.
11. Ibid F-H.

Potgieter J after noting that this submission for the excipient was not alternative to, but flowing out of the first, considered several English cases upholding this proposition, and then held that in the present case no special contract outside the articles was alleged, but one wholly governed by the articles.[1] In other words there was no agreement preventing any subsequent alteration of the articles from amending the terms of plaintiff's appointment as director. In the result the exception was upheld.

Botha J P agreed with this approach. He held that it was clear that, while in terms of s 16 of the Companies Act, 46 of 1926 a company's articles of association bound the company and the members thereof to the same extent as if they had been signed by each member, nevertheless no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, for instance, as solicitor or director, could be enforced against the company.[2]

The relevance of the case to the present topic is, of course, the statement of Potgieter J that the articles constituted a contract not only between the company and the members, but also between the members inter se, but only in their capacity as members.[3] In the Appellate Division, Trollip J A referred to these words, obviously with approval, and then said "the articles therefore merely have the same force as a contract between the company and each and every member as such to observe their provisions".[4] There seems to

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1. Ibid 877A-878G particularly at 878F-G.
2. Ibid 873-874A. In support of this proposition he quoted both Hickman's case supra and Beattie's case supra.
   He then proceeded to deal with the proposition, which is not germane to the present enquiry, that a person might enter into a contract with a company in terms of one or more of the articles which could then by reason of the resulting contractual relationship between the company and such person be enforced by the latter against the company. The contract was on the basis of an alterable article, the alteration of which in terms of the statute, could not be a ground for complaint, although it could lead to damages if such alteration was inconsistent with the existing agreement. See De Villiers' case supra 874A-875.
3. De Villiers' case supra 876-877. See also Chapter 12 at 263-264.
4. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970(2) SA 685 (A) 692F-G. See Chapter 4 at 78 et seq. See also Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 528 and Chapter 12 at 272 et seq.

be no room for doubt that Trollip J A would, if the need arises, include, in this proposition the contract in the constitution between the members inter se.

The statement by Potgieter J in De Villiers' case appears to have been made en passant, in the course of commenting on the effect of Eley's case, Browne v La Trinidad and Hickman's case.[1] It is not surprising, therefore, that there is no reference in the case to Welton v Saffery,[2] or the existence of a controversy regarding the contract in the constitution between the members inter se, or that it was finally settled in Rayfield v Hands.[3]

In the case of Isaacs, Geshen and Co (Pty) Ltd v Ellis the matter is also referred to briefly.[4] Caney A J P there commented on the right of a member to enforce certain rights under the articles as against another member who was acting in a manner which infringed those rights. "Then comes the question", he said, "whether any member, including applicants, became entitled to enforce his rights under the provisions under consideration otherwise than against or through first respondent.[5] In my judgment he could not bring proceedings against any member in occupation in disregard of the provisions of the articles, ... at any rate before third respondent has allocated a space to such a member."[6]

This appears to support the proposition in Welton v Saffery.[7] However, this conclusion is qualified. The member could not act against another member before the company had allocated a space to him. Thereafter, presumably, he could act against the other members without the intervention of the company.

In the second edition of his book, Henochsberg made no reference to De Villiers' case.[8] He did, however, repeat a view in disagreement with that case, namely that the articles do not constitute a contract between the members inter se, whose rights and liabilities as members can only be enforced by or against the members through the company. In spite of this he referred to Rayfield v Hands[9] where, he said, it was held to be unnecessary to join the

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1. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O) 876H.
2. [1897] AC 299 HL.
3. [1958] 2 All ER 194 ChD.
4. 1964(2) PH A59 at 293. See below at 66 et seq.
5. The first respondent was the company.
6. Supra 299.
7. [1897] AC 299 HL.
8. Henochsberg E S : On the Companies Act (Second Edition Durban 1963).
9. [1958] 2 All ER 194 ChD.

company in an action between the members inter se. In the latest edition of his book, Henochsberg, in dealing with s 65(2) quotes extensively from De Villiers' case and from Gohlke's case.[1] In regard to the contract embodied in the constitution between the members inter se he refers to the inconsistent English cases as well as "the valuable judgment of Vaisey J in Rayfield v Hands" which clearly and correctly (in the view of the learned author) favoured the view that the articles do constitute a contract between the members, as such, inter se.[2]

Cilliers Benade De Villiers observe that the question whether the articles can be regarded as a contract between the members inter se had long been in dispute. They acknowledge the affirmative answer in Rayfield v Hands. In South Africa it had been unequivocally stated in De Villiers v Jacobsdal Saltworks that members in their capacity as such were in fact contractually bound inter se.[3]

Hahlo quotes both Welton v Saffery and Rayfield v Hands.[4] The articles constituted a contract between the company and its members and regulated the rights of the members inter se.[5] However, in so far as the articles amounted to a contract between the members inter se, they might be enforced by direct action between the members.[6]

To sum up, therefore, South African academic writers have acknowledged and approved of the answer to the problem given in Rayfield v Hands.[7]

As far as the cases go, both Ross and Co v Coleman[8] and De Villiers'[9] case make it indisputable that the constitution is a contract between the members inter se. It follows without doubt, that it can be enforced by direct action between the members inter se. On the other hand, in Isaacs, Geshen's case, it was stated that a member could not bring any proceedings against other members

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1. Henochsberg 119-122.
2. Ibid 122.
3. Cilliers Benade De Villiers 39.
4. Hahlo 90-91.
5. Ibid 89.
6. Ibid 92.
7. [1958] 2 All ER 194 ChD. See 42 et seq above.
8. 1920 AD 408 at 417-418.
9. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O). See 55 et seq above.

to enforce provisions of the articles otherwise than through the medium of the company, at any rate, until the company had taken certain steps under the articles.[1]

2.3 Conclusion

The existence of a contract between the members inter se arising out of the constitution, is now beyond doubt. It arises as a result of the incorporation of the company and the operation of the statutory rules regulating the manner in which membership of the company is attained and terminated.[2]

It does not rest on consensus between the parties to the contract, although this may be present on the facts. Apart from the company the parties to the contract change as the names on the register of members alter. It is, in fact, a contract imposed on the parties by law. It is nevertheless universally regarded as a contract. No attempt has been made to place it in the category of quasi-contracts in which, it is submitted, it might also be placed, without doing violence to the concept of the latter.

3. The contract between the company and its members

3.1 English law

Both s 20(1) of the English Companies Act, 1948 and the English cases thereon have been dealt with in the preceding section so that there is no need to repeat them. Suffice it to note that in the nineteenth century there was a view, widely held, that the articles were not a contract between the company and its members but only between the members inter se. This was the view in Tavarone Mining Co Re, Pritchard's Case;[3] Eley v Positive Government Security Life Assurance Co[4] and Browne v La Trinidad.[5] It was later, however, clearly stated that the constitution is a contract between the members and the company. The two leading cases for this proposition are Wood v Odessa Waterworks Co.[6] and Salmon v Quin and Axtens Ltd.[7]

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1. Isaacs, Geshen and Co v Ellis 1964 (2) PH A59 at 293. See 58 above et seq.
2. S 103 of the Act.
3. (1873) 8 ChApp 956.
4. (1876) 1 ExD 20 and 88.
5. (1887) 37 ChD 1.
6. (1889) 42 ChD 636.
7. [1909] 1 ChD 311; [1909] AC 442 HL.

One explanation for the early view, that the constitution is not a contract between the company and its members, may be that the company developed from the partnership and contractual concepts of the joint stock association which was purely a contract between the members inter se.

Another is the incomplete recognition, during the nineteenth century, of the emergence of the company as a separate juristic entity. It was not until 1897 that Lord Halsbury declared in Salomon's case, that a company must be treated "like any other independent person with its rights and liabilities appropriate to itself."[1]

Whatever explanations there are for this confusion, the matter was capable of an easy solution. S 20 of the English Companies Act, 1948 and its predecessors, state quite clearly that the constitution contains covenants on the part of each member and that it binds the company.

3.2 South African law

As in the case of the English law, so too in regard to South African law, there is no need to traverse all the authorities. The only case which did not hold the view that the constitution is a contract between a member and the company was Ross and Co v Coleman.[2] Innes C J said in the Appellate Division that the articles were not a contract between the plaintiff (a member) and the company. "Articles of Association," he said, "are in themselves merely an agreement between the shareholders inter se."[3] No attention has been paid to this case in this context, presumably because, as previously mentioned, it was not decided in terms of s 16 of Act 46 of 1926.[3]

Cilliers Benade De Villiers hold the view that it is generally accepted today that the memorandum and articles constitute a contract between the company and its members.[4] Henochsberg says of s 65(2) that its terms are substantially similar to those of the corresponding sections of successive English Companies Acts.[5] He quotes from Gohlke's case, the conclusion that the constitution

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1. Salomon v Salomon and Co Ltd [1897] AC 22 HL.
2. 1920 AD 408.
3. Ibidem. See above at 51-53.
4. Cilliers Benade De Villiers 37.
5. Henochsberg 120.

is both a contract between the company and its members and between the members inter se.[1] Other writers hold the same view.[2] This view was clearly stated in De Villiers'[3] case, in Gohlke's[4] case, and in Rosslare's[5] case.

3.3 Conclusion

The early problems of recognition of the contract between the company and its members coincide roughly with the difficulties attendant on the recognition of the company as a separate corporate entity.[6] Apart from this difficulty, there has been no controversy at all, concerning the existence of this contract.

4. The contract for the benefit of a third party

4.1 Introduction

In South African law it is permissible for two persons to enter into an agreement which is intended to enable a third person to come in as a party to a contract with one of the others.[7] The question has been raised whether such an agreement can validly be contained in a company's constitution. The problem does not arise in English law. It is proposed to outline the position in English law and then to contrast it with the position in South African law.

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1. Ibid 121.
2. Naude 57, Hahlo 89, Pyemont 36.
3. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O) 876A.
4. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) 692F-G.
5. Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 528.
6. In Salomon's case supra.
7. McCullogh v Fernwood Estate Ltd 1920 AD 204 .

4.2 English law

It is considered a fundamental principle of English law that only a person who is a party to a contract can sue on it.[1] The twin obstacles, in English law, to allowing a third person to sue in contract are the doctrine of privity, on the one hand, and the rule that consideration must move from the promissee, on the other.[2]

The application of this principle to the company constitution was first tested in Melhado v Porto Alegre Rail Co.[3] The contract for the benefit of the third person was not the main issue, which was the fact that the contract between the promoters and the company had been concluded before the company was formed. It was held to be void on this ground. Nevertheless Lord Coleridge C J expressed the view that in law the constitution could not be a binding contract between the company and persons not parties to the articles of association.[4]

The question is not whether a member can acquire rights under the constitution in some capacity other than that of member. That is the province of the outsider rule.[5] The question is whether a third party, in no way a party to the articles, can come in as a party thereto. The two issues are not always kept separate in the cases. Thus in Eley v Positive Government Security Life Assurance Co the articles appointed the plaintiff to be the defendant company's solicitor.[6] The fact that the plaintiff subsequently

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1. Dunlop Pneumatic Tyre Co v Selfridge and Co [1915] AC 847 HL. The principle has been criticised by Lord Denning in Drive Yourself Car Hire Co (London) v Strutt [1953] 2 All ER 1475 CA. Its abolition was recommended by the Law Revision Committee in 1937. Yet it was reaffirmed by the House of Lords in Scruttons Ltd v Midland Silicones Ltd [1962] 1 All ER 1 HL 16.
2. Cheshire and Fifoot 367.
3. (1874) LR 9 CP 503. The facts of the case are set out in Chapter 2 at 15 and in Chapter 8 at 180-181.
4. Ibidem 506.
5. The outsider rule will occupy a large portion of this dissertation. See Chapters 8-12.
6. (1876) 1 ExD 20 and 88.

became a member did not prevent the court from holding that he was not a party to the articles, although named therein.[1] As a result, it was held that as far as Eley was concerned the contract in the articles was res inter alios acta, he was no party to it.[2]

The distinction between the stipulatio alteri and the outsider rule is clearly stated in Hickman v Kent or Romney Marsh Sheepbreeders' Association.[3] No article, said Astbury J can constitute a contract between the company and a third person. On the other hand, no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, can be enforced against the company.[4]

These cases clearly indicate that in English law, following the general prohibition, a contract for the benefit of a third, which is found in a company constitution, cannot be enforced by the third.

4.3 South African law

Unlike the English law, and despite the Roman law maxim alterius nemo stipulari potest, South African law does not prohibit a contract for the benefit of a third. It is proposed, therefore, to briefly outline the South African common law on the point and then to consider the stipulatio alteri contained in the company constitution. Although the juristic nature of the third party's rights has been a matter of some controversy, a matter which is not relevant to the present topic, it seems clear that our courts construe the third party's rights in terms of the traditional offer and acceptance theory.[5]

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1. Ibid 90. The case will be dealt with in detail in relation to the outsider rule. It is generally construed as having turned on the fact that Eley's rights arose qua solicitor and not qua member. However, it will be submitted that the court overlooked the fact that Eley became a member. Furthermore, the court decided the case on the basis that the articles are not a contract between the company and its members, and therefore Eley could not acquire rights against the company, under the constitution. The court construed the constitution as a contract between the members inter se. See Chapter 8 at 181-182.
2. Ibidem.
3. [1915] 1 ChD 881 at 900.
4. Ibidem.
5. Hillner M A : Ius Quaesitum Tertio Comparison and Synthesis (1957) 16 LQR 445; De Wet J L : Die Ontwikkeling van die Ooreenkoms ten behoewe van 'n Derde (Leiden 1940).

The typical contract for the benefit of a third person is one where A and B make a contract in order that C may be enabled, by accepting same and notifying A thereof, to become a party to a contract between himself and A. Before C accepts the benefit of the contract, it may be amended by B and C.[1] It must be clear, of course, that the stipulation is in fact made for the benefit of the third party.[2] If it is, it is essential that the third party accepts the benefit.[3] Before the benefit stipulated for has been accepted by the third party, he can be deprived of it by the consent of the two others, for they are at that stage the only persons having rights under the agreement.[4]

Since it is clear that the stipulatio alteri is generally enforceable, provided all the aforesaid requirements are present, the question now arises whether a contract for the benefit of a third can validly be enforced if found in the company constitution. Naude says that South African law is unique in that it recognises both the stipulatio alteri and the contractual nature of the company constitution.[5] There are, he says, no aspects of the company's constitution which raise obstacles in principle to the recognition of any contract for the benefit or a third which may be found therein.[6]

He offers the following example to illustrate the point.[7] A, B and C form a private company to undertake building construction, but being under-capitalised, allot one quarter of the share capital to D. He accepts the allotment, on condition that it is stipulated in the articles for the benefit of X Ltd, that all cement purchases are made from the latter company, in which D is a major shareholder. X Ltd writes to the company, after its formation, accepting the offer. Subsequently, orders for cement are placed elsewhere.

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1. Crookes N O v Watson 1956 (1) SA 277 (A) 288.
2. Baikie v Pretoria Municipality 1921 TPD 376.
3. Thal N O v Baltic Timber Co 1935 CPD 110 at 116.
4. Van der Plank N O v Otto 1912 AD 353; Crookes N O v Watson supra 286A-G. The subject of the stipulatio alteri is by no means free of difficulty. See De Wet J C : Die Ontwikkeling van die Ooreenkoms ten behoewe van 'n Derde (Leiden 1940) 141. Also the judgment of Centlivres C J in Crookes N O v Watson supra. However these difficulties are beyond the scope of this dissertation.
5. Naude 66.
6. Ibid 67.
7. Ibidem. Any references in Naude's example to obstacles to enforcing the rights of the third arising out of his capacity have been omitted and will be dealt with at length as part of the enquiry into the outsider rule.

According to the general view, says Naude, that a third can acquire no rights under the articles, X Ltd would have no remedy. The article was inserted for the benefit of the third. Unless it had no legal consequence, it had to be acknowledged to be a stipulatio alteri, an there was no reason why it could not be enforced.

Likewise, there was no reason why a contract for the benefit of a third person who was a director could not appear in the articles, provided of course that the intention was to confer a benefit on the third.

It was amazing, says Naude, that the opportunity to interpret articles in this manner, arose only a few times and on no occasion was the opportunity taken to make a positive statement on the point.[1] On one occasion the full bench of the Natal Provincial Division did no more than raise a passing doubt on the rule that a third could not acquire any rights under the articles, in the light of the contract for the benefit of a third.[2]

This refers to the obiter dictum of Caney A J P in the case of Isaacs, Geshen and Co v Ellis.[3] The facts were as follows. The articles of a property-owning company provided that each holder of a share was entitled to the exclusive use and occupation of a specific flat and accommodation for one servant. The use of one parking space was also available if the secretary in his sole discretion decided to allocate such space. The secretary had not allocated such parking space. However, the major shareholder of the company, who had financed the building of the property in question, sold shares to prospective occupiers of flats. In the course of doing so, he purported to alienate in perpetuity the right to use 21 parking spaces to the buyers of these shares.

The three applicants were holders of shares in the company. Each of them was, therefore, entitled to occupy a flat and a parking space if one was allocated to him. The respondents were the property-owning company, the shareholding company, the secretary of the property-owning company, and the shareholders in the latter company who were making use of parking spaces in its building. Because the secretary had not made an allocation and because

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1. Naude 67 and footnote 1, thereto, including the references contained therein.
2. Ibidem footnote 1.
3. 1964 (2) PH A59 293.

the parking spaces had in any event been alienated, the three applicants sought a declaritur that this alienation was contrary to the articles and that the secretary was obliged to allocate a parking space to each of them in terms of the articles. The declaritur was granted but the secretary opposed the latter order.

Caney A J P held that each holder of a share was entitled to one parking space if the secretary allocated one to him. Furthermore the secretary did not have a discretion whether or not to allocate parking space. Clearly, said the judge, the company and each member were bound under the articles in terms of s 16 of the Companies Act, 1926. Each member was entitled to enforce the provisions of the constitution as against the property-owning company which was also entitled to compel performance by each member. As to the secretary, on the other hand, he was a stranger to the articles and therefore he had no rights thereunder, nor did he acquire such rights merely because by the terms of the articles the parties made an agreement between themselves relating to him.[1]

"But", said the judge, "quaere this proposition in our law having regard to the rule that a stipulatio alteri may be accepted by him for whose benefit it was made."[2]

However, he said there was a contract between the company and the secretary whose terms were to be found in the relevant articles, and therefore the secretary was bound by them. It therefore became part of his duty to allocate parking spaces to the applicants.

The next question was whether any member could enforce performance by the secretary of his duties.[3] The judge considered that each member had locus standi in this regard because the matter involved the individual right in respect of which each was vested, the right to have the secretary allocate parking spaces.

It is difficult to follow the latter proposition since the secretary's duties arose from a contract with the company and not with the members.

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1. Ibid 298.
2. Ibidem.
3. Ibid 299.

Furthermore, it was a contract apart from the articles, and the secretary acquired no personal rights thereunder. He merely served as the tool to give effect to the company's obligations to allocate the parking spaces.[1]

4.4 Conclusion

South African law, in sharp contrast to English law, permits the enforcement of a contract for the benefit of a third. There seems no obstacle in principle to the enforcement of such a stipulatio alteri contained in the articles, provided that the recognised requirements for a valid stipulatio alteri are present.

Cilliers Benade De Villiers say that it had been argued convincingly that a stipulation in favour of a third party in a set of articles was legally acceptable[2] and that the existence of such a possibility had been raised obiter by the full bench.[3] Our courts had not as yet had the opportunity to state the law in this regard. Provided that all the requirements for such a stipulation were present, and the stipulation related to the interest of the company, its use was both logical and desirable.[4]

The recognition of a stipulatio alteri in the articles, does not make the third a party to the constitution. It is not necessarily an alternative road to membership. A new and separate contract has arisen, separate and apart from the constitution upon the terms of those articles which are intended to be for the benefit of the third. What is more, taking the facts in Naude's example, on acceptance by the third, a contract arises solely between the company and the third. The promoters fall away and have no rights.[5] Of course it could be the road to membership if, for example, it is an option in favour of the third to take up shares. Such a contract is analogous to the contract between the company and the director which is on the terms of the articles, but is separate and apart from them.

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1. Ibidem.
2. This refers to Naude 64-68.
3. This refers to the judgment of Caney A J P in Isaacs, Geshen and Co v Ellis supra.
4. Cilliers Benade De Villiers 36.
5. Crookes N O v Watson supra.

Presumably the stipulatio alteri is alterable, if the relevant article is altered by the company in general meeting - unless the parties by contract excluded this possibility.

Finally, the recognition of the stipulatio alteri in the articles does not negate the general rule that only a party to a contract can sue on it. The third acquires no rights until he accepts. Then he is a party to the contract and only then is he entitled to sue on it.

5. General conclusion

This chapter has been devoted to the contracts embodied in the constitution. As stated in the introduction, it is universally recognised today that the constitution contains contracts between the company and its members, and between the members inter se. There are, presumably, separate contracts between each member and the company and separate contracts between each of the members with each of the other members.

The road to this firm conclusion was troubled by early doubts as to whether or not the contract was one between the company and its members, and, by later reservations whether there was a contract between the members inter se. Both these queries have been resolved in favour of the present view.

In South African law there seems to be no obstacle in principle to enforcing a contract for the benefit of a third which is found in a company constitution. Such a possibility is out of the question in English law. However, unlike the contract between the company and the members, and between the members inter se, the stipulatio alteri, when accepted, is on terms set out in the articles, but is separate and apart from them.

The contracts embodied in the constitution are subject to the general law of contract, and to the provisions of the Act. The development of company law has given these contracts a sui generis character. The special characteristics of the constitution as a contract will be investigated in the forthcoming chapters. In the next chapter attention will be given to their alteration. Thereafter aspects of their enforcement will be considered. Then the remainder of this dissertation will be devoted to the outsider rule.

CHAPTER 4 - ALTERATION OF THE CONTRACTS EMBODIED IN THE CONSTITUTION

1. Introduction

It has already been indicated that the company constitution is statutory in origin and contractual in nature.[1] Furthermore, it is clear that the contracts contained in the constitution are of two types: those between the company and its members and those between the members inter se.[2]

However, these contracts, contained in the memorandum and articles, display various special characteristics.[3] These result in consequences which are not found in other contracts, and which change some of the normal features which are to be found in all contracts. Such a normal feature is the right to alter an agreement from time to time.

It is proposed, in this chapter, to deal with two such special characteristics of the company constitution as a contract, namely the principle of unanimous assent, and the rule against the rectification of the constitution. Both concern methods of alteration of the constitution.[4] In the next chapters it is proposed to consider other aspects in which the normal consequences of a contract are varied in the company constitution. These revolve around the question of the enforcement of rights between the member and the company, and between the members inter se. These rights arise, not only within the contract in the constitution, but also outside it.

In subsequent chapters, the outsider rule will receive detailed attention.

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1. Chapter 2.
2. Chapter 3.
3. Gower 262.
4. Alteration by special resolution is, of course, another method provided by the Act.

2. The principle of unanimous assent

2.1 Introduction

It is a general rule of contract that an agreement can only be varied with the consent of all the parties thereto. They can, of course, impose restrictions on their own powers to vary.[1] There seems no reason why they cannot agree that the contract be varied at the instance of a stated majority of the parties, with or without the further condition that this majority may only vary the contract by means of stated procedures.

However, a company may alter its constitution, without the consent of all the members, in terms of the Act, at the instance of a prescribed majority expressed in the manner laid down in the Act.

Both the memorandum and the articles may be altered by special resolution, duly registered.[2] It has been stated that a company cannot, either by a statement in the articles, or by a contract outside the articles, deprive itself of the power to alter its articles in the manner prescribed in the Act.[3] On the other hand, says Hahlo, it was in one case taken for granted that the articles may require all resolutions to be passed by an increased majority, and that this would presumably include special resolutions.[4] However, shareholders are at liberty to undertake to vote in a particular way, and such voting agreements can be enforced.[5] They can, accordingly, agree on the exercise of their votes on special resolutions generally, and on alterations to the constitution, in particular.

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1. Thus in S A Sentrale Ko-op Graanmaatskappy Bpk v Shifren 1964 (4) SA 760 (A) it was held that the parties may validly agree to contract only in writing and they may also agree not to vary such an agreement except in writing, in which case they are not free to vary same, save in writing (per Steyn C J 766).
2. The memorandum may be altered in terms of s 55 and s 56. The alteration of the articles is governed by s 62 and s 201.
3. Hahlo 93, relying on Allen v Gold Reefs of West Africa Ltd [1900] 1 ChD 656.
4. Hahlo 96, the case being Swerdlow v Cohen 1977 (1) SA 178 (W). The case has been taken on appeal to the full bench of the Transvaal Provincial Division and is reported in 1977 (3) SA 1050 (T).
5. Dublin v Diner 1962 (4) SA 36 (N); Cilliers Benade De Villiers 192 and the other authorities therein quoted.

In a company having a share capital every member has a right to vote at meetings of the company.[1] In a public company a member is entitled to one vote for every share of no par value, and where the shares are of par value, his right to vote is in the same proportion to the total votes as his shares bear to the aggregate amount of the nominal value of all the shares issued by the company.[2] On the other hand, the voting rights of a member of a private company, are, subject to s 193(1), to be determined by the articles of the company.[3] Accordingly, in a private company some shares may carry greater voting rights than others.[4] On the other hand, non-voting shares are not permitted in South African law.[5] However such shares are possible in English law, in both private and public companies.[6]

There are a number of cases, both in English and in South African law, in which the members, or the directors, have by-passed the statutory requirements and have chosen to express the corporate will unanimously and informally. The result of the cases is that the corporate will can be formulated and expressed, in certain circumstances, without the observance of any of the prescribed formalities, provided only that there is complete unanimity among the members, or the directors, as the case may be.[7] This principle has been invoked in regard to two types of situation. Firstly, matters which Beuthin calls internal management, and secondly, in regard to the alteration of the constitution.[8] It is proposed to examine the principle in relation to the latter. However, it is necessary, by way of introduction, to deal with the former. It is proposed to deal with each in English law and in South African law.

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1. S 193(1).
2. S 195(1). In English law, all shares in all companies have equal voting rights, but this can be modified by special provisions in the memorandum or in the articles. Gower 351.
3. S 195(2). In regard to private companies, there is no difference in general principle between English law and our law. Swerdlow v Cohen 1977 (1) SA 178 (W) 184F-G.
4. In English law this is true in both public and private companies; Bushell v Faith [1969] 1 All ER 1002 CA 1004B-C. This case is also reported in [1970] 1 All ER 53 HL.
5. S 193(1) of the Act.
6. Pennington 552.
7. Beuthin R C : The Principle of Unanimous Assent (1974) 91 SALJ 2-3. This will be referred to as "the second article". Beuthin had previously written on the same topic (see Appointment of Directors and Legal Effect of Articles (1970) 87 SALJ 395 at 398 "the first article").
8. Internal management is a phrase used by Beuthin, in the first article, supra. The phrase was referred to with approval by the Appellate Division in Quadrangle Investments (Pty) Ltd v Witind Holdings Ltd 1975 (1) SA 572 (A) 582A-B.

2.2 English law

The English courts have not adopted this distinction between the internal management and the alteration of the constitution. However, the effect of the cases may be summarised in the following rules.

Firstly, the act proposed to be done must be intra vires the company.[1] Secondly, such an act must be honest.[2] Thirdly, there is no need to hold a meeting.[3] Fourthly, an informal decision is binding on new members, who join the company after the decision was taken, that is, where the decision is implemented immediately.[4] Whether it applies to a continuing act is not certain.[5] Fifthly, members who abstain and stand by, well-knowing that the decision in question is being implemented, will be taken to have assented thereto.[6]

The underlying policy of the rule seems to be that the requirements of the statute are for the protection of the shareholders. It is submitted that this is the reason why the members can waive the benefits conferred on them by the statute.[7] The rule has not, however, been free of criticism. It precludes the possibility of full and frank discussion of issues. In addition it makes it difficult for new members, and members of the public, to know what has been decided by a company.[8] On the other hand, it seems reasonable to permit the members of a company, which is small enough to take advantage of it, to enjoy the facility of instant communication and immediate decisions.

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1. Baroness Wenlock v River Dee Co (1887) 36 ChD 674; Salomon v Salomon and Co Ltd [1897] AC 22 HL; Express Engineering Works Re [1920] 1 ChD 466 CA; Bailey Hay and Co Ltd Re [1971] 3 All ER 693 ChD.
2. Buchanan (Peter) v McVey [1955] AC 516 at 521 and 533.
3. Parker and Cooper Ltd v Reading [1926] ChD 975. The court declined to follow Newman (George) and Co Re [1895] 1 ChD 674 CA despite the fact that the latter case had decided that the holding of a meeting was essential on the grounds that it had also held the transaction to be ultra vires and, further, no meeting had taken place.
4. Duomatic Ltd Re [1969] 1 All ER 161 ChD.
5. Beuthin the second article supra 9-10. The learned author is of the opinion that in such cases the principle should not apply.
6. Bailey Hay and Co Ltd Re supra 701G-H.
7. As they were permitted to do in Express Engineering Works Re supra. See also Oxted Motor Co Re [1921] 3 KB 32 at 38.
8. Morse G K : Formality in Company Affairs (1971) 121 NLJ 379 at 380.

On the question of the alteration of the constitution, there is, in English law, only one case in point, a decision of the Privy Council, namely Ho Tung v Man On Insurance Co Ltd.[1] The company had been incorporated, nineteen years previously, by submitting to the registrar a memorandum of association duly signed, and articles which had not been signed by the subscribers. The company was however duly incorporated and the articles were registered as such. Over the years the articles had been put forward as the company's only articles. These articles had been acted on, amended and added to by the shareholders, and the company had conducted its business under the articles for nineteen years without objection. These articles contained a power for the directors to disallow a sale or transfer of shares if they considered the transferee to be undesirable. Relying on this article they refused to register a transferee, who moved the court for relief, arguing that, as the articles had not been signed, they were not the regulations of the company and therefore the directors did not have the power.[2]

In the circumstances the court inferred that the shareholders had adopted and accepted the articles as the valid articles of the company.[3] It was true, said Lord Davey, that the articles had been irregularly registered but this was no reason why the shareholders should not adopt them. The statutory mode of doing so was by special resolution; but this was only machinery for securing the assent of the shareholders, or a sufficient majority of them.[4] Their acquiescence had been shown by a long course of dealing, and as a result the registered articles had become the articles of the company.[5]

It is important to note that under the English Companies Act, 1948 and its predecessors, there is no need to register a special resolution, nor is it void until it is so registered. If registration was a necessary prerequisite to the validity of a special resolution, then, while unanimity could render unnecessary the need for formally passing such a resolution, it could not substitute for the need for registration.[6] In regard to Ho Tung's case, an

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1. [1902] AC 232 PC. This matter was heard on appeal from the Supreme Court of Hong Kong. The relevant sections of the Companies Ordinance (Hong Kong), 1865 are substantially and for all material purposes identical with the same sections in the English Companies Act, 1862 (per Lord Davey at 234). The judgment is generally accepted as good in English law.
2. Ibid 235.
3. Ibidem.
4. Ho Tung v Man On Insurance Company supra 236.
5. Ibidem.
6. This point is made by Beuthin in the first article 398-399.

irregular registration might then be no registration at all, so that the articles could not be adopted in this informal manner. However, in Ho Tung's case this irregular registration of articles did not preclude their adoption by the members informally, as expressed in their conduct over a long period of time.

It is, therefore, submitted that in English law, since there is no need to register the articles in terms of the English Companies Act, 1948, there is no policy involving the protection of creditors, new members, or the public. The shareholders are therefore entitled to waive the benefits conferred on them. The reason, it is submitted, is that the formalities are for their benefit alone.[1] In fact, a special resolution was considered in Ho Tung's case to be no more than machinery for securing the assent of the shareholders.[2] This view is strengthened by the opinion expressed in Duomatic Ltd Re, that new members who join after the decision in question had been taken, are bound by it even if formalities were not complied with, since they are "bound by what had been constitutionally done within the company before they became members of it".[3]

2.3 South African law

As previously mentioned, it is proposed, firstly to deal with the principle of unanimous assent in situations involving matters of internal management. The principle has been applied in several cases and is accepted as settled law.[4] It has been accepted as a sound principle giving effect to the substance rather than the mere form of the members' assent.[5] On the other hand, although the principle has been accepted, it has probably not been thoroughly examined, in either English or South African law.[6]

South African courts have relied on the English authorities to find that, where the matter is intra vires the company, and there is no suggestion of fraud, the company will be bound by the unanimous assent of its members even if this is not expressed in a general meeting.[7] It does not matter whether the assent is

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1. Express Engineering Works Re supra; Oxted Motor Co Re supra 38.
2. Ho Tung v Man On Insurance Co Ltd supra 236.
3. [1969] 1 All ER 161 ChD 169A-B.
4. Per Trollip J A in Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) (A) 694D-E.
5. Ibidem. Support for this view is to be found in s 236 of the Act which limits but does not prohibit an article which validates a written resolution of directors as if it had been passed at a meeting of the board.
6. The second article supra 6-7.
7. Gompels v Skodawerke of Prague 1942 TPD 167 at 171-172. Sugden v Beaconhurs Dairies (Pty) Ltd 1963(2) SA 174 (EC) 179-180; Dublin v Diner 1964 (1) SA 799 (D) 800-801; Quadrangle Investments v Witind Holdings Ltd 1975 (1) SA 572 (A 582A-B.

given by all the members at the same time or place or not. The court will look at all the circumstances to ascertain the existence of unanimous assent. It will seek the intention through minutes and actions at the time of the informal resolution and subsequently.[1] Where there is only one shareholder and director, his frame of mind is that of the company and his acceptance is sufficient.[2] However, the assent must be fully informed.[3] The policy behind the principle seems to be that if a section of the Act is for the benefit of the shareholders, they can waive compliance with such formalities.[4] The principle has been held to apply to resolutions of both directors and members.[5]

In all the cases other than Gohlke's case, and Quandrangle's case, the matters in issue were what Beuthin has described as the internal formalities of resolutions.[6] For example, in Gompel's case the shareholders authorised a contract without passing a formal resolution.[7] In Sugden's case the shareholders, in the same manner, authorised the disposal of a property.[8] In Dublin v Diner an irregular allotment of shares was validated by the unanimous assent of the members.[9]

Beuthin is of the opinion that, although there was some doubt as to whether the principle ought to be accorded a general and universal application, nevertheless it might be invoked in regard to such matters as fell into the category of internal management.[10] It was not unreasonable to preclude existing members, having given their unanimous assent, from complaining of what they had sanctioned.

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1. Avondson Trust (Pty) Ltd v Wouda 1975(2) SA 444 (T).
2. Supra 448 D and F.
3. Taylor L and Co (Pty) Ltd v Grabe 1976(3) SA 75 (T).
4. See for example Sugden v Beaconhurst Dairies (Pty) Ltd 1963(2) SA 174 (EC).
5. Beuthin the first article supra 398.
6. Ibidem.
7. Gompels v Skodawerke of Prague supra.
8. Sugden v Beaconhurst Dairies (Pty) Ltd supra.
9. Dublin v Diner supra.
10. The first article supra 398.

That the principle may be validly invoked to validate a particular act of internal management is rendered beyond question by the Appellate Division in both Gohlke's case and in Quadrangle's case.[1] As long as the act is intra vires the memorandum, it is valid even if it contradicts the articles.[2]

The principle of unanimous assent can only apply where an ordinary resolution is required. The meaning of the term "internal management" is not defined, either by Beuthin or by the Appellate Division.[3] Consequently it is submitted that the yardstick of an ordinary resolution is more accurate. Although it is also not defined as such, it is safe to infer that an ordinary resolution is required save where the Act requires a special resolution.[4] It is, therefore, a much more reliable guide than the test of internal management. There is, however, a more basic criterion. It is submitted that wherever the courts have allowed the members to waive the formalities laid down in the Act, the reason has been that the formalities have been found to be for the benefit of the shareholders alone and therefore they are free to waive same.[5]

Whether the principle can apply to continuing acts which have been authorised unanimously but informally, is doubtful since a new member is probably entitled to insist on strict adherence to formalities.[6] This is certainly the view of Beuthin.[7] In this regard, he draws a distinction between acts which have already run their course and those, the real effects of which continue to live on operating in the future to the prejudice of new members. In the former, he says, it may well be unnecessary and unduly legalistic to insist upon adherence to the prescribed formalities.[8] In the latter, it would be very difficult for the new member to know what the decision was. In fact, in the latter, says Beuthin, their real interests are protected by the

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1. Supra.
2. Quadrangle Investments v Witind Holdings Ltd supra 582A-B.
3. Gohlke and Schneider v Westies Minerale (Edms) Bpk supra 694B-C.
4. Matters requiring a special resolution are listed by Cilliers Benade De Villiers 219.
5. See for example Sugden v Beaconhurst Dairies (Pty) Ltd supra.
6. This would follow from the remarks of Trollip J A in Gohlke and Schneider v Westies Minerale (Edms) Bpk supra 692G-H.
7. Beuthin R C : The Principle of Unanimous Assent (1974) 91 SALJ 2 at 17, "the second article".
8. The second article 10.

formalities, so that the courts should be slow to recognise the principle where new members are concerned.[1]

It is now proposed to deal with the principle in regard to the alteration of the constitution. The matter was first considered in the case of Gohlke and Schneider v Westies Minerale (Edms) Bpk.[2] In this case the Appellate Division considered the doctrine in the light of a clause in a shareholders' agreement between a company and all its members which, it was contended, was contrary to and sought to amend, the articles of that company.[3]

The facts were as follows. A company called Sarusas Minerals (Pty) Ltd was registered under the South West African Companies Ordinance.[4] The relevant articles provided that the number of its directors be determined in general meeting; and that any director, other than a life director, would continue to hold office until otherwise determined by the company in general meeting. The latter also had the power to fill any vacancy caused by the retirement of a director by electing a person to be a director. Two days later all the shareholders and the company entered into a written agreement in terms of which the plaintiffs and the second respondent were entitled, respectively, to appoint two directors to the company's board. Two and a half years later the plaintiffs informed the company that they nominated a director in place of an existing director who had resigned. Some time after their nominee had taken office the plaintiffs sought a declaratory order that he had been duly appointed a director of the company. Trollip J A took the view that the agreement meant that a party's nominee would become a director of Sarusas on his merely nominating him as such.[5]

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1. Ibid 11.
2. Supra.
3. Ibid 692B.
4. No 19 of 1928 which is substantially the same as the South African Companies Act, 1926. In particular s 16 of the Ordinance is in substance the same as the corresponding section in the South African Companies Act, 1926 and the successive English Companies Acts; per Trollip J A in Gohlke's case, supra 692C-E. S 16 is also the same as s 65(2) of the Act.
5. Ibid 691D-E.

It was contended for the defendants, in opposing this order, that on this construction of the agreement it was contrary to the articles, and was unenforceable against the company since it had not been incorporated in the articles.[1]

Trollip J A in regard to this contention, took the view that the act did not render the articles absolutely binding on the company and its members, as though they were statutory enactments. The articles, he said, merely had the same force as a contract between the company and each and every member as such, to observe their provisions.[2] "Now that contract", he said, "is not made immutable or indefeasible by the Ordinance in any respect relevant here. Consequently, I can see no reason why, as with any other contract, it cannot be departed from by a bona fide agreement concluded between the company and all its members to do something intra vires of the company's memorandum, but in a manner contrary to the articles, and why that agreement should not bind them, at least for as long as they remain the only members. Of course, for it to bind new members and affect outsiders, the agreement would probably have to be incorporated into the articles by special resolution which would have to be registered." [3]

Since the latter situation did not arise, Trollip J A expressed the view that, even if the clause in question was contrary to the articles it was nevertheless binding on all the parties. However, on the facts, he did not think that the agreement did conflict with the articles.[4] The latter simply required a general meeting to appoint directors to fill vacancies caused by the retirement or removal of directors, a situation which did not arise. The members, however, had inherent general powers to fill other vacancies such as those caused by resignation, death, incapacity or disqualification.[5] As a matter of practice the members exercise this power, he said, by ordinary resolutions at a general meeting.[6] The latter, said the judge, was only the formal machinery for securing the assent of members, and if such assent had been otherwise obtained it was just as effective. This principle of unanimous

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1. Supra 692B.
2. Ibidem F.
3. Supra 692G-H.
4. Ibid 693.
5. Ibid 693B-C.
6. Ibid 693F .

assent had been applied in the English Courts.[1] In Ho Tung's case the Privy Council considered that the unanimous assent of all the members was sufficient to adopt a new set of articles although they were not signed by the subscribers nor adopted by special resolution. Such assent was virtually the same as a special resolution.[2]

Trollip J A considered that such reasoning would apply a fortiori where only an ordinary resolution would have been required as in the present case. The principle of unanimous assent, he said, had been applied in several South African cases.[3] It was a sound principle, giving effect to the substance rather than the mere form of the members' assent and therefore "we should accept it as being settled law".[4]

The learned judge considered that unanimous assent was sufficient to alter the constitution, certainly for as long as there were no new members. On the other hand he found, as a fact, that the agreement did not contradict the articles. It was not, therefore, necessary for him to make this observation, which may therefore be regarded as merely an obiter dictum. On the one hand he seems to conclude that the formalities required by the Act for a valid special resolution could be dispensed with if there is unanimous assent. On the other hand what was required to achieve the appointment of Wiehahn as a director was not, in his view, a special resolution altering the articles, but an ordinary resolution at a general meeting. This machinery was also not essential if the assent of members was otherwise obtained.[5]

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1. The cases referred to by Trollip J A (693G to end of page) were Salomon v Salomon and Co Ltd [1897] AC 22 HL; Ho Tung v Man On Insurance Co Ltd [1902] AC 232 PC.
2. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970(2) SA 685 (A) 694D-E.
3. Gompels v Skodawerke of Prague 1942 TPD 167; Sugden v Beaconhurst Dairies (Pty) Ltd 1963(2) SA 174 (EC); Dublin v Diner 1964 (1) SA 799 (D).
4. Gohlke's case supra 694D-E.
5. Trollip J A had an opportunity, subsequently, to comment on his own judgment in Gohlke's case in the later case of Quadrangle Investments v Witind Holdings Ltd 1975(1) SA 572 (A) 582A-B. Gohlke's case, he said, applied the principle of unanimous assent to validate the doing of a particular act of internal management which was intra vires the company's memorandum, and which, at worst, was merely contrary to the articles.

Beuthin has commented on Gohlke's case. One result of it, he said, was that a company may be bound to conduct its internal affairs according to the tenor of two conflicting contracts.[1] In his opinion the obiter dictum of Trollip J A to the effect that unanimous assent can be used to alter the constitution, if only temporarily, that is to say as long as there are no new members,[2] would not only lead to a host of unnecessary problems, but was also incorrect.[3] On such an approach, the unregistered unanimous assent would not be binding on existing members and the company once a new member was admitted. What, he asks, is the position of a new member or of a creditor pending registration.

Beuthin notes that notwithstanding this obiter dictum, Trollip J A was of the opinion that the articles only empowered a general meeting to appoint directors to fill vacancies caused by retirement or removal of directors. In addition he agreed that the members had inherent powers to fill vacancies. These powers would be exercised by ordinary resolution at a general meeting. On the principle of unanimous assent, the assent of all the members and Sarusas, as evinced by the agreement, rendered the clause in question binding on all of them just as if they had approved it by ordinary resolution in general meeting. It was not easy to assess the correctness of this decision from the judgment as reported. The articles which empowered the directors to fill any casual vacancy were of vital importance. Even if the power to appoint a director had been vested by the articles in the company in general meeting, the agreement constituted an assent in advance by the two parties, as members, to future appointments.[4] However the parties did not regard what had taken place as constituting any resolution of the company at all, and considered it necessary for the appointments to take place in the normal manner. Furthermore, not all the members were present when the board sanctioned the agreement.[5] In the second place if there was a resolution of members, on the court's construction of it, it was a determination that directors should

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1. Beuthin R C : Appointment of Directors and Legal Effect of Articles (1970) 87 SALJ 395 at 399 the first article.
2. Gohlke's case supra 692G-H.
3. Beuthin R C : The Principle of Unanimous Assent (1974) 91 SALJ 2 at 16 the second article.
4. Gohlke's case supra 690F-G.
5. The first article supra 401.

be appointed not by the organ upon which that power had been conferred by the articles, but by some other persons. If the articles had expressly conferred the power to appoint directors on the company in general meeting, the resolution would have been an attempt to alter or add to the articles.[1] Finally, the general meeting itself was not a legal person but only an organ of the company, and so it had no power to appoint any person to act on its behalf. The company was obliged to act in terms of the registered articles.[2]

Beuthin has also commented on the use of the principle in relation to the alteration of the constitution, requiring as it does, the passing of a special resolution, duly recorded by the Registrar.[3] There was, in his opinion an important difference between the English Companies Act, 1948 and the Act. In the English Act s. 143 contained no declaration that if the special resolution was not registered by the Registrar, it was a nullity. Under the Act, more particularly s 200 and s 203 a special resolution had no effect until it was registered. Therefore, it could not be in any way a formulation and expression of the corporate will. The policy of the Act was that business which required a special resolution was a matter of public concern. Therefore, upon pain of criminal sanctions, a company was bound to give the public timeous and complete notice of what it was doing.[4] Registration was therefore an essential and indispensable formality which could not be by-passed by the simple expedient of obtaining unanimous assent.

It follows of course that the alteration of the constitution, requiring as it does a special resolution, duly recorded, cannot be effected by unanimous assent.

It does not follow, however, that a special resolution can only be passed at a general meeting, and not, for example, by means of a round-robin resolution. There must be a resolution since it must be recorded by the Registrar. This cannot be waived or substituted by unanimous assent manifested

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1. Ibidem.
2. The first article supra 402.
3. He has done so in both articles, as more fully appears below.
4. The second article supra 14 and 18.

in some other way. But there is no need, it is submitted, to pass it at a meeting. The policy requiring registration is for the benefit of the public, so that the members cannot waive it. There is no need to hold a meeting where a special resolution is not required, the reason being that the policy of holding a meeting is for the benefit of the members who can waive it.[1] It is submitted that the same policy applies to the holding of a meeting to pass a special resolution. Support for this view is to be found in s 186(2) of the Act, in terms of which a meeting may be called on a shorter notice than laid down in s 186 (1) if it is so agreed by the majority specified in the section.

The question of the alteration of the constitution was dealt with for the second time by the Appellate Division in the case of Quadrangle Investments v Witind Holdings Ltd which is reported both in the Witwatersrand Local Division[2] and in the Appellate Division.[3] In the latter court Trollip J A delivered the judgment. The crisp question, he said, was whether a dividend declared by a company in contravention of a condition contained in its memorandum, which could lawfully have been contained in its articles of association, instead of its memorandum (as predicated in s 11bis of the Companies Act, 46 of 1926) was valid or validated because all its shareholders unanimously assented to it.[4] The matter arose on an exception to a rejoinder. The facts were as follows. The plaintiff company, Quadrangle, sued the defendant company, Witind, for R50 904,69. In its plea Witind alleged that Quadrangle had declared a dividend of R51 000 and that the dividend was payable to Witind as being then the sole beneficial shareholder of Quadrangle and that the effect of the dividend was to extinguish, by set-off, the R50 904,69 claimed by Quadrangle.[5] In its replication, Quadrangle averred that, in terms of its memorandum, it was

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1. Sugden v Beaconhurst Dairies (Pty) Ltd 1963 (2) SA 174 (EC).
2. 1974(3) SA 364 (W).
3. 1975(1) SA 572 (A).
4. Ibid 575H-576A.
5. Ibid 576H. A further plea of exceptio doli was also raised which is not relevant to the present enquiry.

prevented in law from paying dividends from its capital reserves, of which the said dividend of R51 000 was a portion. Therefore no valid set-off could operate.[1]

Witind rejoined, saying that this condition in the memorandum relating to the declaration of dividends, could lawfully have been contained in its articles instead of its memorandum and could have been deleted by special resolution in terms of s 11 bis of the Companies Act 46 of 1926. However, in the absence of a special resolution, duly passed and recorded, the shareholders of Quadrangle had assented to the declaration of the said dividend so that its declaration was valid, as was the set-off.[2]

Quadrangle excepted to this rejoinder as disclosing no defence, in that it averred that the informal assent of all shareholders was not a compliance with s 11 bis, because no formal resolution was passed, nor was any minute noted or transmitted to the Registrar in terms of s 65 of the said Act.[3]

The exception had been dismissed in the court a quo.[4] Galgut J, in the lower court, had held that s 11 bis was applicable since the clause in question was indeed a condition as contemplated in that section. Hence (so the judgment in the court a quo proceeded), the declaration of the dividend, although contrary to the clause in question, was not ultra vires and it was valid or validated because all the shareholders of Quadrangle unanimously assented to the declaration.[5] The declaration of the dividend, said the judge a quo, did not alter the memorandum and therefore did not require a special resolution. It merely rendered this particular dividend valid.[6]

It was common cause that, despite the repeal of the Companies Act, 46 of 1926, the provisions of this act still governed the dispute. Much of the dispute revolved around s 11 bis(1) of the Companies Act, 1926 in terms of

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1. Ibid 577B.
2. Ibid 577D-578C.
3. Ibid 578C-G. Nor was it delivered to the Registrar in terms of s 11 bis(3).
4. Quadrangle Investments v Witind Holdings Ltd 1974(3) SA 364 (W).
5. Ibid 578H to end of page.
6. Ibid 579B-580B. There is no need to state the ultra vires doctrine in this section. It will however, be dealt with in Chapter 6.

which any conditions in the memorandum which could lawfully have been contained in the articles could be altered by special resolution. This was intended to provide an exception to the rigidity of s 9 of the 1926 Act which prohibited alterations of the memorandum except in the cases provided for in the 1926 Act.[1] The court a quo found that the clause in the memorandum could have been contained in the articles; therefore, by virtue of s 11 bis(1) of Act 46 of 1926 it could have been altered by special resolution; therefore the clause was to be treated on the same footing as though it had been contained in the articles; therefore the declaration of the dividend was not ultra vires the company.

Before the Appellate Division on behalf of the appellant, the rationale of the court a quo was criticised as follows. S 11 bis(1) laid down a method of altering the memorandum. This section did not, however, amend the ultra vires rule. Consequently if an act is not permitted by the memorandum it was ultra vires the company. The judge therefore erred in finding that the declaration of the dividend was ultra vires the company. Furthermore, in none of the cases quoted by counsel for the appellant was there any question of unanimous assent involving the amendment of a memorandum. All the cases referred to acts intra vires the company.[2] Gohlke's case was distinguishable on the ground that it was not concerned with the alteration of the memorandum of a company, but only with a departure from the articles.

In reply to these arguments for the appellant, it was argued for the respondent, that once the clause in the memorandum could have lawfully been contained in the articles, and therefore could have been altered by special resolution, the sole remaining question was whether the ultra vires doctrine applied to s 11 bis(1), so as to defeat the unanimous assent of the shareholders. The underlying approach of the English Companies Act, 1862, had been to prevent the shareholders from doing, by unanimous consent, some act outside the objects of the company. The reason for this prohibition had been that this would enable them to do the very thing prohibited by Act of Parliament.[3] This rigidity had been moderated from time to time. In particular in regard to matters appearing in the memorandum, which could have appeared in the articles, the

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1. S 56 of the Act replaces s 11 bis of the Companies Act, 1926. Any condition in the memorandum may now be altered by special resolution unless the memorandum itself lays down special procedures.
2. Supra 573F-H.
3. Supra 574 - 575.

company was given virtually unrestricted powers to alter the memorandum. This was, therefore, not an attempt to do a thing prohibited by Act of Parliament. The shareholders were doing what the Act entitled them to do, subject to a procedure designed to protect the minority. There was a distinction between what may not be done at all and what must be done by a special procedure. S 11 bis permitted the dividend to be declared, provided there was a special resolution altering the memorandum. The principle of unanimous assent did not relate to acts not permitted by the memorandum - its application was inconsistent with the provisions of the statutes. However, it was no part of the respondent's case that the unanimous assent was equivalent to a general alteration of the memorandum. The memorandum was, in fact, not altered. "The unanimous consent of the members of Quadrangle" had brought about a situation in which they could do what they had done.

Trollip J A, who wrote the judgment, understood the respondent's contention to be that s 11 bis(1) had in effect relaxed the ultra vires doctrine so that conditions referred to in s 11 bis(1) could now be altered by special resolution. Therefore an alteration could also be duly effected by the unanimous assent of the shareholders.[1] Alternatively the offending act was not ultra vires the company and could be validated pro hac vice, that is, without altering the conditions by the shareholders' unanimous assent thereto.

That argument, he said, could not prevail. When a condition, which could have been inserted in the articles, was inserted in the memorandum it became part of the latter and subject to the 1926 Act. It could not be altered, except in the cases and by the method for which express provision was made in the 1926 Act. In cases under s 11 bis it could only be altered by special resolution. It also became one of the provisions of the memorandum which s 16 enjoined the company and its members to observe.[2] It followed that such a condition could not be altered by the unanimous assent of the shareholders, but only by a special resolution. Furthermore, in terms of s 65 of the 1926 Act a special resolution had to be recorded by the Registrar before it became effective. In addition in terms of s 11 bis(2) a copy of the memorandum

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1. Ibid 581A.
2. Ibid 581B-E. S 16 of the Companies Act, 1926 is now s 65(2) of the Act.

as altered had also to be delivered to the Registrar. The purpose of these provisions was to benefit those members of the public such as creditors and shareholders, including prospective ones.[1]

Secondly, he dealt with things done in a contravention of such a condition, that is on which could not be altered, except in the cases and in the mode laid down by the act. It followed, he said, that any such thing was ultra vires and void and could not be validated by the unanimous assent of the shareholders.[2] It was, however, unnecessary to decide whether, without first duly altering such a condition, a company could by special resolution authorise or subsequently ratify the offending act.[3] For in the present case only the unanimous assent of the shareholders was relied on, which was insufficient because it purported to do something which the Act forbade, unless its requirements were first complied with. On the facts of the case, Trollip J A found that s 11bis applied to the condition in the memorandum of Quadrangle, because it was a condition which could lawfully have been contained in the articles. It followed that the declaration of the dividend out of the capital reserve was ultra vires and null and void. It could, therefore, not be valid or validated by reason of the unanimous assent of its shareholders. Hence the exception should have been upheld and the appeal succeeded.[4]

2.4 Conclusion

Where an act requires to be authorised by a special resolution, the principle of unanimous assent cannot be invoked entirely, the obiter dictum of Trollip J A to the contrary, notwithstanding.[5] The members cannot waive provisions of the Act relating to special resolutions because these are not only for the immediate concern of the shareholders, but are also for the benefit of those members of the public who are or may become interested in the constitution, such as creditors and shareholders.[6] On the other hand the holding of the necessary meeting seems to be solely for the benefit of shareholders who may waive this benefit, even in the case of special resolutions, provided that the special resolution itself is duly recorded.

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1. Ibid 581G.
2. Ibidem E.
3. Ibidem H to end of page.
4. Ibid 582B-D.
5. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970(2) SA 685 (A) 692G-H.
6. Quadrangle Investments v Witind Holdings Ltd supra 581G-H.

On the other hand the principle may be invoked in matters of internal management provided that there are no matters of concern to members of the public. In other words, the principle may be freely applied to matters which require no more than ordinary resolutions. Wherever, therefore, a section of the Act is solely for the benefit of the existing members the principle is available, but not where the policy of a section is to protect the public.

3. Rectification of the Constitution

3.1 Introduction

Rectification of a written contract can be obtained in those cases in which it is proved that both parties had a common intention which they intended to express in the contract but which through a mistake they failed to express.

The basis of this rule is that in contracts regard must be had to the truth of the matter rather than what has been written.[1]

However, South African law has accepted the English rule that a written contract is the sole memorial of a transaction so that no evidence is admissible to prove the terms of a contract save the document, or if it is lost, secondary evidence of its contents.[2] Where the written document does not reflect the true intention of the parties, rectification is a necessary prerequisite to a suit on the contract. Such a claim is for rectification of a mutual error and is based on the hypothesis that the parties have failed to place themselves where they intended to place themselves.[3]

In the case of the company constitution, although the memorandum and articles are a contract, rectification is not available where the articles are registered in the wrong form by mistake. This is so, both in English law and in South African law.[4]

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1. Weinerlein v Goch Buildings Ltd 1925 AD 282 at 289.
2. Meyer v Merchants Trusts Ltd 1942 AD 244 at 253.
3. Ibidem.
4. Gower 262; Hahlo 93.

3.2 English law

The matter was dealt with in English law by the Court of Appeal in the matter of Scott v Scott (Frank J) (London) Ltd.[1] In this case a widow of a former shareholder sought a declaration that she was entitled to be placed on the defendant company's register of members for 100 shares which were registered in her husband's name at his death.

The defendants, the remaining shareholders in the company, challenged her right to be so registered. They also claimed that, on a true construction of the articles, the plaintiff was bound to offer the shares to the defendants, alternatively they sought to have the articles rectified in order to provide for such an offer. It was held that on a proper construction of the articles the widow was entitled to be registered as the holder of the shares in question.

On the question of rectification of the articles, the Court of Appeal upheld the view of the court a quo, that it had no jurisdiction to rectify articles of association.[2] The reasons of the Court of Appeal were that a company only came into being when certain statutory requirements had been satisfied.[3] Upon its incorporation, a company could only alter or extend the constitution in terms of the relevant companies act which contained no hint of a power to rectify. On the contrary, it was the memorandum and articles actually submitted to the Registrar which were retained and registered by him. Furthermore, the effect of registration in terms of s 14 of the English Companies Act, 1929, was not to permit rectification.[4] The only contract (in the constitution) was a statutory contract and there was no machinery in the statute for compelling the registrar to register any rectification.[5]

In Pennington's view, the rationale of this standpoint is that for many years the courts had no power to amend the constitution, even where there was a drafting error which the court could rectify in any other contract. Such powers as the 1948 Act had conferred on the court were limited to cases of oppression of minority shareholders.[6]

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1. [1940] 3 All ER 508 CA.
2. Scott v Scott (Frank J) (London) Ltd supra 515G-H.
3. Ibid 516.
4. This corresponds to s 65(2) of the Act.
5. The only previous decision had been Evans v Chapman [1902] 86 LT 381 in which the court came to the same conclusion.
6. Pennington 80. The position is the same in South African law under s 252 of the Act.

3.3 South African law

In South African law the English view has been adopted without question. The matter was referred to in Konyn v Viedge Bros (Pty) Ltd[1]. The matter was turned on the interpretation of an article of a company. Assuming, said O'Hagan J, that the article in question failed to express the true intention of the signatories, the court could not, as a matter of interpretation, give effect to that intention. "Nor does the Court have the power to rectify the articles of association of a company if these articles do not accord with what is shown to have been the concurrent intention of the signatories at the moment of signature"[2].

Naude criticised this attitude on the ground that it did not give due regard to the contractual nature of the articles.[3] A company, as has been previously pointed out, originates in the agreement of its members, but is incorporated as a separate entity on registration.[4] Its constitution has been accurately described as a statutory agreement.[5] In relation to rectification, it is the statutory component which prevails. The company comes into being on registration. It is a creature of statute which can only alter or extend its constitution in terms of the Act. Since the Act is silent on rectification, such a remedy does not exist.

3.4 Conclusion

Despite the existence of this rule, the member is not without relief. As was stated in Evans v Chapman, the proper machinery to amend (and thereby to rectify) the constitution is a special resolution.[6] It is submitted that a refusal by the requisite majority to pass the necessary resolution may make it 'just and equitable' for the company to be wound up by the court.[7] Alternatively, such a refusal may well be unfairly prejudicial, unjust or inequitable conduct in terms of s 252 of the Act. In terms of this section,

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1. 1961(2) SA 816 (EC) 825.
2. Konyn v Viedge Bros (Pty) Ltd supra 825C-D.
3. Naude 64 footnote 1.
4. S 32 of the Act.
5. Per Astbury J in Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 903.
6. (1902) 86 LT 381.
7. In terms of s 344(h) of the Act.

the court has the power to make any order it thinks fit, including an order for the alteration of the articles. The latter power is implied in the provisions of subsections (4) and (5) as well as partly in the provisions of subsection 2(a) of s 252 of the Act.[1]

4. General conclusion

This chapter has sought to illustrate the sui generis nature of the company constitution, by reference to the alteration of the contracts embodied therein, with particular reference to the principle of unanimous assent and to the problem of the rectification of the contract contained in the constitution.

In regard to the former, different results emerge in English law and in South African law. In both, the principle may be invoked to validate a particular act of internal management, provided it is intra vires the constitution. In English law the principle will probably permit the alteration of the constitution, without complying with the formalities. In South African law, this is not the case. The consent of all the parties to the contract does not suffice to vary it. The variation must also comply with the requirements of the Act. In the case of rectification, in both systems of law, the requirements of the statute also prevail. The constitution is a statutory agreement. In these cases the statutory has prevailed over the contractual component.

It is proposed, in the next chapter, to continue the investigation into the special characteristics of the contracts embodied in the constitution, by examining their enforcement as such.

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1. Henochsberg 434.

PART 2

ENFORCEMENT OF RIGHTS IN A COMPANY

In general, a creditor under a contract is entitled to performance by the debtor of all he has promised. The debtor may fail to do what he has undertaken to do, or he may do what he has promised not to do, or he may tender performance late. Where the debtor is in breach of his contract, the creditor is entitled to one of several remedies, depending on the particular facts of the case. For example, he may seek an interdict or an order for specific performance, with or without damages. He may also cancel the contract, and at his option claim damages, or not.[1]

In the case of a company constitution, one would assume, as a result of its contractual nature, that every party to the contract in the constitution has the normal contractual remedies. The validity of this assumption, is, in essence, the subject of this part of this dissertation.

Of course, not all the agreements between the member and the company are found in the constitution. The member may enter into a host of commercial transactions with the company which are embodied in agreements outside the constitution, such as loans, service contracts, or the sale or leasing of goods. One would expect that such commercial and other transactions may be embodied in the constitution. However, this cannot be taken for granted, having regard to the "outsider rule"[2]. Apart from such transactions, a member may acquire claims against his company in delict, for example as a result of a running-down incident or as a result of the fraud of its duly authorised agent or employee. An underlying question in all these situations is whether membership of a company is an obstacle to a member acquiring such rights against the company, and enforcing them.

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1. Alternatively, he may refuse to perform on the grounds of the defaulting party's breach.

2. See Chapters 8-12 below. However, in at least one case, a commercial transaction between the company and its members was embodied in the articles and was upheld without question. See Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339 at 356.

In regard to such rights, that is, those arising outside the constitution, in almost all cases membership is no bar to their enforcement. If it were, a fortiori it would also be a bar to rights arising from the constitution itself.[1]

However, in one case, continued membership was considered to be a barrier to enforcing a right which arose outside the constitution.[2] The validity of the principle set forth in this case will be the subject of the fifth chapter of this dissertation. In regard to rights arising from the constitution itself, several matters require attention.

The first is the ultra vires doctrine, in terms of which a company exists only for the objects for which it has been incorporated and only has the capacity to perform such acts as are indicated by its objects. Since the memorandum and articles constitute a contract between the company and the members, and between the members inter se, a member can invoke the objects as formulated to compel the company to observe its stated objects. In terms of this doctrine, acts which are beyond the capacity or powers of the company are void. The significance of the ultra vires doctrine has been curtailed drastically by s 36 of the Act.[3] These two aspects will form the subject of the sixth chapter.

Thereafter attention will be drawn to the extremely complicated and oft-trodden thicket of the rule in Foss v Harbottle. This rule clearly circumscribes the right of a member to take action to enforce rights arising from the constitution, firstly in regard to a wrong done to the company, and secondly in matters of internal management where the irregularity is capable of ratification by a simple majority. Although it does not purport to restrict the enforcement of the member's personal rights, it raises difficulties in regard to their definition. This will be the subject of the seventh chapter. This, then, is the scope of this part of this dissertation.

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1. The enforcement of rights arising from the constitution itself will occupy Chapters 5-7 of this dissertation.
2. Houldsworth v City of Glasgow Bank (1880) 5 AC 317 HL.
3. Cilliers Benade De Villiers 52.

A further obstacle to the enforcement of contractual rights embodied in the constitution, is the rule that rights purporting to be given by an article in a capacity other than that of a member cannot be enforced against the company.[1] This, the "outsider rule", will be the subject of the remaining chapters hereof.

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1. 'Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900.

CHAPTER 5 - THE PRINCIPLE IN HOULDSWORTH'S CASE[1]

1. Introduction

In both South African and English law, where a person has been induced to enter into a contract by the material and fraudulent misrepresentation of the other contracting party, the contract is voidable and not void. The victim is entitled to maintain the contract or to cancel it. He is, however, obliged to make an election timeously between these mutually exclusive courses of conduct. He cannot do both.[2] In other words, he cannot both approbate and reprobate.

Whether he rescinds or enforces the contract, he is entitled to claim damages.[3] Maintaining the contract and claiming damages may appear, superficially to be inconsistent, but in substance a claim for damages is not an attempt to cancel a contract. Thus, for example, a party who, having been misled into a contract by a fraud, elects to stand by it and claim damages, is not both approbating and reprobating. Fraud is a delict and the action based on fraud is delictual and not contractual in its nature.[4] The victim who stands by the contract while seeking damages for fraud, is in no sense repudiating the contract. He seeks to be compensated in delict for the loss he suffered as a result of the fraud, while adhering to the terms of the contract which he concluded.

The question arises whether these principles apply where a person takes shares from a company. The answer will be sought firstly in English law, and then in South African law.

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1. Houldsworth v City of Glasgow Bank supra.
2. Bowditch v Peel and Magill 1921 AD 561.
3. Frost v Leslie 1923 AD 276 at 279; Trotman v Edwick 1951(1) SA 443 (A) 448H.
4. Trotman v Edwick supra.

2. English law

2.1 Damages without rescission

The right to claim damages in a share transaction, without rescinding a contract which has been induced by fraud, was dealt with by the House of Lords in Houldsworth v City of Glasgow Bank.[1] The question was crisply framed by Earl Cairns L C in the following manner.[2]

"Can a man, induced by the fraudulent misrepresentations of agents of a company to take shares in the company, after he discovers the fraud, elect to retain the shares, and to sue the company for damages?"

The facts in this case were, briefly, as follows.[3] The plaintiff bought £4000 of the stock of the Glasgow bank, an unlimited company registered under the Companies Act, 1862. A year later, when he was still a member, it went into liquidation. He was then, being a member, placed on the list of contributories and paid calls. He claimed that he had been induced to buy the stock by reason of fraudulent misrepresentations made to him by the directors and other bank officials and, since it was too late for him to obtain rescission of the contract of allotment once winding-up had commenced, he brought an action for damages against the company.

It was contended for the appellant that a principal was liable for the fraud of his agent acting within the sphere of his business and that this was so in the case of an incorporated company acting through its directors. Therefore the company was liable to make reparation. It was also argued for the appellant that the defrauded partner could choose to rescind the contract induced by the fraud; or to claim damages without doing so. Furthermore on general principles he could retain his shares and yet get damages.[4] A liquidation could not extinguish this liability. Although it did put an end to rescission and restitution, the right to damages remained. Nor was it inconsistent to claim damages from a company of which the appellant was a member.[5]

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1. (1880) 5 AC 317 HL. The matter was heard as an appeal against a judgment of a Scottish court.
2. Ibid 323.
3. Ibid 318.
4. Ibid 320.
5. Ibid 321. The respondent's counsel was not called on to reply. See 322.

It was held, unanimously, that as rescission was impossible, no action for damages could be brought.[1] However, four speeches were delivered, and it is proposed to set out the salient features of each, and then to review briefly the views of academic writers on the case. Then an attempt will be made to comment on the validity of the principle laid down in the case.

Earl Cairns in his judgment, having stated the facts, assumed that the fraud was such that, if the bank was a going concern, the appellant would have been entitled to rescission and restitution.[2] As against the liquidators, the position was different. After a winding-up it was too late for rescission. His right to claim damages against the liquidators was the same as his right to do so prior thereto, on the assumption that he did not elect to repudiate the contract.[3] The question, therefore, was whether, a victim of a fraud by the agents of a company induced thereby to take shares in that company, could elect to retain the shares and to claim damages.[4]

There was no doubt in the judge's mind that a purchaser of goods enjoyed the right to make this election.[5] However, he questioned whether this right existed where the subject-matter of the contract induced by fraud was shares or stock in a partnership or company. In such a case the buyer undertook to take his share of past liabilities and of profits and losses. He had agreed to contribute to its assets and he had agreed that these be used in a particular way. In such a contract a demand that these assets be used to pay the new partner damages for a fraud was not included, and any application of the assets for such purpose was at variance with the contract. As a result, his claim was at variance with the contract, by which he wished to abide. In other words, in substance, if not in form, he was both approbating and reprobating, which he might not do.

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1. Ibid 317.
2. Ibid 322-326.
3. Ibid 323.
4. Ibidem.
5. Ibidem.

Lord Selborne, in his judgment, started with the rule that a master was liable for the wrong of his agent, in fraud as in any other wrong.[1] A corporate body, he said, was responsible for the fraud of its agent to the extent that it had profited thereby.[2] For many purposes a corporator, having dealings with his own company, and who suffered a wrong at its hands, was in the same position as a stranger, except that he might have to contribute towards his own claim.[3] However in the present case it was impossible to separate the pursuer's claim from his status as a corporator, unless that status was terminated by rescission. As long as he remained a member his loss was equal to his aliquot share of all the debts of the company. His claim was not really against the corporation as an aggregate body, but against all the members, except himself.[4] Its effect was to throw on them his share of the company's debts. But they were as innocent as he was. If the guilt was imputable to them, it was imputable to him. Rescission was, therefore, the only remedy by which the company could be made answerable for this fraud.

Lord Hatherley, in his judgment, proceeded as follows. The agent who made a fraudulent misrepresentation acting in the scope of his authority, thereby inducing his victim to enter into a contract, bound his principal so that the contract was voidable.[5] A corporation was bound by the wrongful act of its agent no less than an individual. If, however, restitution was not possible, the contract could not be rescinded, whatever right for damages might have existed. On the present facts, the fact that the appellant was a member at the date of liquidation was fatal to his case. By remaining a member he assumed a liability for his aliquot share of the debts of the company, including the debt to himself for damages. If there were other shareholders in a like position to him, he would have to bear his aliquot share of liability for their claims. The appellant, he said, was trying to reconcile two inconsistent positions, that of shareholder and that of creditor of the shareholders including himself.[6] No case could be adduced in which a shareholder claimed relief for a debt in which he was himself a co-debtor.[7]

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1. Ibid 326.
2. Ibid 328.
3. Ibid 329.
4. Ibidem.
5. Ibid 331.
6. Ibid 333.
7. Ibid 334.

What had really happened,he said, was that the appellant and the other shareholders in a like position, had suffered the misfortune of having employed a dishonest agent.[1] Since he could not rescind the contract, he would not escape the burden of this common misfortune, that is, in having employed dishonest agents.

Lord Blackburn, in his judgment considered the contract with a joint stock company to be a very peculiar one.[2] It was in substance an agreement to become a partner in the company, and to contribute to all its liabilities, as if he had been a member from the beginning.[3] There was no doubt that a contract induced by fraud was not void but only voidable. It followed that the deceived party might rescind the contract and demand restitution, but only if he himself made restitution. If he could not do so, "it was too late to rescind."[4] On the other hand, he entertained no doubt that, if instead of seeking to set aside the contract, he sought damages, such an action could not be maintained against the company, but only against the directors personally.[5] Furthermore there were strong reasons given by the other judges for holding that "one who had been induced by the fraud of the agents of a joint stock company to contract with that company to become a partner in that company he could bring no action of deceit against the company whilst he remained a partner in it."[6]

In the result the appeal was dismissed, without any dissenting speech being given by any of the judges.

Houldsworth's case was referred to in Appleyard ex parte.[7] The plaintiff had sold to the company certain leases, part of the price being in fully paid-up shares in the company, and by an issue of debentures. The company was ordered to be wound up. The plaintiff was placed on the list of contributories for 500 shares, in reply to which he claimed £1000 damages for a breach of

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1. Ibidem.
2. Ibid 337.
3. Ibidem.
4. Ibid 338.
5. Ibid 340.
6. Ibidem.
7. (1881) 18 ChD 587.

contract by the company, in that fully paid-up shares should have been allotted to him. The court held that the plaintiff was entitled to prove his claim for damages. Houldsworth's case was distinguished as being one, not of contract, but of fraudulent misrepresentation. Hall V C considered that damages for fraud committed on the shareholder by the company could not have been intended to be included in the contract to take shares, and such a claim was inconsistent with the contract. The fraudulent procuring of shares was distinguishable from ordinary claims by a shareholder, which were to be treated as if he were a stranger. In the case of shares, the victim was "seeking from his co-shareholders a full indemnity without himself contributing towards the claim, although the contract was not, and could not be rescinded."[1]

Houldsworth's case was also referred to in Addlestone Linoleum Co Ltd Re.[2] The facts were that the company issued fully paid-up preference shares of the nominal capital of £10 each, for £7.10.0. per share. Four years later the company was wound up and the applicants were placed on the list of contributories for the amount of £2.10.0. per share. The applicants did not deny liability but claimed damages against the company for breach of contract, in the sum of £2.10.0.

Kay J in the court a quo said that, assuming a member could retain his shares and sue for damages, in fact they were obliged as members to pay and furthermore, they had contracted that as members, this money was first to be applied to payment to other creditors, who were not members.[3]

Then, referring to Houldsworth's case, Kay J noted that the shareholder was making a claim which was inconsistent with the contract of membership, and accordingly, as he could not bring this claim before winding-up, he could not do so thereafter.[4]

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1. Ibid 595.
2. (1887) 37 ChD 191 CA. The case is reported in this reference both in the Court a quo, at 191 et seq , and in the Court of Appeal at 201 et seq.
3. Ibid 197-198.
4. Ibid 200. The reference was to the words of Earl Cairns that a share taken from a company is not like an ordinary chattel, in respect of which the purchaser might have a choice of remedies, and that by accepting a share the allottee merged himself in a society and contracted to pay calls when made. See Houldsworth v City of Glasgow Bank (1880) 5 AC 317 HL 324.

In the Court of Appeal Cotton L J considered that the decision in Houldsworth's case precluded the court from allowing the claim.[1] Lindley L J viewed the matter on two alternative grounds.[2] There were two possibilities. Either the contract was to issue shares at a discount, in which case the liability on the shareholders was to pay in full, without any right to claim damages. Alternatively, if the contract was to issue fully paid-up shares, then the appellants might have repudiated them, but having kept them, they could not get rid of them, nor could they claim damages for the loss they sustained through the shares not being fully paid-up. The principle in Houldsworth's case, he said, was that the shareholder contracted to contribute money to be applied to the payment of the debts and liabilities of the company, and it was inconsistent with his position as a shareholder, while he remained such to claim back any of that money. This principle, he said, governed this case.[3]

2.2 English academic writers

Houldsworth's case has been criticised by Gower as showing a confusion between the company and the members, and because its reasoning is unsatisfactory.[4]

Gower also expressed the view that this decision was anomalous and "entirely contrary to the normal rules of the law of contract, for one can recover damages for fraud without also rescinding the contract."[5] The cause of this anomaly was, in his opinion, the failure of the House of Lords to realise that a company was an entity distinct from its members.[5] In his view the decision could be justified, however, as maintaining the capital of the company, by preserving the company's share capital as a guarantee fund for creditors.[5] Consequently a shareholder who wished to rescind had to do so promptly, since the existence of his shares may have led others to extend credit to the company.[5]

Hornby considers this view to be quite unjustified.[6] The case, says Hornby, was demonstrably not an anomaly, but was quite consistent with the

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1. Addlestone Linoleum Co Ltd Re (1887) 37 ChD 191 CA 204.
2. Ibid 205.
3. Ibid 206.
4. Gower L C B : Notes on Cases (1950) 13 MLR 367 note 8.
5. Gower L C B : Modern Company Law (First Edition London 1954) 63-64 and 279 and 314-315.
6. Hornby J A : Reviews and Notices (1955) 71 LQR 415 at 416.

doctrine of corporate personality. The underlying principle was not the protection of outside creditors, but the protection of Houldsworth's fellow shareholders from a claim which was inconsistent with his contract with them.[1]

In the first place Hornby takes issue with Gower's "attempted rationalisation of the case", which dealt only with the situation when it was too late to obtain rescission. It did not deal with the shareholder who had just discovered the fraud.[2] Furthermore in the case where it was too late for rescission, it was not correct to say that damages were just as detrimental as rescission since, as Gower considered, the assets would be equally depleted in either event.[2] On rescission, the plaintiff would recover the amount he contributed. On a claim for damages, he would only receive the difference between his contribution and the true value of the shares, leaving the company with the difference. Finally, he says, Gower did not support his argument by reference to anything said in the case.[2]

In a footnote Hornby says, of Gower's view, that the claim was inconsistent with the contract between the members, that it may be rather old-fashioned to describe the company constitution as being a contract between the members inter se, but it was immaterial whether it was a contract or not.[3]

On a first reading of the report, says Hornby, one might agree with Gower. The company should be vicariously liable, and it should not matter at all that the plaintiff remained a member of the company, since the latter had an independent existence. On the other hand, it was said by Lord Selborne that it was impossible to separate the matter of the pursuer's claim from his status as a corporator. This showed that Lord Selborne's view was that despite the fact that the company had a separate personality and that a shareholder may be a creditor of the company, the claim must fail and the reason was that the claim was inconsistent with the contract between the

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1. Hornby J A : Houldsworth v City of Glasgow Bank (1956) 19 MLR 54 at 55.
2. Ibidem.
3. Ibidem footnote 7.

plaintiff and the other shareholders.[1] It was, however, not sufficient to say that the claim was inconsistent with the contract because it diminished the amount of the company's assets available for the payment of outside creditors. Such a reason would equally prevent a shareholder from ever claiming damages from the company.[2] The consequence of receiving such damages was in effect the variation of the contract between the members. The plaintiff had contracted to bear a certain fraction of the company's liabilities, but on receiving damages he bore only a fraction of the liabilities as he imagined them to be. In electing not to rescind, he affirmed the contract and therefore had to abide by it, and could claim damages for fraud.[3]

It might be objected that the buyer of goods might elect not to rescind the contract, and can nevertheless claim damages. The answer, says Hornby is that there was a distinction between the buyer of goods and the buyer of shares. In the former, there was only the legal relationship between the purchaser and the vendor. In the latter, there was in addition to the relationship between the subscriber and the company, the relationship between the subscriber and his fellow shareholders. The latter were not vicariously responsible for the fraud because the misrepresentations were made by an agent of the company, who was not an agent of the shareholders. To allow the shareholder, who elected not to rescind his contract, to claim damages, would work a grave injustice on his fellow shareholders since it would increase the liabilities for which they were responsible.[4] The judges, says Hornby, were aware of the company's separate entity and took their decision to protect, not its creditors, but its shareholders and were fully justified in so doing.[5]

Gower replied to Hornby's article in a brief footnote thereto.[6] Hornby, he said, argued that the case could be justified as a necessary protection for shareholders. To do so, it was necessary to establish that if

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1. Ibid 56.
2. Ibid 58.
3. Ibid 59.
4. Ibid 60.
5. Ibid 61.
6. Ibidem.

one shareholder were allowed to recover damages for fraud without rescinding, this would cause greater damage to his fellow shareholders, than if he were forced to rescind as well. This, he said, was demonstrably false. It was, he said no doubt true, that if a shareholder could neither rescind nor claim damages this was best for both the shareholders and the creditors. The only plausible explanation for the rule, however, was that a shareholder should not be allowed to deplete the company's "capital".[1] This rule would make more sense if it barred both rescission and damages, rather than merely damages alone. But the theory seemed to be that, as a shareholder, he could not touch "capital", whereas if he rescinded he ceased to be a shareholder, and became a creditor to whom this restraint did not apply. The practical results, he said, were just as absurd under Hornby's explanation, without even a plausible theory to justify them.[2]

Hornby replied to this footnote, to the effect that he did not say that the case intended to protect the shareholders from being placed in a worse position, than if Houldsworth had rescinded, and then claimed damages, but that it was to protect them from a claim which was inconsistent with the contract with the fellow shareholders.[3]

Gower repeated his disapproval of the case in the second edition of his book.[4] He noted that a company's rights against a promoter were greater than those of the subscriber against the company, for it had been held, in this case, that the subscriber could not recover damages for fraud unless he also rescinded.[5] Furthermore where a false statement appeared in a prospectus, the company was not liable in damages when shares had been purchased in such circumstances.[6] This was because, Houldsworth's case laid down the rule that damages could not be recovered from the company unless the allotment was rescinded. The case showed a failure to recognise fully the separation between the company and the member, but it could be explained on two grounds.[6] Firstly, damages were inconsistent with the "implied" contract between the members; or, secondly, it reflected a recognition of the share capital as a guarantee fund for members.[6] A shareholder who wished to rescind had to do

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1. Ibid 62.
2. Ibidem.
3. Hornby J A : Correspondence to the General Editor (1956) 19 MLR 185.
4. Gower L C B : Modern Company Law (Second Edition London 1957) 261.
5. Ibidem.
6. Ibid 295.

so promptly, since his shares might have led others to extend credit to the company. But if he could recover damages, although he had lost the right to rescind, the consequences to third parties would be just as detrimental, since the assets would be equally depleted.[1] As a result a claim for damages for fraud could have no meaning. The only remedies were a claim for rescission and a refund of the purchase price. On the other hand, he said, presumably the rule did not apply to contracts to purchase debentures.

In the latest edition of Gower, disapproval of the case was reiterated and the hope was expressed that the House of Lords would feel free to reverse itself, and rule that Houldsworth's case was wrongly decided.[2] Furthermore, in his opinion, where the representation had become a term of the resulting contract, instead of merely a fraudulent misrepresentation, the rule would equally apply, on the authority of Addlestone Linoleum Co Ltd Re.[3] On the other hand, he said, if the fraud was connected with a take-over, the rule should not prevent action against the company, since the plaintiff would have ceased to be a member when his shares were acquired.[4]

Pennington relies on Houldsworth's case as authority for the proposition that a subscriber for shares cannot, as an exception to the general rule, claim damages for fraud, unless he rescinds the allotment.[5] A plaintiff, he says, could not sue the company for damages while he remained a shareholder, because he was still bound by the contract between him and the company and his fellow shareholders, which contract was implied from his membership, and one of the terms of that contract was that the company's property shall be used only for the purpose of achieving its objects, which did not include the payment of compensation to defrauded subscribers.

Pennington's view is subject to the criticism that such an argument, resting as it does on the objects, would preclude the payment of damages even if there is rescission. It would also prevent the deceived purchaser of goods who is a member from obtaining damages. It is an argument which rests

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1. Ibid 295.
2. Gower 319.
3. (1887) 37 ChD 191 CA 205. As Houldsworth's case was dealing with a cause of fraudulent misrepresentation and not of breach of contract, this case must be taken to have extended the principle. See also Appleyard ex parte (1881) 18 ChD 587.
4. Gower 330 footnote 6.
5. Pennington 242.

on a term of a contract, namely the objects in the company's memorandum. However, fraud is a species of delict, the consequences of which cannot be evaded by the terms of a contract, into which the victim has been induced by the very fraud complained of.[1] A further difficulty in Pennington's views, which rest on the fraud being a term of the contract, is that, on the facts in Houldsworth's case, the fraudulent misrepresentation which had been made by the agent, had not been incorporated into the contract of allotment.[2] This was the view of Hall V C in Appleyard ex parte.[3] As a result, in the latter case the Houldsworth principle was not applied, because the fraud was a breach of contract and not a fraudulent misrepresentation outside the contract.[4] On the other hand, in another case, the same test, that the claim was inconsistent with continued membership, was applied to defeat a claim arising out of a fraudulent breach of a contract.[5] It is not necessary to reconcile these points of view, because the present enquiry is concerned with the question whether continued membership is an obstacle to an action by a member for a claim arising outside the constitution. It matters not, therefore, whether such a claim arises in delict or from breach of a contract.

2.3 An assessment of the principle in Houldsworth's case in English law[6]

The four speeches given in the case disclose two underlying reasons for the conclusion in the case. The first is that an action for damages is at variance with the contract, with which the plaintiff wishes to abide, and that this is, in substance, both approbating and reprobating, which is not allowed. The second is that, although a fraud by an agent renders his principal liable vicariously, nevertheless the existing shareholders, although

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1. See for example the South African case of Oranje Benefit Society v Central Merchant Bank Ltd 1976 (4) SA 659 (A) 673-674D-E and the judgment of the House of Lords mentioned therein, namely Central Railway Company of Venezuela v Joseph Kisch (1867) LR 2 HL 99 at 120.
2. Houldsworth's case supra 322 and 324.
3. [1881] 18 ChD 587.
4. Ibid 595.
5. In Addlestone Linoleum Co Ltd Re (1887) 37 ChD 191 CA. See also Gower 329.
6. Houldsworth v City of Glasgow Bank (1880) 5 AC 317 HL.

they had employed a dishonest agent, could not be held vacariously liable, since they were all innocent of the fraud. Nor could a claim be brought against the company but only against the director personally.[1] In regard to the first underlying reason, the notion that a victim of a fraud, who is induced thereby to enter into a contract, and who elects to abide by the contract and to claim damages, is both approbating and reprobating, is unsound. To reprobate a contract is to repudiate it. To claim damages either in tort, or for breach of contract, is not to repudiate it. There is no doubt that, according to English law a person who purchases goods, concerning which the vendor has made a fraudulent misrepresentation, may retain the goods and claim damages.[2] This is so, despite the fact that the two courses of conduct superficially appear to be inconsistent. In fact, if there is such an inconsistency, it is no bar to a claim for damages together with a claim for specific performance. Despite the fact that a share deal creates an ongoing relationship between buyer and seller, the position is the same: the action for damages does not amount to a repudiation or a reprobation, although there may be some inconsistency.

Gower has offered, as a reason, the need to preserve the share capital as a guarantee fund for creditors. There is no such suggestion in the case. Furthermore such a policy would not stop at barring damages. It would insist on barring rescission as well. It cannot therefore, be regarded as a satisfactory explanation.

The second underlying reason, that the shareholders cannot be held vicariously liable for the fraud of their agent, while it is not incorrect, is arrived at by a series of misconceptions.

Firstly, it rests on the view that the action is not really against the corporate body but against all the members except one, namely the plaintiff.[3] This ignores the separate corporate entity of the company. It also, as a result, ignores the fact that it was the company which gave the agent his mandate, and not the shareholders.

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1. Houldsworth's case supra 340.
2. Ibid 323.
3. Ibid 329.

Secondly, the action against the other members, while it rests on the valid assumption that there is a contract between the members inter se, arising out of the issue of shares, also assumes that they could be vicariously liable, but for the exception created in the case.[1] This liability assumes a mandate from the members to the agent. Now the directors, as such, are not the agents of the shareholders, since they usually have original powers as an organ of the company. If they require specific authority from the company to issue shares, they obtain this from the members' general meeting, functioning as an organ of the company, and this does not constitute a mandate from the members personally. There may, of course, be such a mandate, arising out of the facts of a given situation. Apart from this, it is incorrect to assume, as Lord Hatherley did, that the plaintiff and the other shareholders had employed dishonest agents.[2] If there is no mandate on the facts, the only alternative is a mandate arising out of the contract created by s 20 of the English Companies Act, 1948 and its predecessors, As has been indicated, this contract is a statutory fiction.[3] It is, of course, a contract between the company and the members, and the members inter se. In the present case the contract between the members derived from the activities of the directors. Nevertheless it was in fact created by a statutory fiction which creates legal obligations which would otherwise not exist. This fiction does not extend to creating a mandate by the existing shareholders in favour of an agent to introduce a new member. Hence it is no basis for imposing a vicarious liability on them.

Thirdly, even if the existing shareholders did give the agent a mandate, the new member did not, so that it is impossible to impute a vicarious liability to him.

Fourthly, as to the reason advanced in the case, that the shareholders cannot be held vacariously liable for the fraud of their agent, because they are innocent of the fraud, this misconstrues the basis of vicarious liability.[4]

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1. This situation was not dealt with by the court in this case.
2. Ibid 334.
3. See Chapter 2 at 11.
4. Houldsworth's case supra 329-330.

If the shareholders were not innocent, there would be no need to invoke a vicarious liability. They would be liable as parties to the fraud. In the result, this underlying reason for the outcome of the case is unsound. The company clearly was liable while the shareholders were not.

Apart from these strictures, it is to be noted that the speeches given in this case, while recognising that the company was a separate legal entity, did not view the claim as one by the member against the company, but as a claim by the member against all the other members, as if there was a partnership.[1] The significance of the predecessor of s 20 escaped them. As a result they did not recognise that, in terms thereof, a contract had been created between the company and its members. Nor did they display an awareness that the relationship between the members inter se was not that of a partnership, but arose from a statutory agreement created by this section, and having its own peculiar characteristics. Consequently they did not acknowledge that the contract between the members is also a statutory fiction which only comes into being on registration of the company and of the members.

Likewise, at the time of the exchanges between Gower and Hornby the existence of a contract between the members inter se, arising from the constitution, in terms of the relevant section of the English Companies Act, had not yet been fully recognised. The latter described it as old fashioned to speak of the memorandum and articles as a contract between the members inter se.[2] In the opinion of Gower, the relationship between the members inter se was controversial, and the fact that it was contractual was by no means accepted.[3] However, the issue had not yet been settled, by the case of Rayfield v Hands, in favour of the view that the constitution is a contract between the members inter se.[4] This would not, it is submitted, have altered their viewpoints. Although Gower did not express himself on the matter, Hornby said it was immaterial whether the constitution is a contract between the members or not.[5]

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1. Houldsworth's case supra 329.
2. Hornby J A : Houldsworth v City of Glasgow Bank (1956) 19 MLR 54 at 55 footnote 7.
3. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401; Rayfield v Hands - A postscript and A drop of Scotch (1958) 21 MLR 657
4. [1958] 2 All ER 194 ChD. See Chapter 32 et seq.
5. Hornby's article supra at 55 footnote 7.

3. South African law

3.1 A survey of the cases and academic writings

The proposition that a purchaser of shares, induced to purchase same by a fraudulent misrepresentation, may not retain the shares while claiming damages, was mentioned by De Villiers J A in Pathescope (Union) of S A Ltd v Mallinick.[1] In this case the plaintiff, a teacher in a Government school, applied in August 1922 for 100 shares in the defendant company which were duly allotted to her and paid for by her. In December 1925 she brought an action for rescission on the ground that she had been induced to apply for the shares by the misrepresentations of an agent of the defendant company. The plea was that the plaintiff had been aware of all the facts in 1922 and that, notwithstanding such knowledge, she had taken no steps until 1925 to have the contract rescinded and have her name deleted from the share register, and that, by reason of her delay, she was not now entitled to have the relief she claimed. The court a quo, construed the plea as one of estoppel, found that there had been a deliberate fraud practised on the plaintiff, of which the company became aware and gave judgment for the plaintiff presumably on the ground that such knowledge defeated the defence of estoppel.

The matter was taken on appeal to the Appellate Division where it was argued for the appellant that a shareholder must repudiate and take steps to have his name removed from the register as soon as the facts on which he relies come to his knowledge.[2] The reason for this, it was contended, was the peculiar nature of the contract to take shares which affected the interests of creditors and other shareholders. Therefore, it was said, more than mere repudiation was required.[3]

In his judgment De Villiers J A considered that the substantial defence to the action was the delay, in not having the contract rescinded, and in not having the plaintiff's name deleted from the share register.[4] However, he examined very closely the evidence as to whether the misrepresentation had been material. Although there had been a deliberate fraud, nevertheless the

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1. 1927 AD 292 at 301.
2. Ibid 293.
3. Ibid 293.
4. Ibid 296.

plaintiff entered the contract on a promise that if she was unwilling to take up the shares she need not do so. Accordingly the fraud was not, said the judge, the cause of the contract and so the plaintiff failed.[1] Consequently it was not necessary to consider the defence of delay. However the court a quo had construed the defence as one of estoppel and therefore the judge considered it advisable to consider the true nature of the defence.

In English law a purchaser of goods induced to buy by a fraudulent misrepresentation might elect to retain the goods and recover damages.[2] But, he said, apropos of English law, "the same principle does not apply to shares or stock in a joint stock company, for a person, induced by the fraud of the agents of a joint stock company to become a partner in that company, can bring no action for damages against the company whilst he remains in it; his only remedy is restitutio in integrum and rescission of the contract; and if that becomes impossible - by the winding-up of the company or by any other means - his action for damages is irrelevant and cannot be maintained". As authority for this proposition the judge referred to Houldsworth's case.[3]

There can be little doubt that this statement was obiter dictum. The issue was whether there had been an estoppel arising out of the plaintiff's delay. However, the words quoted above do not relate to the question of delay. An entirely different principle was raised, unrelated to the question of delay, namely whether the purchaser of shares could remain a member and claim damages. Immediately after interpolating this reference to Houldsworth's case, the judge returned to the question of delay, which he said could cause a purchaser to lose the right to rescind.[4] Then he turned to the error of the court a quo in construing the defence as one of estoppel. It was not, he said, a case of estoppel but of a praesumptio juris et jure, founded on the publicity of the register.[5]

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1. Ibid 300.
2. Ibid 301.
3. Ibidem.
4. Ibidem.
5. Ibid 303.

De Wet and Yeats consider that the rule that a person could abide by a contract and claim damages applied equally to a contract for the purchase of shares, as it did to all other contracts which were induced by fraud.[1] The proposition in Houldsworth's case that such a course of conduct was inconsistent with the rights of a shareholder was not, in their opinion, well-founded. In the judgment, they say, it was contended that the plaintiff in such action was bringing an action against all the shareholders and therefore against himself - a proposition which was inconsistent with the separate corporate existence of the company.

Cilliers and Benade noted that the statement that a person could claim damages and at the same time continue to hold the shares, because his continued membership was incompatible with litigition against the company, though historically explicable, negated the separate legal personality of the company.[2] The validity of the obiter dictum quoted above in the case of Pathescope (Union) of S A Ltd v Mallinick , was, in their view, doubtful.[3]

3.2 An assessment of this rule in South African law

It has been previously indicated that, even if the separate legal personality of the company would have been recognised in Houldsworth's case it would not of itself have enabled the judges to grant the relief claimed. Lord Selborne, for one, was aware of the company's separate existence.[4] Their problem was that they viewed the claim as lying, not against the company, but against the members and that the claim was inconsistent with the plaintiff's contract with the other shareholders.[5] The solution lay in two further steps, which the judges did not take. The first was to recognise that the claim rested on delict and that the relief claimed did not repudiate the contract, nor was it inconsistent with it. The second step was to recognise that the plaintiff had entered into contracts with both the company and the

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1. De Wet and Yeats 482 footnote (W).
2. Cilliers H S and Benade M L : Company Law (Second Edition Durban 1973) 132 footnote 18. In Cilliers Benade De Villiers this footnote is deleted.
3. 1927 AD 292 at 307.
4. Houldsworth's case supra 329.
5. Ibidem. See also the speech of Earl Cairns 325.

existing members. In the case of the company, this arose out of the activities of its agent, as well as out of the legal fiction created under the statute. The company was, on the facts, vicariously liable for the fraud of its agent. In the case of the shareholders, the contract arose solely out of the legal fiction which contained no mandate. On the facts the shareholders had given the agent no mandate. Consequently they could not be held vicariously liable for his fraud.

There are no relevant principles of South African law which justify the exception created by Houldsworth's case to the relief available to the victim of a fraud in the purchase of shares. This is so, even though the doctrine of the constitution as a contract has been taken over from English law. It is submitted that the case itself was wrongly decided, and that our courts are therefore, free to depart from it on principle.

4. Conclusion

Arising from this investigation into Houldsworth's case a conclusion may be drawn, it is submitted, that the agreement in the constitution is no more than a statutory fiction, which only comes into existence upon registration of the company and of the members as such from time to time.[1] Furthermore the scope of this statutory agreement is limited in the sense that rights and obligations not stated in the constitution or in the Act will not be readily implied therein. For example, the members in Houldsworth's case found that they had entered into an agreement with the new member due to the efforts of the agent, in this case the directors, who induced him to become a member.[2] Nevertheless, it has been submitted that they could not be held to have given the agent any mandate nor could they be vicariously liable for his conduct. The contractual relationship between the members arose under the statute. The new member had a claim against the company, but not against the existing members. Yet the existing members would have suffered indirectly as a result of the fraud of the company's agent, but for the winding-up, by the diminution

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1. See also Chapter 2 at 11.
2. See 108 above.

of the nett asset value of their shares, as a result of the company being obliged to pay damages.

The principle in Houldsworth's case, precluding, as it does, an action for damages without a rescission of membership, is certainly an obstacle to enforcement of rights in a company. It has been submitted that this principle is unsound and should not be followed or extended, either in English or in South African law. It follows that there is no reason why membership should be a bar to enforcing rights which arise outside the constitution. In chapter seven of this dissertation, which deals with the rule in Foss v Harbottle, the other side of the question arises, namely whether membership is a bar to enforcing rights which arise inside the constitution.

Prior thereto, attention will be given to the ultra vires doctrine insofar as it deals with the enforcement of rights arising from the constitution.

CHAPTER 6 - THE ULTRA VIRES DOCTRINE AND S 36 OF THE ACT

1. Introduction

That the memorandum and articles are a contract between the company and its members and between the members inter se, is a trite proposition at this stage of the development of company law. One aspect of that agreement is that the parties to it, the members and the company, agree that the company will have the capacity and powers set out in the memorandum as read with the Act. The constitution therefore determines the capacity of the company.[1]

Under the common law, the ultra vires doctrine declared that an act done on behalf of a company which was beyond its capacity was null and void. S 36 of the Act, however, states inter alia that no act of a company shall be void by reason only of the fact that the company was without capacity or power so to act.

The relevance of the ultra vires doctrine and of s 36 in regard to the concept of the company constitution as a contract, is that each in its own way affects the methods of upholding that contract.

The ultra vires doctrine is of English origin and has been taken over intact into South African law. S 36 is not to be found in English law, which has adopted another form of statutory relief. In England, s 9(1) of the European Communities Act provides that, in regard to persons dealing in good faith with a company, the powers of directors are deemed to be free of any limitation in the company's constitution.

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1. See Naude S J : Company Contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 at 319-320 and 326. In the view of this learned author the main business of a company would initially fall within the scope of the stated main object, but might change so that an unstated ancillary object may become the main object in terms of s 33(2). Therefore the fact that the memorandum was a contract "founded on rather thin ice." It is submitted, however, that these changes can only be brought about by the directors, acting in terms of their mandate in terms of the constitution. Therefore the constitution continues to determine the capacity of the company although it may no longer reflect it accurately.

Because the ultra vires doctrine has been taken into South African law unchanged, there is no need to deal with the subject first in English and then in South African law. Nor is there any advantage in dealing in any way with s 9(1) of the European Communities Act.

It is, therefore, proposed to set out the statutory arrangement under the earlier Companies Act, 46 of 1926 and the common law ultra vires doctrine. Then detailed attention will be given to s 36 of the Act in the context of the Act's new statutory arrangements. As there are no judicial pronouncements on the meaning of s 36 to date, any interpretation of that section remains to be considered by the courts. On the other hand, a number of writers have ventured their views on the interpretation of the section. In particular, Naude has written a perceptive analysis of s 36 which requires a careful study and assessment.[1] The views of the other academic writers will be referred to from time to time, in the context of Naude's views.

2. The old statutory arrangement and the common law

The ultra vires doctrine rested on the statutory arrangement of the Companies Act, 46 of 1926, which was repealed by the Act.[2] According to s 5 of Act 46 of 1926 the requisite number of persons, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration were entitled to form an incorporated company. S 6 and s 7 provided that the memorandum state the objects of the company. S 9 prohibited such a company from altering "the conditions" contained in its memorandum except in the cases, and in the mode, and to the extent for which provision was made in the said Act. S 17 provided for registration of the memorandum, and s 18 required the Registrar of Companies to certify that the company was incorporated, whereupon it became a body corporate, capable of exercising all the functions of an incorporated company, as specified, expressly or impliedly in the company's memorandum and articles and in the said Act. The articles were subordinate to the memorandum prescribing, as set out in s 12, s 13 and s 14, and the

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1. Naude S J : Company Contracts : the Effect of Section 36 of the new Act supra
2. What follows is a brief resumé of the words of Trollip J A in Quadrangel Investments v Witind Holdings Ltd 1975 (1) SA 572 (A) 579B-H. The case is also reported in the court a quo 1974 (3) SA 364 (W).

regulations for the internal management of the company. Subject to the provisions of this Act, and the conditions contained in the memorandum, the articles could in terms of s 15, be freely altered or added to by special resolution. Trollip J A described the memorandum under this Act as follows :

"Consequently, according to the Act, the memorandum is the constitution of the company; affirmatively it empowers the company to act within the provisions expressed or implied in its memorandum; negatively it forbids the company to do anything which is beyond or contrary to those provisions; ...".[1]

The essence of the ultra vires doctrine in regard to anything done by a company beyond its capacity was, said Trollip J A as follows:
"... if any such thing is done, whilst it would not be illegal, it would be null and void, as having been, in effect, prohibited by the Act; and it would therefore be incapable of validation by subsequent ratification by the shareholders even if they unanimously assent thereto. On the other hand any act or activity, contrary to the articles but within the ambit of the memorandum, is at worst merely voidable and can be validated by the shareholders ratifying it in the requisite manner."[2] That was the ultra vires doctrine as applied to registered companies. In English law, this doctrine was first authoritatively expounded by the House of Lords in Ashbury Railway Carriage and Iron Co v Riche, the locus classicus on the subject.[3]

It is submitted that, in Ashbury Railway's case, the ultra vires doctrine, which had previously been evolved by the courts in relation to companies incorporated by statute, was held for the first time to apply to companies registered under the Companies Acts. In this case, the company had limited objects, so that it was beyond the powers of the company to enter into the contract in question, namely to purchase a concession for constructing a railway in Belgium. This contract was therefore void.[4]

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1. Ibidem 579H (my deletion). This Act was the former Companies Act, 46 of 1926.
2. Ibidem 579H-580
3. (1875) LR 7 HL 653 at 670.
4. Ashbury Railway's case supra 672.

However, historically, registered companies such as the one in Ashbury Railway's case did not derive from companies incorporated by parliament, but were the successors of the former unincorporated companies, whose deeds of settlement merely limited the authority of the directors. These unincorporated companies were essentially large partnerships created by agreement with unlimited liability. Their successors, although they were registered companies, retained the same contractual characteristic: their constitution was a type of statutory agreement.[1] This remains true of the registered company to-day. Yet the courts imposed on them a doctrine created essentially for an entity incorporated by statute, namely the ultra vires doctrine.

To return to the statutory arrangement, it is submitted that the result thereof, outlined by Trollip J A in Quadrangle's case as set out above, was that the company did not have unlimited capacity.[2] It had the capacity set out in the memorandum, as read with the former Companies Act.[3] Its capacity was determined by the agreement contained in the constitution.

In terms of the ultra vires doctrine, acts of the company beyond that capacity were regarded as ultra vires the company.

The result of the ultra vires doctrine was that the agreement in the constitution defined the limits of the company's capacity and the ultra vires doctrine protected these limits. That this was so, is shown by the reasoning of Earl Cairns in Ashbury Railway's case.[4] Quoting the predecessor to s 20 of the English Companies Act, 1948, he said that the memorandum of association was to be a covenant in which every member agreed to observe the conditions of the memorandum, one of which was that the objects for which the company was established were the objects mentioned in the memorandum and that he would not only observe that, but would observe it subject to the provisions of the Act. The covenant was not merely that every member would observe the conditions upon which the company was established but that there would be no change in the objects and that included an undertaking that no object be

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1. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 903.
2. Quadrangle Investments v Witind Holdings Ltd 1975 (1) SA 572 (A) 579.
3. 46 of 1926.
4. Ashbury Railway Carriage and Iron Co v Riche supra 669.

pursued by the company except as was mentioned in the memorandum. This stated affirmatively "the ambit and extent" of the company's powers and negatively that nothing be done beyond that ambit.[1] Therefore a contract by the company which was beyond the objects in its memorandum, was beyond the company's powers and was void at its beginning because the company could not make the contract.[2] Such a contract was therefore wholly null and void and could not be ratified.[3]

A consequence of the fact that an ultra vires act was void, was that any contractual or other obligation, beyond a company's objects and not incidental thereto, was unenforceable.[4] Any of the parties to an ultra vires transaction could assert its invalidity. A member had an inherent right to seek an interdict to restrain a company or its directors from doing an act beyond the capacity of the company.

Another consequence was that each party was obliged to restore to the other what was received and if that was not possible, in South Africa an action on the ground of unjust enrichment was available.[5] Agents of the company which concluded a transaction beyond its capacity were liable to the company for damages suffered, though the court at its discretion might relieve directors and officers from liability. The member could intervene by means of a derivative action on behalf of the company, although the wrong was done to the company. This was so since an ultra vires act was a well recognised exception to the rule in Foss v Harbottle.[6]

Persons who contracted with the company, other than members who had contracted through the constitution, could easily be in an invidious position. The company was not bound unless, firstly, the contract fell within the scope of

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1. Ibid 670.
2. Ibid 672.
3. Ibid 673.
4. Cilliers Benade De Villiers 53.
5. Ibidem.
6. Edwards v Halliwell [1950] 2 All ER 1064 CA 1067A. See Chapter 7 at 160 et se

Hahlo 535 says that while the representative (or derivative) shareholders' action of the common law has not been abolished, it is likely to be replaced by proceedings under s 266. See Chapter 7 at 172-173.

the company's capacity, and secondly, the person acting on behalf of the company had the necessary authority to do so.[1] "According to the ultra vires doctrine, any contract outside the scope of the objects and thus exceeding the company's capacity was void;...".[1] "Moreover, since the objects clause appeared in a public document of the company, a third party was in terms of the doctrine of constructive notice deemed to have knowledge of it."[2]

As far as the authority of the person acting on behalf of the company was concerned, the law of agency provided the basic source of rules.[3] These were applied in conjunction with the doctrine of constructive notice mentioned above, and the Turquand rule , in terms of which the third party was not affected by, but was protected against internal irregularities such as the failure to comply with prerequisites for the exercise of powers on behalf of the company, as laid down in the articles.[4] The interplay of the company's lack of capacity on the authority of its agents was important: the authority of the person or organ to represent the company in transactions, could never exceed the capacity or powers of the company itself.[5]

In order to escape the consequences of an ultra vires act, it had become the practice to state the objects in the memorandum with such prolixity that it had become a ludicrous document.[6] In addition, as a result of the "independent objects clause", each object was considered an independent object. The result of these drafting techniques was to produce a cumbersome and very complicated document. Its effect was to defeat the ultra vires doctrine because it sought for a memorandum giving a company unrestricted objects. "As a result it had failed to protect third parties and in fact became a pitfall for the unwary."[7] The burden of interpreting the memorandum

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1. Naude S J : Company contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 (Naude's article).
2. Ibid 316.
3. Ibidem.
4. Ibid 317.
5. Ibid 318.
6. Van Wyk de Vries Commission 27.08-27.15.
7. Ibid 27.09(c) and (g) and the authorities therein quoted; Gower 87.

was beyond the layman so that it was a vexatious obstacle in the world of business. The operation of the ultra vires doctrine deprived companies of advantageous and profitable transactions. It rarely, if ever, operated to the advantage of the company and seldom to the advantage of third parties. The law remained uncertain, despite or because of the prolixity of objects and the independent objects clause. As regards the shareholder, in fact he had no ready remedy after a transaction had been declared void and the company had suffered loss.

3. S 36 of the Act

3.1 Introduction

This section reads as follows :

> "No act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact and, except as between the company and its members or directors, or as between its members and its directors, neither the company nor any other person may in any legal proceedings assert or rely upon any such lack of capacity or power or authority."

This section forms part of the statutory arrangement of the Act. Although this differs from that of Act 46 of 1926, which it replaces, the present statutory arrangement has for present purposes achieved much the same result.[1] This result is set out in detail by Cilliers Benade De Villiers.[2] For the present enquiry, the following salient features of this arrangement are to be noted. The company is incorporated as a body corporate which is capable of exercising all the functions of an incorporated company. The company's objects are stated, as is its purpose .[3] It has the capacity determined by the main object, as stated in the memorandum, as well as unlimited objects ancillary to the main object, except such as are excluded expressly in the memorandum.[4] It also has plenary powers, save those specifically excluded.[5]

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1. See s 32-33, s 56(1), s 63(1) and s 64.
2. At 54 et seq.
3. S 32-33 and s 52.
4. S 52(1) (c) (i) read with s 34.
5. S 34 read with s 52(1) (c) (ii) and with Schedule 2.

Opinions may and do differ on the interpretation of s 36, and no doubt pending the finality of judicial interpretation, such differences will continue.[1]

It is submitted that the leading article on this topic, which presents a most penetrating analysis of the section, is that of Naude.[2] It is proposed, therefore, to present his major propositions seriatim. It is then proposed to consider those aspects which go to the root of the present enquiry into the nature of the contract in the constitution, together with the views of other South African academic writers in regard thereto, and such submissions as seem appropriate, bearing in mind that this is a most complicated as well as an uncharted area of law.

3.2 Naude's theory

Naude outlined the traditional position with particular reference to the two requirements for the validity of a contract to which a company was a party, namely, that the contract fell within the scope of the company's capacity, and that the person acting on behalf of the company had the necessary authority to do so. He also set out the doctrine of constructive notice and the remedies available. He stressed that, in regard to the question of authority, the law of agency provided the basic source of rules, coupled with the doctrine of constructive notice and the Turquand rule. The requirement of capacity also had direct significance in regard to the question of authority since, authority could never exceed the power or capacity of the company itself.

In regard to the new position under s 36, three major topics received attention: the determination of a company's capacity and powers; the abolition of a company's capacity and powers as a requirement for a contract; and the question of preserving the authority of persons acting on behalf of a company, as a requirement for a contract.

In regard to the first, the determination of a company's capacity and powers, the position remained that a company did not have unlimited capacity or powers. Generally speaking, the validity of a third party's contract with a company was no longer affected by the latter's capacity or lack

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1. Naude's article supra 324.
   Cilliers Benade De Villiers 55-57.
2. Naude's article supra.

of it. One possible interpretation of the second part of the section was that the ultra vires doctrine had been preserved where the third party happened to be an insider. Hence the question of the capacity of the company remained of vital importance. For this reason the learned author gave considerable attention to the question.[1] The outcome of his exercise was that the company continued to have limited powers and capacity, whether it was a company registered under the new Act or an existing company. He then concluded as follows.

"In view of s 36, the extent of a company's capacity and powers has become either wholly or only partly irrelevant - depending on one's interpretation of that section - in determining whether that company incurred contractual liability."[2]

In regard to the second topic, the abolition of a company's capacity and powers as a requirement for a contract, the section provided that no act of a company was void etcetera.[2] Opinions might vary on the interpretation of this innovation.[3] In particular the view, that the phrase commencing with 'except' had the effect of preserving the traditional ultra vires doctrine in respect of contracts between a company and its directors or members, was known to be disputed.[4] This led to a possible distinction between a company's contracts with outsiders on the one hand and with insiders on the other, a useful distinction for the purposes of elucidation and discussion, although not necessarily a valid one.[4]

The validity of a contract with an outsider was clearly not affected by any lack of capacity or power on the part of the company. This was so, whether there was knowledge of this lack of capacity, or even collusion in respect thereof. The contract was no longer rendered void and furthermore neither the company nor the third party might in any legal proceedings assert it or rely on it.[5]

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1. Ibid 318-323. Naude's detailed presentation of this aspect is not relevant to the present enquiry.
2. Ibid 323.
3. Ibid 324.
4. Naude S J : Company contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 at 324 (Naude's article).
5. Ibidem.

The result was to destroy the doctrine of constructive notice, which became irrelevant. It served to encourage directors to ignore the company's main object altogether, and overprotected the third party, because it rendered his actual knowledge irrelevant.[1]

A member could seek an interdict in regard to matters beyond the company's capacity or powers but the theory justifying it had "virtually collapsed".[2] The basis had been that the proposed ultra vires act was an exception to the rule in Foss v Harbottle; "and it was an exception because an ultra vires act was void and could not be ratified by the members in general meeting". Now it was no longer void and ratification was irrelevant, so that the basis of the exception had disintegrated. Secondly, the argument that the member could act because the memorandum constituted a contract inter alia between every member and the company was on rather thin ice, because the memorandum no longer contained an accurate reflection of the company's capacity.[3]

Nevertheless a member could obtain an interdict, but the new basis was the last part of s 36 itself since, as between the company and its members or directors, the company's lack of capacity or power might be asserted or relied on in any legal proceedings. After the contract in question was concluded there was nothing a member could do to set it aside.[4]

The director's fiduciary duty not to act beyond the company's powers and capacity remained, as did his liability for damages, and in fact became far more significant since the company, being bound to the ultra vires contract, was in greater danger than previously of suffering loss. This extended the significance of the exception to the last part of s 36. Such a claim against the directors in question might arise in an action by the company, or as between the members claiming derivatively and the directors. A member might

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1. Ibid 325.
2. Ibidem.
3. Ibid 326.
4. Ibidem.

rely on s 266 to effect the institution of proceedings by the company itself or by a curator ad litem.[1]

It was an unacceptable proposition that the phrase, 'or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact' in s 36, meant that an outsider who contracted with the company had been relieved not only of the first traditional requirement for a valid company contract, but also of the second, namely, that the directors who acted on behalf of the company had to have the necessary authority.[2]

In regard to contracts with insiders, that is with directors or members of the same company, it was clear that in terms of the exception in the last part of s 36, either the company or that insider may in any legal proceedings assert or rely upon any lack of capacity or power on the part of the company for the purposes of the contract.[3]

For what purpose might this assertion be made? There were two views on this part of s 36.[3]

The first view was that the traditional ultra vires doctrine had been preserved in respect of company contracts with insiders only, and that therefore a member or a director or the company would therefore still be able to rely as against the other on the fact that an act beyond the capacity of the company was void. However, s 36 itself stated in the first part that no act of the company was void by reason only of the company's lack of capacity or power. The second part, which prohibited assertion of or reliance upon such lack of capacity was not a proviso to the basic provision in the first part but was complementary to it. Clearly the exception relating to the company, its members and directors, was an exception to this complementary prohibition. Therefore the basic provision that no ultra vires contracts were void applied to all contracts, with an outsider or an insider.[4] This meant that while no attack could be made on the validity of an ultra vires contract, members could rely on the company's lack of capacity or powers to obtain an interdict or claim compensation from the directors whose ultra vires acts caused loss to the company.

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1. Naude's article supra 326.
2. Ibid 327. The words underlined are set out by the learned author in italics. The reasons for his opinion were to be adduced later.
3. Ibidem.
4. Ibid 328.

Furthermore, to preserve the ultra vires doctrine for insiders, would place directors and members in the same position. However, while a director might be expected to know that he was acting beyond the company's capacity and powers, and therefore need not be protected, it would be most unfair towards members. Members were deemed to know the company's capacity and powers, in terms of the constructive notice doctrine, although they may well be unaware of the position. A few shares inherited or purchased in the company, would change their contractual rights towards the company. This interpretation could, therefore, not be supported.

The second view was that the ultra vires doctrine had been destroyed in respect of insiders as well, and that the exception giving insiders the right to assert or rely on the company's lack of capacity or powers, meant that members could seek an interdict and compensation.[1] The reasons for favouring this viewpoint were that in terms of s 36 no act was void by reason only of the company's lack of capacity or powers, and that this was an overriding proposition not subject to any exception. The section contained an additional prohibition, that against asserting the company's lack of capacity or powers, but to this there was an exception in favour of insiders. Consequently, while insiders could make this assertion, it could not alter the fact that the ultra vires act was no longer void. Therefore, insiders could only seek an interdict and damages. Furthermore, any distinction between insiders and outsiders for the purposes of the validity of an ultra vires contract with a company became meaningless, so that previous conclusions regarding outsiders applied to insiders, particularly the fact that the validity of the contract was unaffected by knowledge, and the destruction of the operation of constructive knowledge, and the availability of an interdict and a claim for compensation.

Nevertheless, this interpretation had inequitable implications. A director would be protected, in spite of his knowledge that he acted beyond his authority because of the company's lack of capacity or powers, and would nevertheless have a valid contract with his company. He, and the other directors, would be liable in damages.[2]

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1. Ibid 329.
2. Ibid 330.

In a word, therefore, s 36 had "effectively destroyed the first traditional requirement for a valid company contract, namely, that the company has to have the necessary capacity and powers."[1]

Naude then dealt with the third major topic, namely the preservation of the authority of a person acting on behalf of a company as a requirement for a contract.

The Van Wyk de Vries Commission was not interested in acts by directors in excess of their authority. On the other hand, s 36 provided inter alia that no act of a company would be void because the directors had no authority to perform that act on behalf of the company by reason only of the said fact.[2] This did not mean the abolition of the general requirement that the person acting on behalf of the company must have the necessary authority to do so. However, its meaning, and the reason for the insertion of this phrase was that, prior to the act, a company could not confer on the directors authority that exceeded its own capacity or powers. An ultra vires contract as a result was not binding, both because the company lacked capacity, and because the directors did not have the requisite authority precisely because of the company's lack of capacity. Under the new dispensation, since capacity was no longer relevant, every ultra vires contract would but for this phrase, have been open to attack on the ground that the directors' authority had been exceeded merely because the transaction was beyond the company's capacity or powers.[3] This, the second traditional requirement, still stood in the sense that where an act was within the company's capacity the authority requirement would also have to be fulfilled. If the act fell beyond the company's capacity or powers, the contract could no longer be attacked on the ground that the directors had no authority. (Presumably, this is because in terms of the section, a contract will not be void because of the absence of the directors' authority which is lacking by reason only of that fact.) This was so, although the legislature had preserved this requirement regarding the directors' authority. Therefore, an enquiry on this point should proceed on the assumption that the company had the necessary capacity and powers; if the company would

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1. Ibidem.
2. Ibid 331.
3. Ibid 332.

then be bound this conclusion was not affected by the fact that the capacity and power were in fact lacking. Since this general requirement remained, the law of agency continued to apply, in conjunction with the law of constructive notice and the Turquand rule, but without regard to the company's capacity or powers.[1] Where, however, the articles expressly restricted the director's powers, then a contract entered into on behalf of a company by the directors beyond its capacity with an outsider, would not be open to attack on the grounds of lack of capacity, in terms of s 36.[2] It would be possible to attack this contract on the basis of the directors' lack of authority, because this arose, not only because of the company's lack of capacity and powers, but also because their powers were expressly restricted in the articles. Therefore, unless the company in general meeting ratified the contract, it would not be bound.

This contract was ratifiable.[3] In the past, ratification was possible only if the person who had exceeded his authority did not act beyond the scope of the company's capacity. Now that capacity and powers no longer affected persons contracting with the company, ratification was possible where the agents had exceeded their authority, irrespective of whether the contract was intra vires the company. Such a ratification was effective vis-à-vis the third party, but it was arguable that a member could obtain an interdict against ratification where the act fell beyond the company's capacity or powers.

Naude concluded his learned article with the following submissions:[4]

(a) it was no longer a requirement for a valid company contract that the company had to have the necessary capacity or powers, whether the other party was an insider or an outsider.

(b) the person representing the company still had to have the necessary authority, which could exceed the company's capacity and powers. Therefore the traditional link between company capacity and directors' powers had been broken, certainly

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1. Ibid 333.
2. Ibid 334.
3. Ibidem.
4. Ibid 335.

in respect of the directors acting as a board.[1] An individual agent's acts could, however, still be challenged for lack of authority because his authority exceeded the company's capacity or powers. It was to be hoped that the courts would interpret s 36 so that the phrase "directors" meant not only the board, but also individual directors or any other agent, so that these could also act beyond the capacity of the company if so authorised. Such authority could be actual or ostensible and, therefore, the principles of estoppel would apply, as also the possibility of ratification. The Turquand rule and the doctrine of constructive notice would also continue to operate, the latter with unfortunate results.

On a practical level, the enquiry as to the agent's authority would proceed on the assumption that the company itself had the necessary capacity and powers.[2]

Finally, although the term ultra vires had been used to describe contraventions of statutory provisions (such as s 37, s 38 and s 226) or a common law rule (such as that dividends may not be paid out of capital) s 36 was not designed to apply to these.[3]

In dealing with Naude's views, it is proposed to take for granted those on the determination of a company's capacity and powers, accepting as valid his conclusion that the company continues to have only a limited capacity, as in the past.[4] Consequently, there can still be acts beyond the capacity or powers of the company. The first question which arises, therefore, is whether s 36 has abolished the ultra vires doctrine entirely or only partially.

3.3 The abolition of the ultra vires doctrine

Naude set out two views of the first part of s 36. The first was that the ultra vires doctrine in the traditional sense had been preserved in respect of company contracts with insiders only. The second was that the ultra vires doctrine had been destroyed in respect of insiders as well. In rejecting the first view in favour of the second, Naude advanced the following argument.

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1. Naude's article supra 335.
2. Ibid 336.
3. Ibidem.
4. Ibid 323.

On the wording of s 36 itself the crucial first part stated that 'no act shall be void' by reason only of the company's lack of capacity or power.[1] The second part which prohibited the assertion of or reliance on such lack of capacity in legal proceedings, was not a proviso to the basic provision in the first part, but was complementary to it. The exception relating to the company, its members and directors was an exception to this complementary prohibition. Therefore the basic provision that no ultra vires contract shall be void, applied to all ultra vires contracts, irrespective of whether the third party was an insider or an outsider. As Naude says, to preserve the ultra vires doctrine in respect of insiders would have startling consequences.[2]

Cilliers Benade De Villiers tend to favour the view that the ultra vires doctrine was abolished entirely. They recognise, however, the force of the other point of view, namely that, as s 36 must be taken to have amended the common law strictly within the limits of the wording of the section, the contract of a member with his company would in all respects be regulated by the common law doctrine of ultra vires.[3]

Hahlo also takes the same view, namely that it was well arguable that as regards contracts, the ultra vires rule had been abolished in respect of insiders as well.[4] On the other hand, it followed from the wording of s 36, that ultra vires had not been abolished as regards internal company affairs.

Henochsberg also regards the doctrine of ultra vires as remaining an important part of the law relating to companies, since members and directors could in terms of s 36 itself claim damages or an interdict.[5]

Gibson says that the effect of the section was to abolish the doctrine of ultra vires totally as far as third parties were concerned. As to the position regarding the abolition of the doctrine in regard to insiders, he makes no comment.[6]

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1. Naude S J : Company Contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 at 327-328 (Naude's article).
2. Ibidem. As Naude says, it might be in order in regard to directors, but its operation in regard to members would be most unfair. A member may find his contract void due to a few forgotten shares, acquired years previously.
3. Cilliers Benade De Villiers 57.
4. Hahlo 78.
5. Henochsberg 70.
6. Gibson 304.

It is submitted that the question turns purely on a literal construction of the section. "No act is void" is clear and unequivocal. It brooks of no exception. It is submitted, therefore, that the ultra vires doctrine has been abolished entirely.

The Van Wyk De Vries Commission rejects the suggestion of abolishing the ultra vires doctrine entirely, preferring to protect third parties and to preserve the role of the ultra vires doctrine as far as shareholders are concerned.[1] Nevertheless, having regard solely to the literal meaning of the section, it is clear that no act is void by reason only of the fact that the company was without capacity or powers.[2] Therefore, since the essence of the ultra vires doctrine is that any act beyond the capacity of the company is void, and since such acts are no longer void, the effect of s 36 is to destroy the doctrine entirely.[3]

In opposing this conclusion, it may be argued that the ultra vires doctrine has a double effect. Firstly, the company may not act beyond its capacity or powers, and if it does so act, any such act is void. Secondly, it means that therefore the directors have no authority, It is submitted, however, that the second effect is not a portion of the ultra vires doctrine, but flows out of the law of agency, being based on the simple fact that an agent cannot be invested with greater authority than the capacity of its principal. Thus, although the ultra vires doctrine has been abolished, in the sense that no act beyond the capacity of the company is any longer void, the company remains with a limited capacity and the agency proposition remains the same, namely that the company cannot give the agent authority to do acts beyond the company's capacity.

It is in order to deal with this situation that the legislature, it is submitted, enacted the second main provision of s 36, namely that neither the company nor any other person may in any legal proceedings assert or rely upon any such lack of capacity or of power or authority. To this there is one exception, namely that as between the company and its members or directors, or

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1. S 27.22 (e) ; s 27.24.
2. Naude's article supra 328.
3. See Ashbury Railway Carriage and Iron Co v Riche (1875) LR 7 HL 653 at 670.

as between its members and its directors, such assertions may be made. It would be incorrect to read this as re-instating the ultra vires doctrine in regard to insiders, bearing in mind the overriding effect of the first proposition in s 36, namely that no act is void.

It is submitted by Henochsberg that an act would not be protected by s 36 where the fact that it is ultra vires the company was known to the other party. The other party's knowledge of this constituted an additional factor and the voidness from which s 36 would otherwise protect the act was then not by reason only that the company was without capacity or power so to act.[1]

Cilliers Benade De Villiers, on the other hand, express the view that even when the outsider knew full well at the time of concluding the contract that it was beyond the capacity of the company to enter into that contract, the contract would still be binding and neither party would be able to assert the company's lack of capacity in any legal proceedings.[2]

In supporting the later view , two submissions are made. Firstly, it seems unlikely that the legislature intended the void act to come into existence solely because some third party had actual knowledge that it was ultra vires the company's capacity or powers. There is certainly nothing in the literal wording or meaning of the section to support such a conclusion. Secondly, according to the doctrine of constructive notice, all persons dealing with the company are deemed to have knowledge of its capacity or powers. It is submitted that on the contrary and, as Naude says, the section renders any notice, whether actual or constructive, irrelevant for this purpose.[3]

3.4 The company's capacity

The second major question raised by Naude was whether s 36 has abolished the requirement for a valid company contract, namely that the company itself has the necessary capacity and powers to enter into it, the point of departure being that a company does not have unlimited capacity or powers.[4]

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1. Henochsberg 71. See the criticism of this view by Naude S J : Henochsberg on the Companies Act (1976) 39 THRHR 95-96; also Naude's article supra 324.
2. Cilliers Benade De Villiers 57.
3. Naude S J : Company Contracts: the Effect of Section 36 of the new Act (1974) 91 SALJ 315 (Naude's article) 325.
4. Ibid 323.

The first main proposition of s 36 declares that no act of a company is void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact.

Since such an act is no longer void, does it follow that the company need not have the necessary capacity, having regard to s 36 ?

Henochsberg's view is that neither the company itself, nor those dealing with it, could now resile from a transaction merely on the ground that it was beyond the powers of the company to enter into such transaction.[1]

Gibson's view is that a third party could hold a company bound by a contract made with him by a director on behalf of a company where the performance required by the contract fell outside the capacity of the company.[2]

Cilliers Benade De Villiers hold the view that in terms of s 36 such an act was not void, and since no one could rely on the company's lack of capacity or the directors' lack of authority on that ground, consequently such acts were as valid and enforceable as acts within the company's capacity.[3]

In Naude's opinion, in view of s 36, the extent of a company's capacity and powers had become either wholly irrelevant or only partly relevant - depending on one's interpretation of that section - in determining whether that company incurred contractual liability.[4] In the contract with outsiders, the company's capacity and powers did not come into the picture.[5] The contract could not be successfully attacked on this ground. The lack of capacity or power did not render the contract void, and, furthermore, neither the company nor the third party could in any legal proceedings assert or rely on it.[6]

In the contract with insiders, either the company or the insider could in any legal proceedings assert or rely on such lack of capacity or power.[7]

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1. Henochsberg 70.
2. Gibson 304.
3. Cilliers Benade De Villiers 56.
4. Naude's article supra 323 and 335.
5. Ibid 324.
6. Ibid 325.
7. Ibid 327.

In Naude's opinion, the only purposes for which this assertion could be made were an action by the member seeking an interdict restraining the company and its directors from acting beyond the company's capacity or powers, or an action by the company or initiated by the member, seeking compensation against a director whose acts beyond the company's capacity or powers had caused the company loss.[1]

Consequently any distinction between insiders and outsiders for the purposes of the validity of an ultra vires contract with a company became meaningless.[2] Therefore s 36 had effectively destroyed the requirement for a valid company contract, namely that the company had to have the necessary capacity and powers to conclude that contract.[3] Furthermore, in regard to acts beyond the directors' authority, which also fell beyond the company's capacity or powers, this lack of capacity was not a ground for attacking the directors' lack of authority.[4] The enquiry would proceed on the assumption that the company had the necessary capacity or powers.[5]

This then is Naude's answer to the second major question which he raised in his article. It is Naude's view that s 36 had abolished the requirement for a valid company contract, namely that the company itself had to have the necessary capacity and powers to enter into it. It is submitted that this view rests on two assumptions. The first is that because acts beyond the capacity and powers of the company are no longer void, therefore they are ipso facto binding on the company. The second is that the company's capacity is irrelevant because it cannot be asserted.

Dealing with the first assumption in relation to the company's capacity, it is submitted that several difficulties arise, both in regard to the assumption that acts which are not void are binding, and in regard to the conclusion that the company itself need not have the necessary capacity.

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1. Naude's article supra 329.
2. Ibidem.
3. Ibid 330 and 335.
4. Ibid 332.
5. Ibidem.

The first difficulty is that, in effect, the company has the necessary capacity and powers, which in turn leads to the conclusion that the company is endowed with unlimited powers. Yet this contradicts Naude's first conclusion, namely that a company, in terms of s 36, has only limited capacity or powers.[1]

The second difficulty is that if capacity were truly irrelevant, it is submitted that the legislature would not have framed s 36 in its present form. It would simply have declared that the company has unlimited capacity. Instead, the legislature enacted that no act shall be void by reason only of the fact that the company was without capacity or power so to act. These words themselves imply of necessity that the company may be "without capacity or power so to act".

The third difficulty is that the words "no act shall be void" were intended to abolish the ultra vires doctrine, which held that acts beyond the capacity of a company were void. This meant that at common law such acts were a nullity, non-existent in law.[2] In terms of s 36 it is submitted, such acts are no longer legally non-existent. Henceforth, such acts do exist legally and would be capable of being adopted and ratified by the company if it had the capacity or powers.[3]

The fourth difficulty is that it seems to be inconsistent to assume that the company's capacity or powers are sufficient for any particular purpose (or are unlimited), so that the act in question is valid and binding, while at the same time arguing that the directors who do the act for the company are liable in damages for acting beyond the company's capacity or powers. By the same token there seems to be no grounds for permitting an interdict against the company in respect of an act beyond its capacity or powers, if when it has been concluded, it is to be regarded as valid and binding, and it will be assumed that the company had the necessary capacity and powers.

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1. Naude's article supra 323. See above at 129.
2. See Bell Houses Ltd v City Wall Properties Ltd[1965] 3 All ER 427 QBD 435F-G.
3. It is proposed to return to this question below in dealing with the directors' lack of authority as a result of the company's lack of capacity or powers. See below at 138 et seq.

The fifth difficulty is that it is necessary to argue that the phrase, commencing with the words "no act shall be void", means that the act is binding on the company. However, this phrase merely asserts the negative, namely that such an act is not void. It does not assert the positive, namely that such an act is binding on the company, as if it had the necessary capacity or powers.

It is therefore submitted that although acts which are beyond the capacity or powers of the company are not void, they are not ipso facto binding on the company.

However, Naude's view regarding the company's capacity, mentioned above, rests on two assumptions. Having dealt with the first, it is proposed to deal with the second, namely that capacity is irrelevant because it cannot be asserted. The process of reasoning is, it is submitted, the other way around. The first question is whether the company had the requisite capacity. If it did, caedit questio as far as s 36 is concerned, although an enquiry might ensue on ordinary principles of agency on the directors' mandate. If the company did not have the capacity, then, in terms of the first provision, the act is no longer void. Capacity remains relevant in regard to the authority of the company's representatives, who cannot have authority beyond the capacity of the company.

At this stage the second basic provision comes into force. In the outsider situation, lack of capacity and lack of authority for that reason, may not be asserted or relied upon, because of the second provision. In the insider situation, the enquiry is the same and these questions remain relevant. In this case, lack of capacity and authority may be asserted or relied on because of the exception to the second provision.

In both situations, the company would, but for the second provision, not be bound if its directors lacked authority as a result of the company's lack of capacity. It is submitted that this is the reason why the legislature felt obliged to regulate when these matters may, and when they may not be asserted or relied upon.

An argument in favour of this view is the policy behind the Act which is, it is submitted, to uphold the contract embodied in the constitution. The

Act itself, in s 65(2), declares that this contract is binding. To disregard the limits on the company's capacity or powers and the directors' lack of authority for this reason is, in essence, to argue that although the company and its members have agreed to limit the capacity of the company, and thereby also to limit the authority of its directors, nevertheless such agreed limits are to be ignored. Both the agreement embodied in the constitution and the statutory arrangement of the Act, it is submitted, seek to circumscribe the capacity and powers of the company and the authority of its directors by reference to the agreement embodied in the constitution.

As Gibson notes, the effect of s 65(2) is that there is a contract between the members and the company in terms of the memorandum and articles and "there is no doubt a duty on the directors to conduct the affairs of the company on the basis of that contract."[1]

Support for this conclusion is to be found in the wording of s 36. If capacity was irrelevant, or if the enquiry into the directors' authority proceeded on the assumption that the company had the necessary capacity, there would be no need for the second main proposition of s 36. In other words, there would be no need to provide that neither the company nor any other person may in any legal proceedings assert or rely on any such lack of capacity or power or authority. Such an assertion would be bad in law as conflicting with the implied meaning of s 36, namely that all acts are presumed to be within the company's capacity.

Furthermore, there would be no need for the exception to the second main proposition. There would be no need to draw a distinction between insiders and outsiders, giving the former the right to assert a lack of capacity, while depriving the latter of this right. Clearly there is such a distinction, and as clearly, the insider may make this assertion.

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1. Gibson 305.

3.5 The agent's authority

The third major question raised by Naude was whether s 36 has preserved the agent's authority as a requirement for a valid company contract. This assumes considerable importance once an ultra vires act is no longer void. Under the common law an ultra vires act did not bind the company for two reasons, namely lack of company capacity, as well as absence of authority on the part of the directors to perform an ultra vires act for the company.[1]

Cilliers Benade De Villiers state that an act which the directors had no power to perform for the reason that the act fell beyond the company's capacity or power was in terms of s 36 not void in terms of the main provision. However in terms thereof, neither the company nor any other person might rely in any legal proceedings on the director's lack of authority as a result thereof.[2] S 36, however, expressly provided that this did not operate in the insider situation.

Henochsberg considers that the words in s 36 " or because the directors had no authority ... by reason only of the said fact" appear to be words of supererogation. If the company lacked the capacity or power to perform an act, a fortiori the directors lacked such capacity or power.[3]

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1. Naude's article supra 331-332.
2. Cilliers Benade De Villiers 56.
3. Henochsberg 72.

Gibson's view is that the section in referring to a director's lack of authority is concerned only with such a lack of authority because it is ultra vires the company. In other words a third party could hold a company bound by a contract made with him by a director on behalf of a company where the performance required by the contract fell outside the capacity of the company.[1] But of course, a director could have no actual authority to perform an act which was beyond the company's capacity. The authority could only be ostensible or deemed to arise by virtue of an extensive interpretation of s 36 - an interpretation which was not justified by the wording of the section.[2] It would not however appear, despite the use of the word 'authority' in s 36, that the question of a director's authority was irrelevant. The director's authority remained an issue to be determined in accordance with the principles of the law of agency.[3]

Under the new dispensation, the absence of authority as a result of the company's lack of capacity would, says Naude, become of practical importance.[4] The fact that an act was beyond the capacity or powers of the company now had no effect on third parties and the validity of their contracts with the company. Therefore, every ultra vires contract would still be open to attack on the ground that the directors' authority had been exceeded merely because the transaction was beyond the company's capacity or powers.[5] Hence the need to insert the phrase in s 36, forming part of the first main provision thereof, namely that no act is void because of the directors' lack of authority by reason only of the company's lack of capacity. It is submitted that, although Henochsberg[6] dismisses this phrase as no more than words of supererogation, Naude's explanation set out above is valid.[7] Henochsberg's view is that, if the company lacks the power or the capacity to perform an act, a fortiori the directors lack such capacity.[8] True, but the act is also beyond the authority of the directors because it is beyond the capacity of the company. It is,

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1. Gibson 304.
2. Ibid 305.
3. Ibidem.
4. Naude's article 332.
5. Ibidem.
6. Henochsberg 72.
7. Naude's article supra 332.
8. Henochsberg 72.

therefore, necessary for the phrase to appear in the section.

In evaluating the effect of this phrase in s 36 Naude stresses that s 36 inter alia provided that no act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact.[1] While this did not abolish the general requirement that the person acting on behalf of the company must have the necessary authority to do so, the mere fact that the act fell beyond the company's capacity and powers no longer meant that the contract could be attacked on the ground that the directors had no authority.[2] The legislature having preserved the requirement that the directors must have the necessary authority, the practical effect would be that the enquiry as to this authority had to proceed on the basis that the company had the necessary capacity and powers.[3]

It is submitted that, to all intents and purposes, the practical effect of this is that the company's lack of capacity or powers is irrelevant in examining the authority of its directors or other agents.

The crux of Naude's viewpoint, it is submitted, is that no act is, in terms of s 36, void because the directors had no authority to perform that act on behalf of the company, by reason only of the fact that the company was without capacity or power so to act.[4] Therefore, so the reasoning seems to proceed, such acts are incapable of being avoided or set aside, because the end result of such a process would be to render such acts void, whereas s 36 expressly states that no such act is void.

It is submitted that this line of reasoning puts a very wide meaning on the word "void". It means not merely a nullity ab initio, an act which is non existent in law.[5] It also covers an act which, although unauthorised,

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1. Naude's article 331. The words underlined are italicised by the author.
2. Ibid 332.
3. Ibidem.
4. Ibid.
5. This apt description of an ultra vires act is per Mocatta J in Bell Houses Ltd v City Wall Properties Ltd [1965] 3 All ER 427 QBD 435F-G.

would otherwise be valid in the sense that it could be adopted and ratified by the principal, so as to create a binding contract between the principal and the third party, with whom the agent concluded the unauthorised agreement in the first place. The latter meaning clearly alters the law of agency.

Was this the intention of the legislature? On a literal interpretation of the section it must be conceded that "void" could carry both meanings.

It is however, "a well known canon of construction that we cannot infer that a statute intends to alter the common law."[1] Such a result, it is submitted, must have been clearly intended by the legislature.

Cilliers Benade De Villiers, in a slightly different context, express the view that s 36 must be taken to have amended the common law strictly within the wording of the section.[2]

On the one hand, it is clear that the purpose of s 36 is to alter the common law in respect of the ultra vires doctrine.[3] On the other hand, it is submitted that the intention of the legislature in enacting s 36 was not to alter the common law of agency more than needs be. Furthermore, in construing s 36, in such a way as to restrict the extent to which it amended the common law, it is submitted that it leaves the law of agency intact, save in one respect only. That respect is that, except in the insider situation, neither the company nor any other person may in any legal proceedings assert or rely upon any lack of authority arising only from the company's lack of capacity or powers.

It is submitted that to argue that the section renders acts which are beyond the company's capacity or powers ipso facto binding on the company, although the agent lacked the requisite authority, only because of the company's lack of capacity or powers, is to alter the common law of agency in an important respect. It is proposed, at this stage, to outline the common law position of the principal whose agent acts beyond his authority. This will serve, it is submitted, to clarify the position of the company on whose behalf acts are

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1. Casserley v Stubbs 1916 TPD 310 at 312. See also Steyn 102-106.
2. Cilliers Benade De Villiers 57.
3. Van Wyk de Vries Commission 41.

purported to be done, which acts are beyond its capacity or powers. Under the ultra vires doctrine such acts were void. S 36 expressly states that such acts are not void. The question as to what they are, since they are not void, is to be answered, it is submitted, in the common law of agency.

Kerr states that "the general rule is that if a person acts without another's express or implied or residual authority he 'cannot place under any obligation the person in whose name he does any business of whatever nature'".[1]

De Villiers and Mackintosh state the same proposition as follows:[2] "No act of an agent which falls outside his actual or ostensible authority, which has not been ratified, and which has not unjustly enriched the principal, is binding on the principal with respect to third persons, even though it was done professedly and actually on his behalf (unless it may be brought within the principle of negotiorum gestio)."

The learned authors quote two authorities in support of this principle. The first is Gompels v Skodawerke of Prague.[3] It was there stated by Greenberg J P that the principal's liability in contract depends on actual authority. The second is Harris Clifford (Rhodesia) Ltd v Todd N O.[4] The judge in this matter stated the principle as follows. "It is clear that in contract the principal's liability to third parties for the acts of his agent depends either upon the agent's actual authority, express or implied, or upon the agent's ostensible authority, that is, in consequence of a holding-out and, in such a case, there is said to be an agency by estoppel."[5]

It is submitted that, on these authorities, acts of an agent which are not actually or ostensibly authorised do not bind the principal. On the other hand, the principal may adopt or ratify such acts.[6] There is also the possibility that the principal who finds that his authority has been exceeded by his agent may repudiate liability. The agent who acts on behalf of a principal beyond his principal's authority, is liable to the third party on a

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1. Kerr 66 and the authorities therein quoted.
2. De Villiers and Mackintosh 213.
3. 1942 TPD 167 at 171.
4. 1955(3) SA 302(SR).
5. Ibid 303F-G.
6. Kerr 66; De Villiers and Mackintosh 213; Gompels v Skodawerke of Prague supra; Harris Clifford (Rhodesia) Ltd v Todd N O supra.

breach of his warranty of authority.[1]

On the basis of these authorities, it seems clear that an act on behalf of the company which act is beyond its capacity or powers, but which is not void, having regard to the first main provision of s 36, is not binding on the company at common law. This does not differ from Naude's view of the common law, prior to the promulgation of s 36, namely that "the authority of the person or organ to represent the company could obviously never exceed the capacity or powers of the company itself".[2] It follows, it is submitted, that the principal, in this case the company, could not be bound by such acts. To argue that, because of s 36, such an act becomes binding on the company, it has been submitted, is to alter the common law of agency, as outlined above.

Such an alteration is not apparent from the words of s 36 which states no more than that acts beyond the capacity or powers of the company are not void. It is submitted that this results in such an act being legally in existence, but not ipso facto binding on the company. What then is the legal effect of such an act, as far as the company is concerned? At common law the company's right to adopt and ratify such an act is different from that of a natural persona. Since the company lacks the capacity or power to do that act, it cannot ratify the agent's unauthorised act on its behalf.[3] Can it repudiate the act? To do so the company will perforce have to rely on its lack of capacity or powers. It cannot assert that such an act is void for this reason. It would but for s 36, assert or rely on the fact that the directors had no authority to perform that act on behalf of the company by reason only of its lack of capacity or powers.[4]

At this stage the second main provision of s 36 comes into play, serving to alter radically the common law position set out above. Although the contract is not binding on the company at common law, neither the company nor any other person may, in any legal proceedings, assert or rely on any such lack of capacity or power or authority, except as between the company and its

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1. Blower v Van Noorden 1909 TS 890 at 899.
2. Naude S J : Company Contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 (Naude's article) 318.
3. If it purported to ratify such an act, this would, it is submitted, give rise to remedies by the insiders. See 145 below et seq.
4. Naude's article supra 318.

members or directors. The result, although the contract is not binding on the company, is the same as if it were, a result, it is submitted, which arises solely by virtue of the provisions of s 36, which produces an unassailable transaction, despite the company's lack of capacity or the directors' lack of authority arising solely as a consequence thereof. It is for this reason that, in the outsider situation, there is no way in which the company may cancel the transaction nor any need to ratify it.

On the other hand in the exceptional position, that is, in the insider situation, the second main provision does not apply. The act which is unauthorised, because of the lack of the company's capacity or powers, remains unauthorised, and what is more, the insiders and the company may assert or rely on such lack of capacity or power or authority.

Their right to do so arises under the common law of agency, and s 36 does not deprive them of this right.

To conclude, therefore, it is submitted that s 36 has preserved the agent's authority as a requirement for a valid company contract. However, an enquiry into the agent's authority does not proceed, it is submitted, on the basis that the company had the necessary capacity and powers. On the contrary, the assumption is that the company has a limited capacity and powers, and that the common law of agency remains unaltered, save where an alteration is expressly provided for by s 36, or is a necessary implication from its words. Consequently in the outsider situation, an act beyond the capacity or powers of the company remains beyond the authority of its agents but, since this cannot be asserted or relied on, the result is an unassailable transaction, despite the company's lack of capacity or the directors' lack of authority solely as a consequence thereof. In the insider position the common law prevails, the act remains beyond the capacity or powers of the company and the directors' lack of authority as a consequence thereof, and the insiders may assert or rely on this.

For what purpose may this assertion be made in the insider situation? Is it confined to interdicts and claims for compensation, or does it include claims to set such an unauthorised agreement aside ? Is the company, on the other hand, entitled to ratify the act ? These questions lead to a further major aspect of s 36, namely the remedies available in this exceptional situation,

the theoretical basis for such remedies, and the rights of various insiders, particularly the members, to enforce such remedies; and the question of ratification by the company.

3.6 The insider's remedies

Naude states that the member could not have an agreement between the company and the outsider set aside, either on the ground that the company lacked the requisite capacity, or that the directors lacked the requisite authority as a result only of the lack of the company's capacity.[1] The member could, however, seek an interdict preventing the company from entering into this agreement with the outsider, although the theory justifying it had "virtually collapsed."[2] After it was concluded, the member could do nothing to have the agreement set aside. At this stage, an action would lie against the directors for damages in an action by the company or as between the members claiming derivatively and the directors.[3]

In regard to contracts between the company and insiders, that is, with directors or members of the same company, the contract could no longer be attacked.[4] All that the member could do was, as in the outsider situation, to seek an interdict before the agreement in question was concluded, or damages from the other directors, after the agreement was concluded.

Cilliers Benade De Villiers note that a member may rely as against the other insiders on the fact that an act beyond the capacity of the company was in breach of the memorandum.[5] Members (in their capacity as such) would still be able to assert among themselves and against the company the contract between them as contained in the memorandum. An injunction would be appropriate before the company concluded any contracts with third parties beyond its capacity or powers. Thereafter the company would be powerless to resile from the contract with the third party, and the members could not compel it to do so. The members

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1. Naude's article supra 324 and 329.
2. Ibid 325 and 329.
3. Ibid 329.
4. Ibid 329-330 and 335.
5. Cilliers Benade De Villiers 56-57.

could however proceed against the directors personally for acting beyond their authority and in breach of their fiduciary duties.[1]

Hahlo expresses the view that shareholders may still apply to court for an interdict if the directors propose a course of action beyond the company's main object or otherwise ultra vires.[2]

Henochsberg likewise is of the opinion that an individual shareholder may bring proceedings to restrain the company from committing an ultra vires act before it is done.[3]

Gibson, after noting that there was a contract between the members and the company in terms of the memorandum and articles, as provided for in terms of s 65(2) of the Act, asks what remedy the member had where the directors guided the company into an ultra vires contract.[4] For practical purposes, the right to an interdict was illusory. It could only be exercised before the company was bound in contract. Once the contract was concluded with a third party, whether or not it was ultra vires, a member could not prevent the performance of the contract. Even a claim by the third party for specific performance could not be contested. However, s 36 envisaged that in some legal proceedings, that is as between the company and its members or directors, or as between its members and its directors, a party to the proceedings could assert or rely on the lack of capacity of the company. The remedy contemplated was that set out in s 266, in terms of which a member could initiate proceedings on behalf of a company as a result of 'any wrong, breach of trust or breach of faith' committed by that director. Whether this included an ultra vires contract was not entirely clear. In addition, although s 36 reserved the right of a member to assert or rely on ultra vires as against the company, proceedings under s 252 were dependent on acts which were 'unfairly prejudicial, unjust or inequitable', and not on any question of ultra vires.

It is now proposed to offer several submissions on this subject.

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1. Cilliers Benade De Villiers 56-57.
2. Hahlo 78.
3. Henochsberg 72.
4. Gibson 305-308.

The member's rights of recourse in respect of acts beyond the capacity of the company are, it is submitted, threefold : the member may seek an interdict restraining the company from acting beyond its capacity; he can call on the company to seek compensation against a director who causes the company to act beyond its capacity; and he may, in the insider situation, call on the company to set aside any act beyond its capacity. He may, in the latter two instances, initiate the proceedings himself in a derivative action on behalf of the company, either under the common law or under s 266 of the Act.

The member's right to seek an interdict against the company or compensation against a director who causes the company to enter into an agreement beyond its capacity, is not controversial. However, a possible defence to such an action falls to be considered, namely whether such transaction or the wrong committed by the director, in acting outside the company's capacity or his authority, is capable of being ratified by the company. If this is possible, neither the interdict nor the damages action could be entertained, at least until the matter is referred to the members.[1] If there is a ratification, then neither an interdict nor damages would be possible, on ordinary principles of agency.

The member's right to have the contract set aside in the insider situation, and the question of ratification are closely linked to each other, and to the limitations on the member's rights to act in terms of the rule in Foss v Harbottle.

In regard to the member's right to have the contract set aside in the insider situation, the fundamentals have already been postulated, namely that, although the act beyond the company's capacity or powers is no longer void, it continues to be ultra vires and beyond the authority of the directors for that reason. Furthermore s 36 has not altered the common law of agency in the insider situation, so that such an unauthorised act, while not being void, is also not binding on the company, unless the company ratifies it.[2]

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1. This view is based on the analogy of Bamford v Bamford [1969] 1 All ER 969 CA where an act by the directors, which was intra vires the company but voidable due to the directors' improper motives, was capable of being ratified by the shareholders in general meeting by ordinary resolution, after full disclosure by the directors. (The case is also reported at [1968] 2 All ER 655 ChD.)

2. That this is the common law of agency, and that it has not been altered by s 36, save in this important respect has been submitted above at 141 et seq.

Where the act is within its powers and capacity, the company is entitled to adopt and ratify it, or to repudiate it.[1] Where the act is beyond the capacity or powers of the company, it is submitted that it is not entitled, at common law, to adopt or ratify it. On the contrary, it ought to repudiate the act as ultra vires, and is not precluded from doing so in the insider situation, having regard to s 36. If the company, in an insider situation, purports to adopt and ratify an act beyond its capacity or powers, the member, it is submitted, is entitled to call on the company to have it set aside, and to intervene, if it refuses to do so.

It is now proposed to examine, in some detail, the members' right to intervene, both under the common law, and in terms of s 266. A concomitant enquiry is the company's capacity or power to adopt and ratify the unauthorised act. In answering these questions, it is necessary to bear in mind always that in the insider situation, the essential allegations of lack of capacity and the consequential lack of authority may be asserted and relied on.

As far as the common law is concerned, Lord Davey stated in Burland v Earle[2] that the court will not interfere in the internal management of companies acting within their powers, and furthermore "in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself". As an exception to the second rule, the member could institute proceedings on behalf of the company in certain circumstances.[3] One of these circumstances was stated by Jenkins L J in Edwards v Halliwell, as follows:
"Where the act complained of is wholly ultra vires the company, the rule has no application since the action cannot be confirmed by the majority."[4]

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1. Where the act is not in terms of the constitution, but is not beyond the company's capacity or powers, the member may well have the right to demand that the company conduct its affairs according to the constitution. See below at 151 et seq.
2. [1902] AC 83 PC. This is, of course, the rule in Foss v Harbottle.
3. Ibidem.
4. [1950] 2 All ER 1064 CA 1066F-1067.

Naude, noting that a member can, in the light of s 36, as in the past, seek an interdict, then says :[1] "The traditional theory justifying an individual member's right to enforce compliance with the provisions of the memorandum has, however, virtually collapsed." He offers two reasons for this conclusion. Firstly, the exception to the rule in Foss v Harbottle in the case of an ultra vires act rested on the fact that an "ultra vires act was void and could not be ratified by the members in general meeting. Since such an act is in terms of s 36 no longer void, and ratification is quite irrelevant to the validity of the contract, the basis of this exception has disintegrated."[2] The second reason was that the argument that "the member's right to hold the company and its directors to conduct within the company's capacity" was based on the fact "that the memorandum containing the object(s) constitutes a contract inter alia between every member and the company."[3] Because the company's memorandum no longer necessarily contained an accurate reflection of the company's capacity, this was "founded on rather thin ice."[3]

In regard to the first reason it is submitted, however, that the position is not as stated by Naude. The reasoning in support of this submission is as follows. It is manifest that s 36 has not abrogated the rule in Foss v Harbottle. It follows that where a wrong is done to a company, the position remains that the action to redress this should prima facie be brought by the company itself.[4] With this rule remain the so-called exceptions to it.[5] One of these arises where the acts complained of are beyond the capacity of the company.[5] It has already been submitted that, although s 36 renders an ultra vires act no longer void, it has not eliminated the fact that it is beyond the capacity of the company. It is submitted that ultra vires acts will remain an exception to the rule in Foss v Harbottle, despite the fact that they are no longer void, for the reason that they are beyond the capacity or powers of the company and therefore incapable of ratification by a simple majority by an ordinary resolution.[5] Authority for the narrow proposition, that the majority cannot

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1. Naude S J : Company contracts: the Effect of Section 36 of the new Act (1974) 91 SALJ 315 (Naude's article) 325.
2. Ibidem.
3. Ibid 319-320 and 326. See above at 1 footnote 1.
4. MacDougall v Gardiner [1875] 1 ChD 13; Edwards v Halliwell [1950] 2 All ER 1064 at 1067A.
5. Ibidem. It would be more accurate to state that the rule in Foss v Harbottle does not apply to matters which are ultra vires the company. See Bamford v Bamford [1968] 2 All ER 655 ChD 659-660.

ratify acts which are beyond the company's capacity or powers, is to be found in the following cases. These cases were, however, not decided in relation to s 36. Two dealt with the common law ultra vires doctrine, while one was concerned with unauthorised acts of directors which were not ultra vires the company. Nevertheless, it is submitted that the principle to be found in these cases can be invoked as support for the view that the majority cannot ratify acts which are beyond the company's capacity or powers.

The first of these cases is Edwards v Halliwell.[1] Jenkins L J there said: "Where the act complained of is wholly ultra vires the company, the rule has no application since the action cannot be confirmed by the majority."

The second is Bamford v Bamford.[2] Harman J, in dealing with acts of the directors which were "wrongly done", said that the directors could "by making a full and frank disclosure and calling together the general body of the shareholders, obtain absolution and forgiveness of their sins; and provided the acts are not ultra vires the company as a whole, everything will go on as if it had been done all right from the beginning."

The third is Quadrangle Investments v Witind Holdings Ltd.[3] Trollip J A there said of the ultra vires doctrine, that anything which is beyond or contrary to the provisions of the memorandum "would be null and void, as having been, in effect prohibited by the Act; and it would therefore be incapable of validation by subsequent ratification by the shareholders, even if they unanimously assent thereto".

This statement by Trollip J A could, of course, mean that the act which is contrary to the provisions of the memorandum is void and is therefore incapable of ratification, or it could mean that because it is beyond the

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1. Supra. The relevance of ratification of such acts has, it is submitted, been dealt with above at 142 et seq.

2. [1969] 1 All ER 969 CA 972E-F. This case is dealt with at length in Chapter 7 at 168 et seq.

3. 1975 (1) SA 572 (A) 579 It should be noted that there are cases on the rule in Foss v Harbottle in which the majority have breached the articles with impunity for instance McDougall v Gardiner [1875] 1 ChD 13; Mozley v Alston (1847) 1 Ph 790. However in neither was the breach ultra vires the company. It is always difficult to be certain of propositions on the rule in Foss v Harbottle. There are judgments on it which are difficult to reconcile. However, the latest cases and academic viewpoints favour the view that the majority is incapable of ratifying a breach of the articles, because it constitutes a breach of contract. See below at 151 at footnotes 1 and 2.

provisions of the memorandum, therefore it is "in effect prohibited by the Act" and consequently it is both null and void and incapable of ratification. In the light of the other two cases, the latter seems to be the preferable interpretation. In other words, the act was both void and incapable of ratification. Both are the result of common law rules. Although the act is, as a result of s 36, no longer void, it is submitted that it remains incapable of ratification in terms of the common law. The reason for this, it is submitted, is that acts which are beyond the capacity or powers of the company are incapable of ratification.[1]

Wedderburn has written an article dealing inter alia with the shareholders' personal right of action to have the constitution generally observed, subject to the rule in Foss v Harbottle.[2] In it he notes the words of Plowman J in Bamford v Bamford,[3] to the effect that the articles were a contract and that each member was entitled to have the affairs of the company conducted according to the articles. "This proposition is merely an exegesis of s 20(1). Its purpose is to demonstrate that the plaintiffs are suing in respect of their own individual contractual rights and that the rule in Foss v Harbottle is therefore excluded."[3]

Accordingly, the minority's contractual rights had been enlarged by the principle that the shareholder had a contractual right to have the constitution generally observed. The minority shareholder could not bring a successful action if the matter was a procedural irregularity or the like which the ordinary majority in general meeting could validate, or some other impropriety (such as a breach of duty by the directors) which the general meeting had the power to ratify and did ratify.[4] This argument was advanced in respect of acts by the majority intra vires the constitution. A fortiori this argument must, it is submitted, prevail where the act is ultra vires the constitution. Only a special resolution altering the memorandum can alter the capacity of the company. Therefore an ordinary resolution, which has no retrospective effect, is inadequate. It does not suffice to

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1. See Chapter 7 at 167 et seq. The present reference anticipates the matter and is, therefore, perforce only a brief summary.
2. Wedderburn K W : Going the whole Hogg v Cramphorn ? (1968) 31 MLR 688.
3. [1968] 2 All ER 655 ChD 659-660.
4. Wedderburn supra 692.

ratify a breach of duty by the directors, or the action of the majority in ratifying the directors' conduct by an ordinary resolution.

It is submitted, therefore, that the ultra vires exception to the rule in Foss v Harbottle continues to be soundly based on principle.

Naude, however, bases his view that this exception had fallen away on a further ground namely that the constitution no longer reflects the agreement between the company and its members, because the memorandum no longer reflected all the objects, because the directors might change the company's business in terms of s 33, and thereby change the objects in the memorandum.[1] This situation is analogous to that in s 221(2) in terms of which the directors may issue unclassified shares upon terms in their discretion, thereby conceivably altering the agreement between the company and the members as set out in the constitution, by prescribing the rights relating to the shares. It is submitted, however, that the ultimate source of the directors' authority to change the company's business, or to issue shares, is the constitution. Therefore their exercise of this authority does not in any way alter the fact that the constitution is a contract which is binding in terms of s 65(2) of the Act.

It is the agreement embodied in the constitution which, in the framework of the Act, determines the capacity of the company, and the authority of its directors, and the rule of the majority which is inherent in the rule in Foss v Harbottle. This agreement also defines the boundary to that majority rule, so that it would be more accurate to say that the rule in Foss v Harbottle does not apply to acts of the company beyond the scope of that agreement, rather than to consider the ultra vires situation as an exception to this rule.[2]

In conclusion, therefore, it is submitted that s 36 has not altered the "ultra vires" exception to the rule in Foss v Harbottle, although it has obviously afforded a defence to a member's derivative action in the outsider situation, namely that lack of capacity or powers may not be asserted. In addition, and for the same reasons, s 36 has not rendered ratification either possible or irrelevant in regard to an act by the company which is beyond its capacity or powers. In the insider situation, where this lack of capacity or powers may be relied on, it will, it is submitted, be of no avail to allege by way of a defence, that the ultra vires act was ratified by the majority of

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1. Naude's article supra 320.
2. See Chapter 7 at 162 et seq.

members. Furthermore, in the insider situation, it is submitted that the company may refuse to adopt or ratify an ultra vires contract, and that the member may take action to set it aside apart of course from his right to an interdict before the event, and to demand compensation from the directors after the event. Finally, it is submitted, that it is no defence for either the company or the directors to plead that the contract was, or is capable of being ratified by an ordinary resolution passed by a simple majority of members.

Having dealt with the member's right to have the ultra vires contract set aside in the insider situation, and the member's right to intervene under the common law, and the question of ratification by the company of the ultra vires act, it remains to consider the member's right to intervene under the Act.

It will be recalled that Gibson, in dealing with the right, in the insider situation, to assert or rely on the lack of capacity of the company, refers to the new derivative action embodied in s 266.[1] Cilliers Benade De Villiers set out the workings of s 266 in detail.[2] A member was entitled to initiate proceedings on behalf of the company against the directors or officers of the company in respect of acts which constituted a wrong or a breach of trust or breach of faith, as a result of which the company suffered damages or loss, or had been deprived of any benefit and the company itself had not instituted proceedings on such a ground.[2]

Gibson's view is that it was not entirely clear whether an ultra vires act was covered by this wording.[3] The director might have acted in the bona fide if mistaken view that the act would be for the benefit of the company. Furthermore the concepts of ultra vires and lawfulness might not coincide. On the other hand, an ultra vires act might "amount to a 'breach of trust' (if scarcely to a breach of faith) whether or not the directors acted bona fide". As a result of such difficulties, a member initiating action under s 266 did so at considerable peril, unless the directors acted dishonestly. Furthermore, "proceedings under s 252 for relief were dependent on acts, omissions or the conduct of affairs of the company which were 'unfairly prejudicial, unjust or inequitable,' and not upon any question of intra or ultra vires."[3]

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1. Gibson 306.
2. Cilliers Benade De Villiers 430.
3. Gibson 308.

It is submitted that, in the absence of judicial interpretation, it is not possible to take the matter further.

3.7 The meaning of the phrase in s 36 "as between the members and the directors".

Naude indicates that legal proceedings to enforce directors' liability where they have breached their fiduciary duties to the company to act within its powers and capacity, may be brought as between a member claiming derivatively and the directors.[1]

Henochsberg conveys no more in relation to this phrase, than this, that obviously such a claim cannot be brought if there is a benefit to the company arising out of such a transaction, instead of a loss.[2]

Cilliers Benade De Villiers observe that s 36 permits a member to rely as against the company and other insiders on the fact that an act beyond the capacity of the company is in breach of the memorandum. An obvious example, was when a member wanted to hold the directors, and accordingly the company, to conduct within the company's capacity.[3]

Gibson en passant, notes that s 36 envisaged that, in legal proceedings between the members and the directors, a party thereto could assert or rely on the lack of capacity of the company.[4]

S 36 postulates that, as between the members and the directors, the company's lack of capacity and the directors' lack of authority arising therefrom, can be asserted. The problem therefore arises under which circumstances there could be legal proceedings as between the members and the directors.

As between the individual member and the individual director there is no nexus, since the individual director has no fiduciary duty to the individual member.[5] Nor is there a nexus in terms of the articles, since the director is not a party to the constitution.[6]

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1. Naude's article supra 327.
2. Henochsberg 72.
3. Cilliers Benade De Villiers 56.
4. Gibson 306.
5. Percival v Wright [1902] 2 ChD 421 Cilliers Benade De Villiers 263.
6. This follows from the fact that the constitution is a contract between the company and the members, and the members inter se. See Chapter 3 at 32 et seq.

As between the members collectively and the directors collectively, other considerations apply. It is arguable that the words "the directors" refer to the board of directors.[1] It is equally arguable that the words "the members" refer to the members in general meeting. This is a preferable interpretation, since there is no nexus between the individual member and the individual director, arising solely out of the constitution. Likewise there is no nexus between the board of directors and the individual members.

Furthermore, the members in general meeting are an organ of the company, and their decisions properly taken are acts of the company. Since s 36 provides for the situation between the company and the directors, this seems to render the phrase "as between the members and the directors" redundant.

On the other hand, the act has given to the members a statutory derivative action in terms of s 266. This section, taken literally, affords the member the right to institute proceedings against the directors. Although the action is to be brought on behalf of the company, this section may be said to create a nexus as between the members and the directors, sufficient to give a meaning to the phrase in question. This is a rather thin interpretation because, strictly speaking, the member in bringing the derivative action acts on behalf of the company. Nevertheless, it does have the advantage of giving these words in s 36 a meaning.

4. Conclusion

The common law doctrine of ultra vires forms a background to the new and unexplored s 36 of the act, the meaning of which has not as yet been blessed with the certainty of judicial interpretation.[2] Whatever one says of its meaning, one is venturing into the world of the unknown, and of controversy. There are three questions which are most likely to cause dissention.

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1. Naude's article supra 332.
2. Cilliers Benade De Villiers 57. In one case the matter was raised in argument. See Patakh Centre (Pty) Ltd v Stern N O 1978 (1) 259 (D) 260 and 262E-G. It was contended that an act by a company which, in terms of its memorandum it has no power to perform, is void and an agreement to perform such an act is also void. It was, however, held that the company had the power, in terms of the memorandum, to do the act in question.

The first is whether the act beyond the capacity of the company, because it is no longer void, is ergo binding on the company, despite the lack of authority of its directors, arising only from its lack of capacity.

The second is the right of the member to seek to set aside an act beyond the capacity of the company, where such act is between the company and an insider.

The third is whether the act beyond the company's capacity is capable of ratification by the majority by ordinary resolution, having regard to the fact that it is no longer void.

An attempt has been made in the preceding pages to submit answers to these questions. In doing so the following propositions have emerged as portion of these answers.

In the first place, it is submitted that s 36 has radically altered the common law in regard to enforcement of the contract in the constitution by abolishing the ultra vires doctrine entirely. This has occurred despite the recommendation of the Van Wyk de Vries Commission that the best course would be to attempt no general repeal of the existing law of ultra vires, but to provide protection to third parties contracting with companies against the unfair operation of the ultra vires rule.[1]

In the second place, it is submitted that s 36 has altered radically the operation of the agreement embodied in the company constitution. In defining the capacity of the company, the constitution reflects the contract between the company and the members. Whereas under the common law doctrine of ultra vires acts of the company beyond its capacity were simply non-existent, now such acts do exist.

In the third place it is submitted that what has emerged, after the abolition of the ultra vires doctrine, is the restoration to practical importance of the rules of agency in the insider situation. Although an act beyond the capacity or powers of the company does exist, it is by no means ipso facto

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1. Par 41.

binding on the company in all situations. Such an act by its agents is unauthorised as far as the company is concerned, and is beyond the terms of the constitution as far as the members are concerned. As a result such an act is incapable of being adopted or ratified by the company, and an interdict restraining such an act prior to its occurrence, and compensation by the responsible agents to the company, remain legal remedies available to the company and the insiders.

In the outsider situation, lack of ratification by the company is irrelevant to the question of the company's liability for an act of its agents beyond its capacity or powers, since such a lack may not be asserted or pleaded as a defence. This, of course, does alter the common law of agency.

In the insider situation it is submitted that, in terms of s 36, such an act is not binding on the company, because the act was unauthorised and incapable of ratification, and these facts may be asserted or pleaded in terms of s 36.

Finally, it is submitted that the section, although complex in its consequences, is workable and is consistent with the common law. It protects the third party at the expense of the insider's rights, while giving the insider rights of recourse against the company's agents who exceed their authority.

CHAPTER 7 - THE RULE IN FOSS v HARBOTTLE

1. Introduction

In an investigation into the concept of the constitution of a company in general, and into its enforcement in particular, the rule in Foss v Harbottle cannot be left unmentioned. The constitution, being a contract between the company and the members, and between the members inter se, gives rise to a number of contractual rights and obligations between these parties. The rights to be enforced may therefore be those of the company or of a member or a group of members. The legal rule developed under the appellation of the rule in Foss v Harbottle, and the various exceptions allowed to that rule, directly affects the enforcement of those various rights.

The manner in which to treat that topic, however, causes a dilemma. On the one hand the topic has been extensively dealt with, both in academic writing, and in the cases.[1] The subject is, furthermore, notorious for its difficulties, and a number of judgments on it are by no means easy to reconcile.[2]

On the other hand the rule has become a major obstacle to the enforcement by a shareholder of his rights.[3] What is more, it has been noted by both Wedderburn and Naude that, as the constitution contains a contract between the members and the company, a member should be able to defend himself against an unjustified variation thereof, and to compel the company to comply with the terms of this agreement. Both have said that the fact that the majority may act in an irregular manner, provided that it can ratify such an internal irregularity, clashes head on with the principle of pacta sunt servanda.[4]

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1. Cilliers Benade De Villiers 425 and the authorities therein quoted.
2. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) C L J 194. As this article is referred to frequently in this section, the article will be referred to as "Wedderburn".
3. Van Wyk de Vries Commission 42.10.
4. Naude 177; Wedderburn supra 209.

It is therefore proposed to set out the rule in Foss v Harbottle in general outline, indicating briefly the different types of action involved and the statutory relief now available. Then attention will be given to the existence of a clash between the rule against interference with the internal affairs of a company and the concept of the constitution as a contract. The rule will be dealt with primarily in English law, and then reference will be made briefly to South African law, which has taken it over from English law, virtually as it stands, with one possible variation arising out of s 36 of the Act.

2. English law

2.1 The rule in Foss v Harbottle

The rule was described by Lord Davey in Burland v Earle as follows.[1]

"It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself."

"But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the courts allow the shareholders to bring an action in their names."

"The cases in which the minority can maintain such an action are ... confined to those where the acts complained of are of a fraudulent character or beyond the powers of the company."

"It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue, if the act

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1. [1902] AC 83 PC. The deletion is mine.

when done regularly would be within the powers of the company and the intention of the majority of the shareholders is clear..."

A more recent formulation is to be found in Edwards v Halliwell.[1] The facts in that case were as follows.[2]

One of the rules of a trade union, a defendant in the case, provided that regular contributions of employed members would be as set out in certain tables and also that no alteration to same be made until a ballot vote of the members had been taken and a two-thirds majority obtained. A meeting of delegates of the union, without taking any ballot, passed a resolution increasing the amount of the contribution of employed members. The plaintiffs, two members of the union, claimed against two members of the committee and against the union itself a declaration that the alteration adopted at the delegate meeting was invalid.

It was argued for the defendants that when an action was brought by an individual in respect of a mere irregularity in a matter which was intra vires a trade union and concerned its internal management, the court would not as a rule intervene. A mere irregularity, it was conceded, did not cover fraud, oppression or unfairness.[3]

In the view of Asquith L J expressed in one of the judgments of the court, "the matter was strongly tinctured not, indeed with fraud, but with oppression and unfairness. Here were men who had a right not to have their contributions increased, except by a ballot resulting in a two-thirds majority. This right was clearly violated."[4] Jenkins L J in his judgment in the case dealt with the reluctance of the court to interfere with the domestic affairs of a company and the more general proposition commonly called the rule in Foss v Harbottle. He then set out the rule as he saw it, of which the following is a summary.[5]

Firstly, the proper plaintiff in an action in respect of a wrong alleged to have been done to a company was prima facie the company or the association of persons itself.

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1. [1950] 2 All ER 1064 CA.
2. Ibid 1065A-G.
3. Ibid 1065G-H.
4. Ibid 1065H.
5. Ibid 1066G-1067.

Secondly, where the alleged wrong was a transaction which might be made binding on the company by a simple majority of the members, no individual member was allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members were in favour of what had been done, then cadit quoestio.[1] No wrong had been done to the company. If on the other hand a simple majority of members of the company was against what had been done, then there was no valid reason why the company itself should not sue. It was implicit in the rule that the act complained of was one giving a cause of action to the general body of members, as opposed to one which an individual member could assert in his own right.

There were certain exceptions to the rule. These were as follows.

Where the act complained of was wholly ultra vires the company, the rule had no application since the action could not be confirmed by the majority.

Furthermore where the action was a fraud on the minority and the wrong-doers were in control of the company the rule was relaxed in favour of the aggrieved minority who were allowed to bring a minority shareholders' action on behalf of themselves and all others. If this were not so, the grievance would never reach the court because the wrong-doers themselves being in control would not allow the company to sue.

Finally the rule did not prevent a member from suing where the act could not be sanctioned by a simple majority but only by some special majority. In this case the company was attempting to do, without a special resolution, that which required a special resolution. If it could assert that it alone was the proper plaintiff, this would allow a company to do de facto by ordinary resolution that which according to its own regulations could only be done by special resolution.

The final exception, set out above, in the opinion of the judge, fitted the case exactly. Here the act complained of could only validly be done by a special majority. This had not been the case.

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1. This spelling is exactly as in the judgment.

As far as the facts were concerned, these did not fall into the general ambit of the rule. It was not a matter where the wrong was done to the union, in which case the cause of action would belong primarily to the union. On the contrary, the members complained that the union had invaded their individual rights, by a purported, but invalid, alteration of the tables of contributions. In those circumstances the rule in Foss v Harbottle had no application at all, for the individual members were suing not on behalf of the union but in their own right as members.[1] Judgment was therefore given in favour of the plaintiffs.

2.2 Types of action

Arising from the rule, different types of action are to be instituted. Where the member is entitled to act against the wrong-doers to assert the company's rights, his action is called a derivative action. Where he acts to assert his own personal rights under the constitution it is called an individual action. Where he acts on behalf of himself and those who are in the same position as himself to assert the right of the group, his remedy is described as a representative action.[2]

In Gower's view the decisions on whether the action should be by or against the company are confusing because frequently the same facts give rise to both possibilities.[3]

The difficulties arising from the rule have led to a form of statutory relief contained in s 210 of the English Companies Act, 1948.[4] Any member who complains that the affairs of a company are being conducted in a manner oppressive to some part of the members (including himself) may petition the court, which, if satisfied that the facts would justify a winding-up but that this would unduly prejudice that part of the members, may make such order as it thinks fit.[5]

2.3 The rule and the observance of the contract

It is proposed at this stage to deal with the proposition that there is a clash between the rule in Foss v Harbottle and the concept of the

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1. Edwards v Halliwell supra 1067H.
2. Gower 587-594; Wedderburn supra 205.
3. Gower.
4. Gower 598.

constitution as a contract. Such a clash could arise in the area of the enforcement of such a contract. If the majority may ratify a breach of this contract, so that the member is precluded from seeking relief from such a breach by the rule in Foss v Harbottle, then there is indeed such a clash. Anyone who becomes a minority shareholder in a company does so with the obvious knowledge that where his point of view conflicts with that of the majority, the latter's will is likely to prevail.[1] The matter turns on the extent to which the majority can overrule the minority, or in other words, on the boundaries of majority rule, which, in Wedderburn's view define the limits of the rule in Foss v Harbottle.[2] It is therefore necessary to examine these boundaries, and in doing so, the first step is to ascertain whether the source of majority rule is to be found in the contract in the constitution. If it is, then the enforcement of that contract is the yardstick both of majority rule and of the rights of the minority, as the source and limit of the rule in Foss v Harbottle.

2.4 Majority rule and its source

That the majority derives its rights from the constitution, that is to say the contract in the constitution, is a proposition not frequently stated in the cases, but its truth is nevertheless, it is submitted, beyond question. Buckley J in Hogg v Cramphorn Ltd stated that the court should not itself interfere with the exercise by the majority of its constitutional rights.[3] Plowman J stated the matter in somewhat stronger terms in Bamford v Bamford.[4] He there said that the articles were a contract binding on the company and all its members and each member was entitled to have the affairs of the company conducted according to the articles. This proposition, he said, was merely an exegesis of s 20(1). In other words, it is submitted, the member contracted in the constitution to be bound by the decisions of the majority.

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1. Hogg v Cramphorn Ltd [1966] 3 All ER 420 ChD 428B-D.
2. Wedderburn supra 198.
3. [1966] 3 All ER 420 ChD 428C-D.
4. [1968] 2 All ER 655 ChD 659-660. See also Harmer (HR) Ltd Re [1958] 3 All ER 689 CA 704F-G and 706G-H.

2.5 The boundaries of majority rule[1]

Since the source of majority rule is to be found in the contract in the constitution, it also defines the boundary of majority rule. This boundary may be ascertained as follows. Where there are breaches of that contract by the majority, the power of the majority and of the minority is manifested by the majority's power to ratify such breach and the minority's power to prevent such ratification. This power derives from the right, be it express or implied in the constitution, to enforce the contract contained therein. This question of ratification is therefore the next aspect to be considered.

2.6 The earlier view : that in certain cases the majority may ratify its breaches of the articles

There have undoubtedly been cases in which the majority have been held to be entitled to ratify any act which is intra vires the company even if it be in breach of the articles.[2] On the other hand, not all the cases have said this. What is more, the majority is not as powerful as the former line of cases suggests.[3] There are cases where the majority has not been permitted to bind the minority.[4] What, therefore, is the dividing line between what the majority may do, and what it may not do ? Clearly it may not act beyond the capacity of the company itself, nor may it act in fraud of the minority. Nor can it do by an ordinary resolution that which requires a special resolution. Nor does it intrude into the area of the personal rights of members.[5] In other words the member has the right to prevent the terms of his contract with the other members being altered by a simple resolution rather than a special resolution. This contract is the one which always arises from the articles in terms of s 20 of the Companies Act, 1948 and its predecessors.[6] The courts, said Wedderburn, had recognised the member's contractual rights in general terms, and his personal rights, as well as his right to enforce same.[7]

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1. See Gower on the subject of the controlling shareholders' duties, viz chapter 24 at 561-581.
2. Gower 199 and the examples there quoted, particularly footnotes 34-36.
3. See for example Wood v Odessa Waterworks Co (1889) 42 ChD 636.
4. Wedderburn supra 199.
5. Edwards v Halliwell supra 1066-1067.
6. Wedderburn supra 208.
7. Ibid 209-211 and the authorities therein quoted.

This agreement was strengthened, he says, because many actions were in form 'representative'. The shareholders appeared as representative plaintiffs just because their fellow members, or a class of them, shared an interest in the matter. Wedderburn's authority for the view that the member has a contractual right to enforce the contract in the constitution is Salmon's case.[1]

It will be recalled that Salmon brought an action on behalf of himself and all the other shareholders, except the defendants, to restrain the company and its directors from acts which were inconsistent with the articles.

Salmon, he says, could not have been trying to protect his unique right to dissent from the directors' decision, a right of veto which was vested in the member by the articles alone. As member he had no right of veto; the articles purported to give that right to him in his capacity as managing director and not as member. He could not exercise his right qua managing director because in such capacity, as an outsider, he could not enforce the contract arising from the articles.[2] He, therefore, as

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1. Salmon v Quin and Axtens Ltd [1909] 1 ChD 311; [1909] AC 442 HL. See Chapter 8 at 192. This point is made by Wedderburn supra 212-213. This proposition, insofar as it touches on the "outsider" rule, will be dealt with again in a more appropriate section. It illustrates forcefully the interlocking nature of the enquiry into the legal nature of the constitution, its enforcement and the outsider rule. It also shows the links between the rule in Foss v Harbottle and outsider rule. See also Wedderburn K W : Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965)28 MLR 347 at 348 where the same proposition is advanced.

2. It will be submitted below in Chapter 8 at 191 that this right of veto was given to Salmon qua member, and was exercised by him qua member, even though it was part of his right to participate in the management. It was the basis of his membership that he would be a managing director and that he would have a right of veto at the level of the board of directors. It was, in other words, a term of the contract in the constitution that the company would be run in a particular way, namely by the directors who could, however, not do certain things, if there was objection thereto by Salmon or by Axtens.

is evidenced by the form of representative action adopted, sued as a shareholder to protect a right personal to him, but common to all the members. This right was to have the articles observed by the company. Wedderburn's 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. He considered that a general application of the right of a member to call upon the company to observe the articles conflicted with the rule in Foss v Harbottle.[1] It clashed with the view in MacDougall v Gardiner that the member did not have the right to complain of irregularities even if they contravened the articles.[2] He then listed examples of the same clash at other levels.[3] He considered several answers to the problem, for example that the majority could ratify what was in substance an alteration of the articles, or a complete transformation of the company.[4] Neither of these was a general guide. The truth was that in each case a line had to be drawn through the articles. On one side stood clauses, the breach of which could not be ratified; on the other stood those in the grip of the ordinary majority. The cases afforded little satisfactory assistance in deciding where each article would fall. Therefore matters of internal management ought to be confined to matters already covered by judicial pronouncements, although this would leave anomalies. Outside of these cases, the member might enforce his contractual rights. In effect Wedderburn sought to break away from the internal management rule, leaving it where the courts have brought it. The same view is supported in Gower on the basis that it eliminated ratification as a bar to an action by a member in respect of some impropriety.[5]

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1. Wedderburn K W: Shareholders' rights and the rule in Foss v Harbottle (1957) CLJ 194 at 213, which article has been referred to as "Wedderburn".
2. Ibidem. The reference is to MacDougall v Gardiner (1875) 1 ChD 13 at 22-23.
3. Wedderburn supra 213 and the authorities therein quoted.
4. Ibid 214.
5. Gower 264 and 586.

This approach seems unsatisfactory. It accepts that the cases are inconsistent and are incapable of being reconciled, either with each other or with an underlying principle. It also accepts that the majority is entitled to breach the articles and to ratify such breach by an ordinary resolution.[1] Furthermore, it accepts that this is an inroad into the concept of the constitution as a contract, since in this respect it is not enforceable as such. It leaves the minority in the hands of the majority, which is shielded by a rule whose application is unpredictable.

2.7 The later view : that the majority may not ratify its breach of the articles

Wedderburn has, however, taken the matter further.[1] He has done so in response to two cases, namely Hogg v Cramphorn Ltd[2] and Bamford v Bamford.[3] These cases deal, not with the rule in Foss v Harbottle, but with the breach of fiduciary duties of directors. Nevertheless, the boundaries of majority rule are clarified by reference to the power of the majority to ratify irregularities by means of an ordinary resolution. In addition, the extent of the majority's right to act without reference to the merits of its views, and the source of that right in the company constitution, emerges with some clarity. At the same time the minority's right to require that the affairs of the company be conducted in terms of the articles, also emerges. What is more, it is submitted, the right of the majority to act in breach of the articles, disappears into thin air. Before dealing with Wedderburn's article, it is proposed to set out the cases.

In the case of Hogg v Cramphorn Ltd the directors, in order to foil a take-over bid attached special voting rights to a number of unissued preference shares and allotted them to a trust to which they made loans with which to pay for the shares.[4] These transactions were challenged by a shareholder. The court held that on a proper interpretation of the articles the directors had no power to attach special voting rights to these shares. However, it did not follow that the allotment be set aside, since the trustees could elect to retain the shares without the special voting rights.[6] However,

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1. Wedderburn K W : Going the whole Hogg v Cramphorn? (1968) 31 MLR 688.
2. [1966] 3 All ER 420 ChD.
3. [1968] 2 All ER 655 ChD; [1969] 1 All ER 969 CA.
4. [1966] 3 All ER 420 ChD.
5. Ibid 426A.

it was necessary to refer the allotment to the general meeting, without whose ratification the allotment was liable to be set aside.[1] In exercising their rights, the majority at such a general meeting could ratify the allotment and the loans. Unless the majority in a company acted oppressively towards a minority, the court would not interfere with the exercise by the majority of its constitutional rights, or embark on an enquiry into the respective merits of the views held or policies favoured by the majority or the minority.[2]

The case of Bamford v Bamford was heard on appeal from a judgment of Plowman J in the Chancery Division.[3] As in the previous case the observance of the constitution was not the central issue. Plowman J in the court a quo did, however, approve counsel's contention that the rule in Foss v Harbottle had no place where the plaintiffs sued in respect of their own individual contractual rights.[4] The facts were as follows. By way of a defence to a take-over, the directors of a company had issued 500 000 unissued ordinary shares to a third company at par for cash. Under the company's articles all unissued shares were at the disposal of the directors. In an action by two shareholders for a declaration that the allotment was void it was alleged that the allotment was not made in good faith in the interests of the company and was therefore in excess of the directors' powers. The matter arose on a preliminary point of law that is to say, whether, assuming the directors had not acted bona fide in the interests of the company, the allotment was capable of being ratified by an ordinary resolution of the members, and if this were done whether such a resolution would be effective. In the appeal court the matter was dealt with on the issue of the division of powers between the directors and the general meeting and on the existence of a residual power to be found in the general meeting. Harman J viewed the matter in this light, holding that if the directors did things wrongly which they could have done, had they complied with the constitution then the general meeting could ratify their acts.[5] He was also inclined to frown on the judgment of Plowman J in the court a quo, as being "unapt".[6] He considered that any question as to whether the general

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1. Ibid 429E-F.
2. Ibid 428C-D.
3. [1968] 2 All ER 655 ChD; [1969] 1 All ER 969 CA.
4. [1968] 2 All ER 655 ChD 659-660.
5. Bamford v Bamford [1969] 1 All ER 969 CA 973C.
6. Ibid 973I.

meeting had any residual power to allot was irrelevant since the company in general meeting was not called on to make an allotment. It merely ratified that which the directors had already done and prevented it being undone. Nevertheless Harman J did not disapprove of the reliance placed by Plowman J in the court a quo on Hogg v Cramphorn Ltd.[1] This case was, said Harman J "very like the present" since in both cases the matter was referred to a general meeting for ratification.

Wedderburn has written a note on Bamford's case in which he dealt with the judgment in the court a quo.[2] One aspect of this judgment is directly in point in the present enquiry, namely the judicial comment on the concept of the constitution as a contract in relation to the rule in Foss v Harbottle. In this article Wedderburn observed that Plowman J was unravelling five principles of company law, previously interlocked in an inelegant way.[3] These were, firstly, the constitution as a contract; secondly, the rule in Foss v Harbottle which prevented the member from suing where the majority could ratify, by ordinary majority; thirdly, the residual power of the general meeting; fourthly, the shareholder's personal right of action to have the constitution generally observed, subject to the rule in Foss v Harbottle; fifthly, the individual shareholder's right to bring a derivative action to protect his company against wrongs where the wrong-doer was in control. Plowman J's view was that the articles were a contract, and that each member was entitled to require of the company and of every other member that the affairs of the company be conducted according to the articles for the time being in force. This proposition was merely an exegesis of s 20(1). "Its purpose is to demonstrate that the plaintiffs are suing in respect of their own individual contractual rights and that the rule in Foss v Harbottle is therefore excluded."[4]

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1. Hogg v Cramphorn Ltd [1966] 3 All ER 420 ChD which was referred to in the court a quo. See Bamford v Bamford [1968] 2 All ER 655 ChD 668H.

2. Wedderburn K W : Going the whole Hogg v Cramphorn? (1968) 31 MLR 688 particularly 691-692.

3. Ibidem 688.

4. Per Plowman J in Bamford v Bamford [1968] 2 All ER 655 ChD 659-660. Wedderburn in this article, Going the whole Hogg v Cramphorn? supra 691 footnote 22, notes the similarity of this view with that in Harmer (HR) Ltd Re [1958] 3 All ER 689 CA. In the latter case (704F-G) it was stated that conduct was oppressive if it deprived the minority of shareholders of their right as members of the company to have its affairs conducted in accordance with its articles of association (see also 706G-H).

The effect of this, said Wedderburn, was to enlarge the minority's contractual rights by adding to the concept of the constitution as a contract, the further principle that the shareholder had a contractual right to have the constitution generally observed. Wedderburn had, of course, advocated this view previously.[1]

It also clarified the extent to which the rule in Foss v Harbottle had placed limits on these latter principles. According to this judgment the minority shareholders could not bring a successful action if either the matter was a "procedural irregularity" or the like, which the ordinary majority in general meeting could validate, or the matter concerned some other impropriety (such as a breach of duty by the directors) which the general meeting had the power to ratify and did actually ratify.[2] The ordinary principle had so far been that a minority shareholder had no locus standi to bring an action wherever it was possible for the ordinary majority to ratify, save in the case of wrongs to the company. This was the principle in McDougall v Gardiner, even though there had been a breach of the articles.[3]

Once the member had the right to have the constitution generally observed, that disposed effectively of any right which the majority might have had to ratify such breach. In demanding that the affairs of the company be conducted according to the constitution, the individual member was suing to enforce his own individual rights. The majority could not rely on the rule in Foss v Harbottle.[4]

2.8 The existence of a clash between two principles

It seems fair to comment that Wedderburn has departed from his previous view that the rule in Foss v Harbottle might be an excuse for a breach of the articles and a barrier to their enforcement by a member.[5] It is further submitted that, despite the strictures of Harman J, the words of Plowman J clearly illustrate that in fact there is no clash between the two principles.[6]

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212-213, referred to above as "Wedderburn".
2. Wedderburn K W : Going the whole Hogg v Cramphorn? (1968) 31 MLR 688 at 692.
3. Ibidem.
4. This is the effect of the judgment of Plowman J in Bamford v Bamford in the court a quo supra 659-660.
5. See Wedderburn 213-214.
6. Harman J's views are set out in Bamford v Bamford, supra in the Appeal Court.

Wherever a member can rely on contractual rights given to him in the articles, the rule in Foss v Harbottle does not apply.[1] Such contractual rights are individual, such as the right to vote, and are also general, such as the right to have the affairs of the company conducted in terms of the articles. The majority, too, has constitutional rights with which the court will not interfere. Apart from rights derived from statute, these rights, like those of all members, derive from the constitution, that is to say, from the contract in the constitution.[2] There is no conflict between the members' individual rights and the rights of the majority, because they both have a common source, that is to say, the same contract, which provides the same limits. Therefore the rights of the minority and the majority have common boundaries and thus there can be no clash. A breach of the articles is no more than an attempt to change these boundaries. Whether conduct is in fact a breach of this contract, is no more than a factual enquiry: what are the terms of the contract ? Do the facts in question amount to a breach of those terms or not ?

There seems, therefore, to be no clash in principle between the rule and the concept. That there are, on the other hand, cases which are inconsistent with this proposition, is beyond question.[3]

3. South African law

3.1 Introduction

The rule in Foss v Harbottle has been taken over in South African common law as it stands. However, the rule has been referred to infrequently.[4]

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1. See also Bastin N A : The Enforcement of a Member's Rights. The Journal of Business Law January 1977 17 at 23.

2. Hogg v Cramphorn Ltd [1966] 3 All ER 420 ChD 428C-D.

3. See for example Mozley v Alston (1847) 1 Ph 790.
MacDougall v Gardiner (1875) 1 ChD 13 at 22-23.
In this enquiry, care has been taken to avoid a detailed analysis of cases and of definitions. Thus "personal rights" and "ratifiable irregularities" are but two concepts which, in the context of the rule in Foss v Harbottle, require special study. Since the rule itself is beyond the scope of the present dissertation, no attempt is made to define same.

4. See the following cases :
Cohen v Directors of Rand Collieries Ltd 1906 TS 197
Robinson v Imroth 1917 WLD 159
Eales v Turner 1928 WLD 173
Moti v Moti and Hassim Moti Ltd 1934 TPD 428
Spiliopoulis v The Hellenic Community of Johannesburg 1938 WLD 160
Cooper v Gavratt 1945 WLD 137
Miller v Miller 1963(2) SA 199 (SR)
Grundling v Beyers 1967(2) SA 131 (W)
Sorenson v Executive Committee Tramway and Omnibus Workers Union(Cape) 1974 (2) SA 546(C). See also Pantos v Kelly 1975(1) 21C (W) 223C-D.

The academic writers in effect deal with the English law on the subject.[1] As in English law, the rule reinforces the power of the majority. Likewise, the source of majority rule is to be found in the contract in the constitution.

3.2 Majority rule and the rule in Foss v Harbottle

The rule of the majority has been expressed by Trollip J A in Sammel v President Brand Gold Mining Co Ltd.[2] He said: "By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder (cf. sections 16 and 24). That principle of the supremacy of the majority is essential to the proper functioning of companies." Clearly it is by his contract in the constitution that the member is bound by the decisions of the majority.

On the rule in Foss v Harbottle itself, the prevailing view is that of the Van Wyk de Vries Commission, namely that the possibility of a shareholder intervening in matters (such as a wrong committed by the directors against the company) is stringently limited by the Foss v Harbottle rule; and that the field of the derivative action is so narrow that it has little significance in the context of shareholder protection.[3] Consequently, as in English law, recourse is had to the Act to provide a remedy.

3.3 Statutory remedies

The Act provides various remedies for members. The most important are: s 252 which affords a member's remedy in case of oppressive or unfairly prejudicial conduct and s 266 which provides for the initiation of proceedings

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1. Cilliers Benade De Villiers 423; Naude 167; Hahlo 535.
2. 1969 (3) SA 629 (A) 678G and 679C and the authorities there quoted. See also Aspek Pipe Co (Pty) Ltd v Mauerberger 1968 (1) SA 517 (C) 528F-G.
3. Par 42.10.

on behalf of the company by a member, a type of statutory derivative action.[1] Hahlo says of s 266 that it is likely to replace the representative or derivative shareholder's action of the common law.[2] S 266 may be invoked in respect of a wrong or a breach of trust or breach of faith as a result of which the company suffered damages or loss or has been deprived of any benefit and the company itself has not instituted proceedings on such a ground. The action may be instituted against the present or former directors or officers who caused the damage. The member may initiate proceedings on behalf of the company against these persons, and this is so in spite of any ratification or condonation of the cause of action. The member is obliged to call on the company itself to institute these proceedings and if the company fails to do so in one month he may do so. Cilliers Benade De Villiers summarise the effect of the section in the following way.[3] If a member can satisfy the court that (i) the company has not instituted the proceedings; but (ii) there are prima facie grounds for such proceedings; and (iii) an investigation into such grounds and the desirability of the institution of such proceedings is justified, the court may appoint a provisional curator ad litem. He is obliged to undertake that investigation and report to the court on the return day. On his report the court may either discharge the provisional order or confirm his appointment and authorise the institution of the proceedings.

3.4 The effect of s 36 of the Act

Naude holds the view that s 36 of the Act has altered the South African law on the rule in Foss v Harbottle.[4] A member could seek an interdict in

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1. Other remedies are set out in Chapter IX of the Act which provide for access to the company's records, and for methods of inspection and investigation. Apart from s 266, s 252 and ss 253-265 constitute major statutory safeguards for shareholders. Other provisions are scattered throughout the Act (Hahlo 549).
2. At 535. It has been suggested that s 266 was probably enacted to deal with the difficulties in the rule in Foss v Harbottle. See Brown v Nanco (Pty) Ltd 1976 (3) (SA) 832 (W) 834E.
3. At 431.
4. Naude S J : Company Contracts : the Effect of Section 36 of the new Act (1974) 91 SALJ 315 at 324 et seq. See Chapter 6 at 124.

regard to matters beyond the company's capacity or powers but the theory justifying it had "virtually collapsed". The basis had been that the proposed ultra vires act was an exception to the rule in Foss v Harbottle; "and it was an exception because an ultra vires act was void and could not be ratified by the members in general meeting."[1] Now it was no longer void and ratification was irrelevant, so that the basis of the exception had disintegrated. Secondly, the argument that the memorandum constituted a contract inter alia between every member and the company, was on rather thin ice because the memorandum no longer contained an accurate reflection of the company's capacity.[2]

It has been submitted that the position is not as stated by Naude.[3] There is no need, it is submitted to traverse the same ground again, save to repeat the conclusion offered, as follows. An act beyond the capacity or powers of a company was, at common law, both void and incapable of ratification. Although such an act is, as a result of s 36 of the Act, no longer void it has been submitted that it remains incapable of ratification because it is in breach of the contract embodied in the constitution.[4]

4. Conclusion

For the present purposes, it is not necessary to attempt to resolve any of the difficulties inherent in the rule in Foss v Harbottle, if that were at all possible. That rule is only relevant to illustrate, as it does, the relationship between the member and the company, arising from the constitution. Both the company and the member have rights arising from the contract contained in the articles. Each is subject to limits.

The members' rights are of two types. His personal rights which are not subject to the will of the majority, and his corporate rights, which are subject to the majority. An example of the former is the right to receive notices, or the right to vote. An example of the latter is the right to receive a dividend, if so declared by the majority. In addition the member may have a general right to have the affairs of the company conducted in terms of the articles.

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1. Ibid 325.
2. Ibid 326. See Chapter 6 at 124.
3. See Chapter 6 at 149 et seq.
4. Ibidem

The rule in Foss v Harbottle seeks to reconcile the conflicting interests of the company, the majority, the minority and the individual member. In the first place it grants to the company the sole right to protect itself against wrongs to itself. In the second place it seeks to protect the majority in the exercise of its prerogatives. In the third place it recognises that in the interests of justice, there must be situations in which the member ought to be able to act, in respect of a wrong to the company, and also in instances where the majority is not entitled to ratify the irregularity in question. In such a situation the member's right exists in spite of the views of the majority to the contrary. Finally it is clear that the rule in Foss v Harbottle was not intended to intrude into the area of the contract contained in the articles or into the field of the personal rights of members, which are not in any way prejudiced by it, or to permit a breach of the articles. However, just as the formulation of a single rule in Foss v Harbottle, instead of two, is of limited value, so too this simple proposition by no means resolves all issues.[1] For example, the uncertainty of the concept of majority rule, and for that matter of the definition of personal rights, indicate that many answers are lacking. The inconsistencies and gaps in the case law, of necessity, leave the rule in Foss v Harbottle in a state of disarray.

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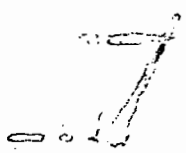
1. See Naude 172 on the subject of one rule in Foss v Harbottle, also Wedderburn 198.

PART 3

THE OUTSIDER RULE



CHAPTER 8 - THE OUTSIDER RULE

1. Introduction

The importance of the outsider rule in dealing with the constitution as a contract is that it clearly seeks to inhibit the contractual effect of the constitution, by limiting its enforceability to rights conferred on the parties to the contract in their capacity as members and in no other capacity. The outsider rule, also described as the qua member rule, was originally formulated by Astbury J in Hickman v Kent or Romney Marsh Sheepbreeders' Association.[1] In this chapter, it is proposed to review the seminal judgment of Astbury J in this case, and his formulation of the outsider rule, which he postulated as a method of reconciling two apparently conflicting lines of earlier cases in that regard. In doing so, he formulated the tests of capacity and generality, as the yardstick for the validity and enforceability of the contract in the constitution.

In order to place this judgment in its historical context the cases preceding Hickman's case will be examined to determine the meaning and extent of the outsider rule, with a view to ascertaining whether they contained the germ of the outsider rule and its twin criteria of capacity and generality, that is to say, whether they showed any evidence justifying the introduction of the outsider rule.

2. Hickman's case

In Hickman v Kent or Romney Marsh Sheepbreeders' Association the defendant association brought an action to stay proceedings in an action against it by a member who sought relief in respect of matters arising solely out of the affairs of the association in substance to enforce rights under its articles.[2] The stay was sought in terms of the Arbitration Act, 1889, the submission to arbitration being an article of the association's constitution. Whether the article constituted a written agreement between the member and the company was the crisp issue in the case.

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1. [1915] 1 ChD 881 at 900.
2. [1915] 1 ChD 881

In deciding the issue, Astbury J was faced with apparently conflicting authorities, holding on the one hand, that the articles do not constitute a contract between the company and its members, and on the other hand, the opposite point of view.

He quoted four cases namely Pritchard's case, Melhado's case, Eley's case, and Browne v La Trinidad.[1] These cases will be referred to as the Eley cases. These cases acknowledged that the articles are a contract between the members inter se, but denied that they are a contract between the company and the members. However, Astbury J found that in the Eley cases "the articles relied upon purported to give specific contractual rights to persons in some capacity other than that of shareholder, and in none of them were members seeking to enforce or protect rights given to them as members in common with the other corporators".[2] "The actual decisions," he said, "amount to this. An outsider to whom rights purport to be given in the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles treating them as contracts 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 to enforce rights which are res inter alia acta and not part of the general rights of the corporators as such."[3]

On the other hand, Astbury J observed that in other cases the company had been held to be entitled, as against its members, to enforce and restrain breaches of its regulations.[4]

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1. Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956.
   Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503
   Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88
   Browne v La Trinidad (1887) 37 ChD 1.
2. Hickman's case supra 896.
3. Ibid. 897.
4. Ibidem.
   The other cases quoted by Astbury J are:
   MacDougall v Gardiner (1875) 1 ChD 13.
   Pender v Lushington (1877) 6 ChD 70.
   Imperial Hydropathic Hotel Co Blackpool v Hampson (1882) 23 ChD 1.

It was also clear to him that shareholders as against their company can enforce and restrain breaches of its regulations.[1]

In all these cases[2] Astbury J found that the respective articles sought to be enforced related to the rights and obligations of the members generally as such and were not given to persons in some capacity other than that of shareholders.[3]

In order to reconcile these two classes of decisions, and the judicial opinions therein expressed, Astbury J held in Hickman's case that "no article can constitute a contract between the company and a third person; secondly, that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as for instance, as solicitor, promoter, director, can be enforced against the company; and thirdly, that articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively."[4]

The first proposition is of course a restatement of the English law relating to privity of contract. The second and third proposition, read together, will be referred to as the outsider rule.

Astbury J sought to reconcile two apparently conflicting lines of cases in order to determine when articles are, or are not, binding as between the company and its members. He regarded the Eley cases which found that there was no contract between the member and the company, but only between the members inter se, as refusing to enforce as between the member and the company, articles which purported in each case to give specific contractual rights to persons in some capacity other than that of shareholder.[5] Furthermore, he considered that the relief sought in these cases was not the enforcement of rights given to the member in question in common with other shareholders.[6] He concluded therefore, that such rights could not be

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1. In support of this he referred to Johnson v Lyttle's Iron Agency (1877) 5 ChD 687 at 693. Wood v Odessa Waterworks Co (1889) 42 ChD 636.
2. That is, the Eley cases and the other cases. The Eley cases are set out at 177 above, footnote 1. The other cases are set out at 177 above at footnote 4.
3. Hickman's case supra 899-900.
4. Ibid 900.
5. Ibid 896-897 and 900.
6. Ibid 896-897.

enforced by the member against the company as arising from the contract embodied in the articles.

His view of "the other cases" was that, by contrast, the rights and obligations in question were enforceable because they were general and were held by the members in their capacity as such.

Astbury J then examined the facts before him in the light of these tests. He found that the plaintiff's action was in substance to enforce his rights as a member under the articles against the association.[1] Furthermore, he held that the article in question was a general article applying to all the members as such.[2] It therefore created enforceable rights and obligations as between the member and the association.[3]

In order to offer a critical assessment of Hickman's case, it is essential to review the English cases preceding it. Much of the judgment in Hickman's case rests on Astbury J's view of and his attempt at reconciling the judgments in these cases. It is therefore proposed to examine these cases preceding Hickman's case to ascertain whether they provide any evidence of the outsider rule; the criteria of capacity and generality; and its purpose of limiting the contract contained in the articles to matters relating solely to membership.

The Eley cases, which in the view of Astbury J purported to give specific contractual rights to persons in some capacity other than that of shareholder, will be dealt with first. Then the other cases mentioned in Hickman's case will receive attention, together with several cases not referred to by Astbury J.

3. The Eley cases[4]

In Tavarone Mining Co Re Pritchard's Case the articles provided that the company should, immediately after incorporation, enter into an agreement to purchase a mine; the price to be paid partly in cash and partly in fully

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1. Ibid 902.
2. Ibidem.
3. Ibid 903.
4. The Eley cases are :

   Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956
   Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503
   Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88
   Browne v La Trinidad (1887) 37 ChD 1. See 177 above at footnote 1.

paid-up shares to be allotted to the vendor or his nominees.[1] The articles were signed by the vendor and six other persons and were duly registered. The directors allotted the shares to the vendor or his nominees, but no further agreement was entered with the vendor. The company was then ordered to be wound-up. One of the nominees of the vendor was placed on the list of contributories in respect of shares allotted to him and not paid up. Under s 25 of the Companies Act, 1867, every share was deemed to have been issued and to be held subject to payment in cash, unless the matter had been otherwise determined by a written contract. The only written contract was the articles. However, the articles were not considered to be a contract in writing between the vendor and the company, but only a contract between the shareholders inter se in respect of their rights as shareholders.[2]

Since there was, in the view of the court, no contract between the member and the company, there could be no enquiry into either of the concepts of capacity or generality in Hickman's case or their elements.

In the case of Melhado v Porto Alegre Rail Co the articles of association of the company provided that the directors were authorised, at their discretion, to pay certain pre-incorporation expenses.[3] The plaintiffs claimed these expenses, having disbursed same in the course of promoting and establishing the company. The court held that there was no contract between the plaintiffs and the defendant company.[4] Furthermore, said the court, supposing there was a contract among the promoters before the company came into being, purporting to bind it, the company could not ratify such a contract.[5] Finally, the court concluded that apart from this there was in point of law, no contract between the defendant company and persons not parties to the articles of association.[6]

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1. Pritchard's Case supra.
2. Ibid 960.
3. (1874) LR 9 CP 503; 43 LJCP 253.
4. Ibid 505 expressly relying on Kelner v Baxter (1866) LR 2 CP 174.
5. Ibid 505.
6. Ibid 505. This view is in keeping with the English law on the contract with a third. See Scruttons v Midland Silicones Ltd [1962] 1 All ER 1 HL; Getz L: Contracts for the Benefit of Third Parties (1962) Acta Juridica 38 at 53. See Chapter 3 at 62 et seq.

There is no suggestion that the plaintiffs were members of the company. In fact, they were found by the court to be in no way parties to the articles.[1] The article was regarded as nothing more than a valid authority to the directors to pay these expenses if they saw fit.

There is nothing to support the view, implicit in the comment of Astbury J, that the case ought to be regarded as dealing with an article which defines the right of a shareholder in his capacity as an outsider.[2] In fact all that was said in the case was that a person who is not a party to the articles cannot sue the company on the contract contained in the articles.

There is no sign of any of the elements of the outsider rule - neither capacity nor generality are to be found in it, nor any concept akin to them.

The judgments in Eley v Positive Government Security Life Assurance Co[3] in both the court of first instance and in the court of appeal are referred to by Astbury J.[4] In one of the articles of the defendant company the plaintiff was appointed as its solicitor, stipulating that he should not be removed from office except for misconduct. A year after its incorporation the plaintiff became a member of the company. He acted for a couple of years in all as its solicitor. Then his services were no longer required and the defendant company instructed other solicitors.

The plaintiff claimed relief arising out of the breach of the agreement contained in this article between himself and the defendant company appointing him as its solicitor to do its business. The plaintiff's contention was that, by s 16 of the Companies Act, 1862, the articles formed a contract on which the plaintiff could sue the company.[5]

The defendant disputed this, contending that the articles did not in themselves constitute a contract between the company and third parties but only between the members inter se.[6] Amphlett B, in the court of first instance, upheld the defendant's contention. Although the matter went to

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1. Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503 at 506.
2. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 903.
3. (1876) 1 ExD 20 and 88.
4. Hickman's case supra 892-895.
5. Eley's case supra 23 and 88.
6. Ibid 23.

the Court of Appeal, Astbury J quoted the view of Amphlett B, stressing that in consequence, the articles cannot as a result give a right of action to a person who is not a party to the articles although named therein.[1]

The line of reasoning expressed by Amphlett J was upheld by Cairns L C in the Court of Appeal, who held that the articles were an agreement inter socios.[2] The article in question was therefore a covenant between the parties to it that they would employ the plaintiff. Furthermore, it was res inter alios acta, the plaintiff was no party to it.[3] The directors of the company, in employing the plaintiff as a solicitor for the company, were doing what they were bound to do as between themselves and the company though not between themselves and the plaintiff.[3]

The court, having found as a matter of fact that there was no agreement between the plaintiff and the defendant outside the articles, also concluded that as a matter of law the articles in themselves were not such a contract. Furthermore, the court was of the opinion that the plaintiff was not a party to the covenant between the members to employ him.[4] This was the court's view, despite the fact that Eley subsequently became a member.

Since the court found, in Eley's case, that there was no contract between the plaintiff and the company, there was no room for a discussion on Eley's capacity, or on whether the article was of general application. Neither of these aspects was in fact discussed in the case.

In Browne v La Trinidad[5] an agreement was entered into between the plaintiff and a trustee for a company to be formed, in terms of which the plaintiff would be a director and would not be removed until a certain date. The company, called La Trinidad Limited, was subsequently incorporated.[6]

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1. Hickman's case supra 893.
2. Supra 89-90.
3. Ibid 90.
4. Ibidem.
5. (1887) 37 ChD 1.
6. Ibid 2.

One of its articles provided that the directors should adopt this agreement; another provided that the company might remove any director.[1] The plaintiff was not a subscriber to the memorandum,[2] but he did have shares allotted to him.[3] He became a director but was removed prior to the expiry of his term of office.

The plaintiff challenged his removal contending inter alia that upon a true construction of the articles and the pre-incorporation contract referred to therein, he could not be removed prior to the expiry of his term of office. The plaintiff failed in his action. In the first place, it was held that the contract was not adopted by the company. In the second place, the articles were held to be a contract not between the member and the company but only between the shareholders inter se having regard to Eley's case.[4]

Lindley L J in taking this view, found that there might have been some difficulty in arriving at this conclusion, but for the authorities. The plaintiff was, he said, a member and, having regard to s 16 of the Companies Act, 1862 there would be some force in the argument that the contract referred to in the articles had become binding between himself and the company. However, there would be no contract until the shares had been allotted to him. It would be remarkable, he thought, that thereupon a contract would arise between him and the company as to a matter not connected with the holding of shares. However, these difficulties were removed by the authorities, said the judge, so that the plaintiff had no contract with the company.[5]

The case, therefore, turned on the simple proposition that the articles are no more than an agreement between the members inter se. Questions identifiable with the concepts of generality and capacity in Hickman's case therefore did not arise. However the remarks of Lindley L J[5] quoted above, that a contract in the articles as to a matter not connected with the holding of shares would be remarkable, raises questions which might lead to such

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1. Ibid 3.
2. Ibid 2.
3. Ibid 14.
4. Ibid 13.
5. Ibid 14-15.

answers as capacity or generality. This is the closest one can come to finding the elements of the outsider rule in the preceding cases.

4. Other cases[1]

It is now proposed to examine the other cases referred to by Astbury J in the course of his judgment, leading up to the outsider rule, bearing in mind that in his view, in all these cases (unlike Eley's cases), the respective articles sought to be enforced related to the rights and obligations of the members generally.[2]

Of these, Astbury J described three as cases where the company was entitled as against its members to enforce and restrain breaches of its regulations.[3]

The first of these was MacDougall v Gardiner.[4] At a general meeting of a company a resolution was moved, in terms of its articles, and a poll was called to vote on the motion, also in terms of the articles. The chairman ruled that there could not be a poll on the question of an adjournment and left the room. The plaintiff brought an action on behalf of himself and all the other shareholders, except the directors, against the directors and the company, seeking an order, inter alia, declaring that the conduct of the chairman was illegal and improper.

It was held that the action could not succeed as it violated the rule in Foss v Harbottle since it sought the interference of the court in the internal management of the company.[5]

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1. The other cases are:

   MacDougall v Gardiner (1875) 1 ChD 13
   Pender v Lushington (1877) 6 ChD 70
   Imperial Hydropathic Hotel Co Blackpool v Hampson (1882) 23 ChD 1 and 13
   Johnson v Lyttle's Iron Agency (1877) 5 ChD 687
   Bradford Banking Co v Briggs (1886) 12
   Wood v Odessa Waterworks Co (1889) 42 ChD 636
   Salmon v Quin and Axtens Ltd [1909] 1 ChD 311; [1909] AC 442 HL
   Welton v Saffery [1897] AC 299HL.

2. Hickman's case supra 899.
3. Ibid 897.
4. Supra.
5. Ibid 14.

The court stressed that no one shareholder could bring an action regarding internal disputes unless there was something illegal, oppressive or fraudulent. Every litigation, he said, had to be in the name of the company, which had to determine whether it would act to remedy a wrong done to it.[1]

Astbury J was correct, therefore, in quoting this case in support of the proposition that a company is entitled to enforce and restrain breaches of its regulations.[2] However, there was no suggestion in the case that the company could not do so. Rather, the question was whether the shareholder was also entitled to do so. In relation to the outsider rule, the capacity in which the right was given in the article was that of a member, and without doubt the article, relating to the adjournment of the meeting, applied alike to all shareholders. However, neither the outsider rule nor any of its elements was invoked either in argument or in the judgments.

The second was Pender v Lushington.[3] In this case the chairman refused to count certain votes cast in a poll. As a result certain shareholders brought an action in their names and that of the company to restrain the defendants from ruling out these votes. It was said for the defendants that the company ought not to have been a plaintiff. However, Jessel M R rejected this contention, leaving it to the parties to the action to call a general meeting of the company to confirm or reject the action.[4]

The matter in dispute was the members' right to vote, clearly a membership right given in that capacity and in no way an outsider right. As to generality, there is no doubt that the right to vote is a general right, applicable alike to all members. As in the previous case neither of these tests nor any of the elements of the outsider rule are to be found which would justify the formulation of the outsider rule at a later stage.

The third of these cases was Imperial Hydropathic Hotel Co Blackpool v Hampson.[5] The plaintiff company alleged that a general meeting of members had removed two directors and had elected two new directors in their place.[6]

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1. Ibid 21-22.
2. Hickman's case supra 897.
3. (1877) 6 ChD 70.
4. Ibid 79.
5. (1882) 23 ChD 1.
6. Ibid 4.

The company sought an order *inter alia* that the defendant had been properly removed from his office as a director. The action having been dismissed, the plaintiff company brought an appeal, contending that the resolution removing the director was valid, relying on an article which gave power to the general meeting to alter the articles.[1] The appeal was dismissed. Jessel M R said in his judgment that a company had no incidental or inherent power to remove a director but could only do so under a power in the articles.[2] In the absence thereof, the directors, having been elected in terms of the articles for a stated period could not be removed during such period. In his view the article relied on by the appellants merely gave the general meeting a power to alter the articles but not to remove directors.[3] They could only proceed by way of alteration of the articles and thereafter by way of removal under a power given under the altered articles.

Cotton L J in his judgment in the case, put the matter in this way: the articles were a contract between the shareholders to comply with the articles. These provided for the election of directors and for the period of office. The articles of this company provided that the duly elected directors remain in office until the expiry of a period.[4] There was nothing in the act or in the articles which directly enabled a general meeting to remove directors.[5]

Undoubtedly the rights given under the articles to appoint directors, were given to the members in their capacity as such and were applicable alike to all shareholders. However, neither capacity nor generality were touched on in argument or in the judgments, nor was there any need to do so. The matter turned entirely on the interpretation of the contract between the members as embodied in the articles. The judgment did not deal with the possibility that the contract could be unenforceable as giving outsider rights to any of the members.

Astbury J quoted these three cases - in which the company enforced its rights against the members - as a foil to the Eley cases, illustrating

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1. Ibid 5.
2. Ibid 7.
3. Ibid 8.
4. Ibid 10.
5. Ibid 11.

by contrast the fact that in the Eley cases certain rights and obligations could not be enforced because they failed the twin tests of generality and capacity.

The approach of Astbury J would have been valid if in these three cases some reference were made to these tests or to their elements or to some concept akin thereto. But this was not done in any of these three cases.

For the same purpose, Astbury J referred to a further five cases in which the shareholders were held to be entitled, as against their company, to enforce the contract.[1] Astbury J said of them that in each case there appeared judicial expressions of opinion which were impossible to disregard.[2] Attention will now be given to these cases.

In Johnson v Lyttle's Iron Agency directors of a company made a call on shares but the plaintiff did not pay on due date and in fact ignored a warning to pay same plus interest by a certain date.[3] The directors thereupon passed a resolution forfeiting his shares. It was held that the notice did not comply with the relevant article and was therefore bad and the forfeiture was invalid.

The notice did not comply strictly with the provisions of the contract between the company and the shareholders which was contained in the regulations of Table A.[4] The action was instituted by a shareholder against the company and was successful. In upholding the shareholder's right to enforce the contract embodied in the articles as against the company, neither capacity nor generality were canvassed in argument or the judgments of the court. Nor can there be any doubt that the shareholder could enforce the right in his capacity as member. Furthermore the right was applicable alike to all shareholders, thus conforming to the test of generality.

In Bradford Banking Co v Briggs[5] one Easby, a coal merchant, was a member of the respondent company who pledged his shares to the appellant bank as

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1. These cases are referred to in Hickman's case supra 897-898.
2. Ibid 898.
3. (1877) 5 ChD 687 CA.
4. Ibid 693.
5. (1886) 12 AppCas 29.

security for his indebtedness. In terms of the articles of the respondent company, it had a lien on the shares of every shareholder for all debts due to the company. The appellant bank gave notice to the respondent company of the pledge. Easby's estate was declared insolvent at a time when he was indebted to both parties to the action and when he was the registered holder of the shares. The dispute between the parties to the action was as to which of them was entitled to regard the shares as security for their claims in priority to those of the other of them.[1]

Blackburn L C gave judgment in the action, with which the other judges concurred. He held that "the articles are, by virtue of s 16 of the Companies Act of 1862, a contract between the company and its members".[2] Consequently "the property in the shares was bound to the company".[2] However, the bank's notice put an end to the preference enjoyed by the company under the lieu. After the date of such notice the bank's claim ranked prior to that of the company.[3]

This case is quoted by Astbury J in Hickman's case as authority for the proposition that shareholders as against their company can enforce and restrain breaches of its regulations.[4] However the issue in the case was the ranking of creditors on the shareholder's insolvency. Astbury J also quoted the case as an example of the enforcement of an article relating to the rights and obligations of the members generally as distinct from rights of the character dealt with in the Eley cases.[5] In fact the House of Lords was silent on the question of generality although there can be no dispute that the rights and obligations in the article applied alike to all shareholders. On the question of capacity there was also no judicial comment in the case. Was Easby's obligation to subject his shares to the company's lien limited to matters relating only to his capacity as a member ? Was his indebtedness to the company that of a member ? All that was said in the case was that Easby was a coal merchant and that he had been a customer

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1. Ibid 33 and 35.
2. Ibidem.
3. Ibid 37.
4. Hickman's case supra 898.
5. Ibid 899.

of the respondent company and owed it a considerable sum. It seems that the capacity of a customer is not that of a member.[1] Consequently, applying the outsider rule to the case, one would expect the result to be that the lien was unenforceable since it related to a claim against the member in some capacity other than that of member. Yet the House of Lords was silent on the matter which was not raised in argument before it. In fact the lien created in the articles was clearly regarded by the court as valid and enforceable.

In the case of Wood v Odessa Waterworks Co[2] the action was brought by a shareholder on his own behalf and on behalf of all the other shareholders against the company. The complaint was that the directors proposed, on behalf of the company, to dispose of the profits in a manner not provided for in the articles. The plaintiff was held to be entitled to an injunction against the company in respect thereof. Once again there can be no doubt that the plaintiff acted in his capacity as a member in respect of matters applicable alike to all shareholders. However, these matters were not before the court at all. In fact the burden of the judgments in the case was, as has been referred to previously,[3] and as was quoted by Astbury J[4] that the articles were a contract, not merely between the shareholders and the company, but between each individual shareholder and each other.[5]

Astbury J, having quoted this statement, also quoted a comment thereon.[6] Farrell L J in Salmon v Quin and Axtens Ltd had confirmed that the articles were a contract not merely between the shareholders and the company but also between the members inter se.[7] However, he said, "it may well be that the Court will not enforce the covenant as between the shareholders in most cases".[7]

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1. See for example Dale and Plant Limited Re (1889) 43 ChD 255 and Leicester Club and Country Racecourse Co Re (1885) 30 ChD 629. For a detailed reference to these cases, see 197 and 198 below.
2. (1889) 42 ChD 636.
3. Ibid 641-642.
4. Hickman's case supra 898-899.
5. Wood v Odessa Waterworks Co supra 642.
6. See Hickman's case supra 899. On the question of a direct nexus between members arising from the contract in the articles see Chapter 3 at 32 et seq.
7. [1909] 1 ChD 311 at 318.

It is by no means certain that Farrell L J was contemplating the application of the outsider rule to the contract in the constitution as between the members inter se. It is more likely that he was referring to the controversy raised by the judgment of Hershell J in Welton v Saffery.[1] This, of course related only to the enforceability of this contract between the members inter se, by any means other than through the medium of the company. It would, therefore, not take the present enquiry any further. It is, on the other hand, not suggested that the outsider rule has no place in the contract between the members inter se. On the contrary it will be demonstrated that Astbury J probably intended the rule to apply to this contract.[2] There is one authority subsequent to Hickman's case confirming the applicability of the outsider rule to the contract in the constitution as between the members inter se.[3]

Salmon's case is, nevertheless, very important but for reasons other that the reference to it by Astbury J.[4] As it was heard both in the court of first instance and on appeal by the House of Lords, it is proposed to refer only to the report in the House of Lords in the name of Quin and Axtens Ltd v Salmon.[5]

In this case an article entrusted the management of the company to a board of directors. The board included two of the major shareholders, who were the managing directors. Under another article, the managing directors had a right of veto over certain decisions of the directors. Salmon, one of these managing directors, vetoed certain of these resolutions, acting within the scope of his veto. These vetoed resolutions were then referred to a general meeting of members and were there passed by a simple majority. In a representative action Salmon, on behalf of himself and all other shareholders except the defendants, sought an injunction against the company and against Axtens and another, restraining them from acting on such resolutions.

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1. [1897] AC 299 HL 315. See Chapter 3 at 36-38.
2. See Chapter 9 at 222 et seq.
3. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G. See Chapter 3 at 39.
4. Salmon's case is referred to by Astbury J in Hickman's case supra 899.
5. [1909] AC 442 HL.

It was argued before the House of Lords that the resolutions of the general meeting of members were a higher authority than a resolution of directors, and that the veto could only be effective upon resolutions of the directors, but not upon those of the company.[1] Loreburn L C disposed of these arguments simply by saying that the bargain of the shareholders contained in the articles amounted to this, that the directors should manage the business of the company but they could not manage it in a particular way. They could not do things if Salmon or Axtens objected.[2]

As the resolutions passed by the general meeting were inconsistent with the articles in question the resolutions were not binding.[3] Only a special resolution could effect an alteration of the articles.

There is no mention in the case of the outsider rule or any of its elements. Applying the rule to the facts, it might be reasonable to infer that Salmon's right of veto over directors' decisions was given to him as a director and was not part of the general regulations applicable alike to all members. Viewed thus, the case clashes with the outsider rule. It would, however, be equally accurate to argue that the right was given to a member and was exercised by him qua member, even though it related to the member's right to participate in the management. It could also be said to be part of the general regulations, in the sense that the company was to be run in a particular way, namely by the directors who could, however, not do certain deeds if there was objection thereto by Axten or Salmon.[4]

However, both interpretations, either that the right was given qua director, or that the right was given qua member, are ex post facto rationalisations, no more than attempts to fit the case into the outsider rule. Yet there is no sign in the judgments of the rule.

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1. Ibid 443.
2. Ibidem. Loreburn L C also said (Ibid 443-444) that the failure of the directors to grant these leases did not remit the matter to the discretion of the company in general meeting. This case therefore established the principle of the division of powers between the directors and the members.
3. Ibid 444.
4. Ibid 443.

Another interpretation of the case is that of Wedderburn.[1] In his view, Salmon was not trying to protect his unique right to dissent from the directors' decision.[1] As member he had no right of veto; the articles purported to give that right to him in his capacity as managing director and not as member. Salmon sued as a shareholder to protect a right personal to him, but common to all shareholders. 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 was therefore obvious that Salmon enforced the right of a member to have the articles observed by the company. "It is true," he stated, "that the proposition to which this conclusion gives rise apparently conflicts with the rule in Hickman's case that outsider rights can never be enforced by reliance upon the articles."[2]

Wedderburn's views as stated above, are not entirely accurate since he attempted to press the judgments in the case into the mould of the outsider rule, whereas there is no sign of it in these judgments.[3] As Lord Loreburn L C said in the case, the shareholders entered into a bargain to allow the directors to manage the company in a certain way, namely, subject to the veto of Salmon and Axtens.[4] It was this contract contained in the articles which the court enforced.

Nevertheless, his conclusion that the case clashes with the rule is doubtless correct.

It remains to note the high authority of Salmon's case, being a decision of the House of Lords, in respect of which other judicial decisions in conflict or inconsistent with same, cannot stand.[5]

Returning to the judgment of Astbury J in Hickman's case, the case of Welton v Saffery was also referred to in support of the proposition that

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1958) CLJ 194 at 212.
2. Ibidem.
3. Ibidem. Wedderburn proceeded to formulate his theory of the indirect enforcement of outsider rights, as a method of reconciling Salmon's case with the outsider rule. See Chapter 10 at 235 et seq.
4. Quin and Axtens Ltd v Salmon supra 443.
5. Halsbury Vol 22 pars 796-807 on the status of decisions of the House of Lords.

rights and obligations relating to the members generally can be enforced.[1]

This case, said Astbury J, was one of those in which the shareholders were held to be entitled, as against their company, to enforce the contract embodied in the articles.[2] The learned judge quoted from the dissenting judgment of Lord Hershell in Welton v Saffery that the articles constituted a contract between each member and the company.[1]

The issue in Welton v Saffery was whether a company could issue shares at a discount. The articles expressly authorised this. When the company was wound up the liquidator placed the holders of these shares on the list of contributories, notwithstanding that all creditors had been paid in full from the assets of the company. It was argued that a company could issue shares at a discount and that a contribution could only be levied in respect of such shares in order to pay creditors but not to settle the rights of the shareholders inter se.

It was held, with Lord Hershell dissenting, that it is ultra vires the company for it to issue shares at a discount. As Lord Macnaughten said, "there was an offer, but it was one which the law does not allow, to which there was an acceptance. But that offer and acceptance could not constitute a contract. Both parties acted under a misconception of law and the whole thing was void."[3] On the facts there was no room for the consideration of the outsider rule or of capacity or generality. The article conflicted with the statute and being therefore ultra vires, was void. As such, no questions of invalidating an otherwise valid article arose. The proposition that the articles constitute a contract between the member and the company, referred to above, of course leads to the conclusion that such a contract is enforceable by the shareholders and the company. But it does not elucidate the outsider rule or its elements.

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1. [1897] AC 299 HL. Lord Hershell in Welton v Saffery supra 315, also dealt with the enforceability of the articles as a contract between the members inter se. It is submitted that his views thereon are irrelevant to the present topic. See Chapter 3 at 36 et seq. on the contract embodied in the company constitution between the members inter se.
2. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 898-899.
3. Welton v Saffery supra 321.

In all Astbury J quoted eight cases, other than the Eley cases. Three dealt with the company's rights against its members, and the other five dealt with the members' rights against the company. These five, as with the first three were intended to illustrate, by way of contrast, the outsider rule. None of these cases made mention of the elements of the outsider rule, nor did the judgments uphold either the company's or the member's rights by way of distinguishing such rights from outsider rights. This silence in regard to the outsider rule, or its elements or any doctrine akin thereto, it is submitted, weakens considerably any suggestion that the outsider rule was inherent in the English law of the time.

5. Cases not mentioned in Hickman's case

Having dealt with all the cases quoted by Astbury J, there remain other judgments which could have had a bearing on the matter and which and which do not seem to have been considered in Hickman's case, either in argument or in the judgment. It is proposed to deal with these now.

In Pulbrook v Richmond Consolidated Mining Co [1] the articles provided that no person be a director unless he holds, as a registered member, shares of a nominal value of £500 at least. The plaintiff, being the registered holder of the requisite number of shares, was elected a director. He had, however, mortgaged his shares and had executed a deed of transfer of his shares to the mortgagee who, after the plaintiff's election as a director, in error caused the shares to be registered in the name of the mortgagee. As a result the plaintiff was not allowed to take his seat as a director. The plaintiff obtained an order of court rectifying the error but the directors persisted in their attitude, refusing to allow him to act as a director.[2] In a motion to restrain the directors by injunction from thus interfering with the plaintiff's rights, it was argued for the other directors that if there was a wrong, the action should be brought in the name of the company.

Jessel M R delivered the judgment of the court.[3] He said that in this case the plaintiff was necessarily a shareholder, in order to be a director and as a director he was entitled to fees and to remuneration.[4]

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1. (1878) 9 ChD 610.
2. Ibid 611.
3. Ibid 612.
4. Ibidem.

His exclusion from the board was an individual wrong, since he had been deprived of his legal rights. He had a right by the constitution of the company to take part in its management. This right might affect his individual interest as a shareholder, as well as his liability as a director. Besides that, he was in the position of a shareholder, of a managing partner in the affairs of the company and he had a right to remain managing partner.[1]

Here clearly there seems to be an enforcement of rights granted in the articles to a member in a capacity other than that of member. On the other hand the restriction imposed in the articles, namely that no person be a director unless he held as a registered member a stated number of shares, applied alike to all members. This would comply with the test of generality.

The court, in upholding the member's right to be a director, adopted an approach quite unlike that of the outsider rule, in terms of which the right to be a director is an outsider right, and as such is unenforceable.

The court in Pulbrook's case found itself in an analogous position to that of the court in Hickman's case, yet it reacted differently and found no need to create something akin to the outsider rule. The outcome in Pulbrook's case is consistent with the historical evolution of company law, in terms of which provision for participation in the management of a company was always a major factor in drafting the constitution of a company and of its predecessor, the joint-stock company.

In Boston Deep Sea Fishing and Ice Co v Ansell a company was engaged in carrying fish between a fleet of fishing smacks and its home port.[2] These fishing boats were owned by members of the company but the fish were carried home in the company's vessels. One of the articles of the company imposed the obligation on every one of its members who owned a fishing boat and who used it to catch fish with the rest of the fleet, to send all his fish home by a company vessel.[3] The article provided both a penalty and a bonus. In a dispute between the company and a member who owned a fishing boat, this article was described by the court as a direct contract between such member and the company as regards his smack and was held to be enforceable as such. The right given to the company and the obligation

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1. Ibid 613.
2. (1888) 39 ChD 339.
3. Ibid 356.

placed on members to use the company's vessels was clearly of an outsider nature. Nor was it of general application. It only placed an obligation on some members, that is to say, those who were smack owners.

Yet no doubts were raised, either in argument or in the judgment, as to the enforceability of the article in question. Nor did the court, in upholding this article, examine the right or the concomitant obligation, by either of the twin criteria of capacity or generality or any notion similar thereto.

Another case which is relevant to the present enquiry is Wheal Buller Consols Re.[1] In this case the articles provided that the qualification of a director was the holding of 250 shares, that he might act before acquiring his qualification but that his office be vacated if he did not acquire it within three months after his election. The appellant subscribed the memorandum for 10 shares, was subsequently elected a director and attended meetings of directors for more than three months after his election, but never applied for, nor had allotted to him, any shares other than his original ten. The company was wound up and the appellant was placed on the list of contributories for 250 shares. The argument for retaining him as a contributory was that by s 16 of the Companies Act, 1862 all members are bound by the articles. Furthermore, as the appellant had signed the memorandum and taken ten shares, he therefore was a member, so that all the stipulations of the articles were binding between him and the company.[2] It was argued furthermore that although by Eley's case nothing in the articles could be a contract enforceable by an outsider, the appellant was not an outsider. He was a member of the company and bound by the articles which imposed upon any person becoming a director a duty to take shares. In substance each shareholder covenanted that if he became a director he was to contract to take shares.[3]

The court held that the appellant had signed the memorandum and therefore became bound under the Companies Act, 1862 to conform to the regulations contained in the articles.[4] However all the judges agreed that the article in question did not impose a duty on a member who became a director to take shares.[5] On the contrary the article was held to say no more than that,

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1. (1888) 38 ChD 42.
2. Ibid 46.
3. Ibidem.
4. Ibid 48-50.
5. Ibid 49.

if a director did not acquire the requisite number of shares within three months, he should cease to be a director.[1] It appears that, had the article imposed a duty on a member who became a director to take shares, the appellant would have been held liable. The obligation was not imposed on a director but on a member, that is one who became a director. It was part of the general regulations of the company applicable alike to all members. In addition the obligation was imposed on the member in his capacity as a member. However, neither of these criteria, which form the basis of the outsider rule, were canvassed at all in the case.

The distinction between one capacity and another in one person was not unknown in the nineteenth century. The question arose in cases in terms of s 38(7) of the Companies Act, 1862, in terms of which no sum due to a member, in his capacity as such, was payable to him in competition with creditors who were not members. In these cases the question was whether unpaid fees claimed by directors were due to them in their capacities as members or as directors.

In Dale and Plant Ltd Re it was argued under the aforesaid section, that fees due to a managing director were due to him in his character as a member.[2] Kay J, the judge in the case, had no difficulty in rejecting this argument.[3] The managing director was appointed as such because of his special skills. This was also true of the solicitor who was a member. Likewise, a member who sold bricks to the company was not a creditor in his character as a member.

In his judgment, Kay J defined the character of a member for the purpose of s 38(7) and by reference to its wording. Moneys due to the member by way of dividends or profits, or something analogous to these, were due to him in his character as a member.[4]

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1. Ibid 50.
2. (1889) 43 ChD 255 at 258.
3. Ibidem.
4. Ibid 259.

The opposite view was taken in Leicester Club and Country Racecourse Co Re.[1]

In this case Pearson J held that directors' fees were due to the director in his character as member. The directors, he said, could not divest themselves of their character of members of the company.[2] He concluded that strictly within the terms of the section the debt in question was due to the director in his character as a member.[3] Both Gower[4] and Wedderburn[5] have criticised the judgment as bad law, since as a general statement, to view the directors as merely a sub-species of member, is palpably incorrect.

Dale and Plant's case and Leicester Club's case clearly recognise the possibility of a person owing duties or enjoying rights in a dual capacity. Consequently these authorities do not support the proposition that rights given, in some capacity other than that of member, are unenforceable. These cases, therefore, do not anticipate in any way the outsider rule.

There is another relevant case bearing the name of Dale and Plant Ltd Re.[6] In this case the plaintiff entered into an agreement with the promoters of the company, not yet formed, to be its secretary for five years at a stated salary. The plaintiff signed the memorandum for one share. The company was subsequently registered after the agreement was signed and one of the articles provided that the plaintiff should be the secretary, and authorised the directors to enter into an agreement on the terms of the pre-incorporation agreement. Instead of concluding a new agreement, the directors merely passed a resolution adopting and ratifying the pre-incorporation agreement. The judgment dismissed the action on two grounds. The first was that it was impossible for a company to ratify anything that was done or any contract that was made before it came into existence. The second was that articles, being merely a contract between the shareholders inter se on the principle of Eley's case, were not binding on the company.[7]

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1. (1885) 30 ChD 629.
2. Ibid 633.
3. Ibid 634.
4. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 at 402 footnote 9 (The first note).
5. Wedderburn K W : Effect of Articles as a Contract - remedy against Directors (1958) CLJ 148 at 149.
6. (1889) 61 LT 206. Apart from the identical names there is no other similarity between the two cases.
7. Ibid 207.

This is, therefore, another case where the questions of capacity and generality could not arise because, although the plaintiff was a member, no contractual nexus between him and the company arose, as far as the court was concerned.

6. A general comment on the preceding cases

6.1 The Eley cases[1]

Astbury J's views on the Eley cases were important, since they led him to his formulation of the outsider rule.[2] In deciding whether the articles before him, in Hickman's case were a written agreement of submission in terms of the Arbitration Act, he expressed the opinion that the Eley cases ought to be regarded as dealing with and applying to articles purporting, first, to contain an agreement with the company and a third person or, secondly, to define the rights of a shareholder in some capacity other than that of a member of the company. To reconcile these decisions with the other expressions of judicial opinion abovementioned, some such view, he thought, should be adopted and general articles dealing with the rights of members "as such" treated as a statutory agreement between them and the company as well as between themselves inter se.[3] In other words he treated the Eley cases as if the questions of capacity and generality were the issues. Yet neither of these questions were before the court in any of the Eley cases.[1]

The view which Astbury J took of the Eley cases was not the contemporaneous view.[4]

Buckley in 1891 viewed the four Eley cases as authority for the proposition that a third party cannot sue on a contract contained in the articles,[5] and that articles which provided that a certain person be employed

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1. The Eley cases are :
   Tavarone Mining Co Re, Prichard's Case (1873) 8 ChApp 956
   Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503
   Eley v Positive Government Security Life Assurance Co (1876)1 ExD 20 and 88.
   Browne v La Trinidad (1887) 37 ChD 1. See 179 above et seq.
2. See 177 above.
3. Hickman's case supra 903.
4. See Buckley: On the Companies Acts (Sixth Edition London 1891) 213 and 555; Palmer : Company Law (Fourth Edition London 1902) 32. See also Dale and Plant Ltd Re (1889) 61 LT 206 at 207, in which the articles were described as a contract between the shareholders inter se "within the principle of" Eley's case.
5. Buckley: On the Companies Acts supra 213 note (111) and 525 footnote (e).

in a particular office, for instance, as solicitor, did not consittute a contract with him. In Buckley's view, this was so even if he was a member (notwithstanding s 16 of the Companies Act of 1862) since, following the authorities, there was only a contract between him and the other members and not between him and the company.[1]

This view of the contractual effect of the articles, although it follows both Pritchard's Case[2] and Melhado's case[3] is no longer regarded as good law.[4] It was followed, but questioned for the first time in 1887 in Browne v La Trinidad.[5]

In that case Lindley L J said of Eley's case that its conclusion that no contract existed between the member and the company might have been difficult to reach but for the authorities,[6] since Eley had shares allotted to him and was therefore a member of the company. Having regard to the terms of s 16 of the Companies Act, 1862, the judge thought there would be some force, or at all events some plausibility in the argument that, being a member, the contract which was referred to in the articles had become binding between the company and him.[5]

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1. Ibid 559 footnote (9). This view is also expressed by Kay J in Dale and Plant Ltd Re (1889) 61 LT 206 at 208.
2. Tavarone Mining Co Re, Pritchard's Case (1873) LR 8 ChApp 956.
3. Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503.
4. Wood v Odessa Waterworks Co (1889) 42 ChD 636 at 642.
5. (1887) 37 ChD 1 at 14.
6. Lindley L J used the term "authorities" without specifying to which authorities he referred.

A century later Eley's case has become a locus classicus.[1] It is to-day regarded as one of the leading authorities for the outsider rule.[2]

The actual basis of the judgment has faded from view, namely, that the articles were viewed as no more than a contract between the members inter se, and therefore conferred no rights as between the company and its members.[3] It seems that Eley might well have succeeded, had the judges adopted the later view that the articles are binding, not only between the members inter se, but also as between the members and the company; and had they also recognised that Eley subsequently became a member.[4] On this assumption and had the court elected to adopt the same reasoning as was subsequently adopted in Pulbrook's case, it could then have upheld the right given to a member to be the company's solicitor, at least prospectively.[5] It may well be that Eley had no retrospective rights to be the company's solicitor prior to the date of his membership.

To say that a member may contract in the articles for his right to be a solicitor is consistent with Pulbrook's case, but it is quite inconsistent with the outsider rule.[6]

In terms of the outsider rule, such a right is not part of the general regulations applicable alike to all members, since the right is given to one member and not to all the members. It seems, however, that if a right or an obligation rests on one or more members or on a category the corresponding obligation or right rests on all the other members alike.[7] It is still therefore part of the general regulations.

In the second place, it might be argued that in terms of the outsider rule such a right is given in some capacity other than that of member. To

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1. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88.
2. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 218C-F.
3. Eley's case supra 89-90.
4. Wood v Odessa Waterworks Co (1889) 42 ChD 636.
5. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610; which in turn is in line with the following cases:
   Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339
   Salmon v Quin and Axtens Ltd [1909] 1 ChD 311; [1909] AC 442 HL.
   Bradford Banking Co v Briggs (1886) 12 AppCas 29.
6. Pulbrook's case supra.
7. See for example Rayfield v Hands [1958] 2 All ER 194 ChD. See Chapter 3 at 42 et seq.

this there seems to be no answer, save to recognise that, in terms of the Pulbrook line of cases, a member may regulate many aspects of his membership, including his right to be a director, or even a solicitor to the company.[1]

6.2 The other cases[2]

These cases were referred to by Astbury J as examples of articles which were enforced and which related to the rights and obligations of members generally.[3] They served as a contrast to the Eley cases, which in his view, purported to give specific contractual rights to persons in some capacity other than that of shareholder. These other cases have been examined in this chapter in the light of the twin tests inherent in the outsider rule, namely capacity or generality.

In all these other cases, except for Bradford Banking Co v Briggs, Salmon v Quin and Axtens Ltd, and Welton v Saffery, had the outsider rule been invoked, and had the tests of capacity and generality been applied, the article in question would have been found to be enforceable.[2] In fact, therefore, the rule was not contradicted by the outcome of the cases nor was it supported by these cases, which made no mention thereof nor of its elements.[3]

In Welton v Saffery,[4] there was no room for a consideration of the outsider rule, since the article in question was in conflict with the Companies Act, 1862 and was therefore void.

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1. See 201 above at footnote 5.
2. The other cases are :
   MacDougall v Gardiner (1875) 1 ChD 13
   Pender v Lushington (1877) 6 ChD 70
   Imperial Hydropathic Hotel Co Blackpool v Hampson (1882) 23 ChD 1 and 13
   Johnson v Lyttle's Iron Agency (1877) 5 ChD 687
   Bradford Banking Co v Briggs (1886) 12 AppCas 29
   Wood v Odessa Waterworks Co (1889) 42 ChD 636
   Salmon v Quin and Axtens Ltd [1909] 1 ChD 311 ; [1909] AC 442 HL.
   See 184 above et seq.
   Welton v Saffery [1897] AC 299 HL.
3. Hickman's case supra 899.
4. [1897] AC 299 HL.

However, in Bradford Banking Co v Briggs[1] and in Quin and Axtens Ltd v Salmon[2] the obligation in the one, and the right in the other, was in relation to the member in his capacity as an outsider. In the former case the article creating a lien in favour of the company was applicable alike to all shareholders. However, in the latter case, the test of generality could not be passed. Nevertheless, in both cases there was no mention of the outsider rule. In upholding the right and obligation in question the courts in fact contradicted the outsider rule. Apart from these cases, Astbury J also quoted several judicial expressions of opinion.[3] These do not, however, take the matter any further. They merely reiterate that the articles are an enforceable contract both between the members and the company and the members inter se.

6.3 The cases not mentioned in Hickman's case

The six cases mentioned below have been reviewed in this category.

In these cases, no mention is made of the outsider rule. In two of them, namely Pulbrook v Richmond Consolidated Mining Co [4] and Boston Deep Sea Fishing and Ice Co v Ansell[5] the right and the corresponding obligation provided for in the articles in question were of an outsider nature. Yet the rights were upheld on grounds which contradict the outsider rule. In the latter case, although not in the former, the obligation did not apply alike to all members, yet it was held to be enforceable.

In one case, Wheal Buller Consols Re, the obligation was not imposed on an outsider, namely the director, but on the member who became a director.[6] It was part of the general regulations of the company applicable alike to all members. Furthermore the obligation was imposed on the member in his capacity as a member. Nevertheless neither the criterion of generality nor that of capacity was investigated in the case.

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1. (1886) 12 App Cas 29.
2. [1909] AC 442 HL.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 897-899.
4. (1878) 9 ChD 610.
5. (1888) 39 ChD 339.
6. (1888) 38 ChD 42.

In two other cases, namely Leicester Club and Country Race Course Co Re,[1] and Dale and Plant Ltd Re,[2] the distinction was recognised, albeit in a different context, between rights and obligations resting on the member as such and others resting on him in a different capacity.

Another case of the same name simply reiterated the rule that a company cannot ratify a pre-incorporation contract and the now rejected view that the articles are merely a contract between the members inter se.[3]

6.4 A conclusion on the preceding cases

From this survey of the cases preceding Hickman's case, certain conclusions may be drawn.

In the first place three cases - where claims were brought by members against their companies arising out of the contracts in the articles - were decided on the simple proposition that the articles are no more than a contract between the members inter se, and therefore confer no rights as between the company and its members. The cases are Tavarone Mining Co. Re, Pritchard's Case[4], Eley v Positive Government Security Life Assurance Co[5] and Dale and Plant Ltd Re.[6]

In the second place two cases reaffirmed the same principle although the parties were not members. The cases are Browne v La Trinidad[7] and Melhado v Porto Alegre Rail Co.[8]

In the third place there are three cases in which rights could be described as outsider rights, following the examples given by Astbury J, were exercised by members qua members and were upheld as such. The cases are Pulbrook v Richmond Consolidated Mining Co ,[9] Boston Deep Sea Fishing and Ice Co v Ansell[10] and Quin and Axtens Ltd v Salmon.[11] In upholding

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1. (1885) 30 ChD 629.
2. (1889) 43 ChD 255.
3. Dale and Plant Limited Re(1889) 61 LT 206.
4. (1873) 8 ChApp 956.
5. (1876) 1 ExD 20 and 88.
6. (1889) 61 LT 206.
7. (1887) 37 ChD 1.
8. (1874) LR 9 CP; 43 LJCP 253.
9. (1878) 9 ChD 610.
10. (1888) 39 ChD 339.
11. [1909] AC 442 HL.

such rights the court did not consider whether or not such rights were granted in a capacity other than that of member, nor whether such rights formed part of the general regulations applicable alike to all members. These cases are in fact inconsistent with the outsider rule, representing as they do, a response on analogous facts by the courts in question, which was quite different from that of Astbury J in Hickman's case.[1]

This review of the cases preceding Hickman's case[1] therefore clearly indicates a lack of evidence of the existence of the elements of the outsider rule, or an awareness of its twin criteria of capacity or generality, or any judicial attempt to limit the contract contained in the articles by means of the outsider rule or any of its elements. It would, therefore, not be an overstatement to conclude that the outsider rule is a departure from the previous cases, and places a novel interpretation on the issue.

7. A critical assessment of Hickman's case

In the first place, it seems that Astbury J regarded the contract in the constitution as valid, even though some of its provisions may be unenforceable. This in turn suggests that the contract in the constitution might well be severable.[2] There is, however, nothing in the judgment on the point which was not raised at all.

In the second place, the question arises whether the outsider rule applies to the contract between the members inter se. On the facts in Hickman's case there was no need to decide the point. The defendant company brought an action to stay proceedings brought against it by a member, and to refer the dispute in issue to arbitration in terms of its articles.[3] The question before

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1. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881.

2. Hickman's case supra 897 and 900.
In English law, if a contract contains a number of promises, some lawful, others unlawful, the question is whether the whole contract is to be condemned, or the bad rejected and the good retained.
This subject of severance, has had a chequered career. The present position is that if the unlawful promise forms the whole of the consideration, severance is ruled out, and the contract fails in toto. If it is only part of the consideration, being merely subsidiary to the main purpose of the contract, severance is permissible. Cheshire and Fifoot 395 et seq.

3. See 176-179 above.

the court was therefore whether the articles were an agreement between the company and the members. Can one draw any inferences regarding the applicability of the outsider rule to the contract in the constitution between the members inter se ?

Reference has already been made to the attempt by Astbury J to reconcile two lines of cases.[1] The basis of his reconciliation was that in the Eley cases, where a contract between the members inter se was recognised, the contract between the members and the company was denied, because the articles in question were not general and gave rights to the members in some capacity other than that of member. It would follow that such rights would be unenforceable between the members inter se. He, of course, may have intended to interpret those cases which denied the existence of the contract between the company and the member, as stating positively that the articles are an agreement between the members inter se for all purposes and in all capacities and not merely in their capacity as members. It is submitted, however, that this is unlikely, since such a result would have been inconsistent with his view on the nature of the contract between the company and its members. If the articles are only a limited contract, in regard to one relationship regulated thereunder, there is no reason why the articles should be more all-embracing in regulating another relationship. This view is supported by the remarks which he made at the commencement of his enquiry into the nature of the contract contained in the articles.[2]

> "It is laid down," he said, "in text books of the highest repute that the articles are not a contract between the member and the company; ... but a contract with the other members; and that the articles are a contract only as between the members inter se in respect of their rights as shareholders."

Furthermore, towards the end of his judgment, Astbury J said that general articles dealing with the rights of members "as such" ought to be treated as a statutory agreement between them and the company as well as between themselves inter se.[3]

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1. See 176-179 above.
2. Hickman's case supra 890.
3. Ibid 903.

It is submitted, therefore, from the tenor of his judgment that Astbury J might have applied the outsider rule to the contract contained in the articles between the members inter se. This possibility was somewhat hesitantly recognised in London Sack's case.[1]

In the third place, provisions which are unenforceable by reference to the outsider rule are not so because they are contra bonos mores. Such provisions were not described by Astbury J as illegal, immoral or repugnant to public policy. Instead his view was based on his attempted reconciliation of the Eley cases and the other cases.

In the fourth place, the interpretation of the Eley cases was erroneous. It has been noted that these cases did no more than reflect an early view in the evolution of English company law. This view held that the articles are only a contract between the members inter se, and not a contract between the company and its members.[2]

The Eley cases reached their conclusion, without any reference to the capacity in which the right was given in the articles, or the generality of the rights and obligations therein created. Nor did they refuse to give effect to the contract as between the company and the member on grounds which might be described as applying the tests of capacity or generality. They simply denied the existence of an agreement between the company and the member.

As regards the other cases, rights and obligations were upheld as between the company and the member because, in the view of Astbury J, they were general and because they conferred rights on the members in their capacity as such.[3]

The learned judge's conclusion on these other cases was, it is submitted, correct in the sense that the rights and obligations were of a general character and were indeed held by the members in their capacity as such.[4] However, it has also been submitted that in none of these cases was the ratio decidendi the outsider rule or any of its elements.[5]

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1. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765. See also Chapter 9 at 222 below et seq.
2. See Chapter 3 at 33. Later cases, of course, clearly established the existence of the latter. See Chapter 3 at 36.
3. These are the cases set out in 201 above at footnote 5 and in 202 above at footnote 2.
4. See above at 184 et seq.
5. See above at 194.

In the fifth place, the formulation of the twin tests of capacity and generality seems to be unsatisfactory.

As far as capacity is concerned, did Astbury J provide a test to ascertain which rights are membership rights and which are outsider rights ? Astbury J gave a few examples. Rights purported to be given to a person as a solicitor, promoter, director were given in a capacity other than that of member.[1] It is therefore a question of fact in each case, depending on the interpretation of the article in question.

In regard to generality Astbury J referred to a number of cases in which, in his view, the articles related to the rights and obligations of the members generally and not to rights of the character referred to in the Eley cases.[2]

Generality cannot be construed as the obverse of capacity, viewing it as the positive aspect and capacity as the negative aspect. Consider the following example: a set of articles permits all members to occupy flats in a building owned by a company and to pay rent thereon. Such articles do afford rights to the members in common with other members, namely to occupy flats. However, the rights are given in a capacity other than that of member, namely as tenant. The articles in question therefore do not comply with the capacity test.

It is not clear how the generality test would work in varying circumstances. In the abovementioned example each member is entitled to occupy a specific flat - this is not the same right given to other members, who are entitled to occupy other flats. Thus the right to occupy a given flat is not a right common to all members.

In this example one could, of course, argue that the generality test is complied with, even if the right to occupy a flat is given to only one member. One basis could be that the right to occupy flats (although not the same flat) is given alike to all members. Another basis could be that, although the right to occupy a specific flat is given to a member, the corresponding obligation is general

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1. Supra 900.
2. Ibid 899-900.

in the sense that it rests on all the members. This would, however, not be so. The obligation rests on the company as distinct from its members. Although there is a contractual nexus between the members to be found in the articles, it does not follow that there is an obligation on all the members to ensure to one of them the right of occupation in question.

Nor is it certain how the generality test operates in respect of preferential rights given to a class of members, for example in respect of dividends.

However, Astbury J does not answer these questions. As with capacity, the question of generality therefore remains a question of fact, to be determined by the court by reference to the article in question.

In the sixth place, in formulating the outsider rule, Astbury J looked to the terms of the articles in order to ascertain whether the right conferred in the constitution, was an outsider right or not.[1] Yet he also considered that no rights given in the articles to persons in some capacity other than member were enforceable. Thus the nature of the right given in the articles depends on the capacity of the member enjoying it. The test becomes volatile, quickly changing its emphasis from the article and the right therein contained, to the member and his capacity. In fact, it becomes impossible to lay down a firm test for an outsider right. All that one can say, is that it depends on the circumstances of each case.

In the seventh place, it has been submitted that the cases preceding Hickman's case clearly indicate a lack of evidence of the elements of the outsider rule, or an awareness of its twin criteria of generality or capacity. It is therefore submitted, as a major criticism of the judgment of Astbury J in Hickman's case, that it is a departure from the previous cases.

In the eighth place, it is submitted that underlying his view of the preceding cases is an assumption which Astbury J made in regard to the interpretation of the predecessor of s 20(1) of the English Companies Act, 1948.[2] This emerges from the following.

In the view of Astbury J the company was bound either by statute or by contract and it was clear to him that it was "in this section that its

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1. See 203 above et seq.
2. Namely s 16 of the Companies Act, 1862.

obligation was to be found".[1] To reconcile the decisions to which he referred, some of which recognised an agreement between the company and the members, the others recognising only a contract in the constitution between the members inter se, he considered that "general articles dealing with the rights of members as such" should be treated as a statutory agreement between them and the company, as well as between themselves inter se.[2] Other articles, which were not general, and which purported to give rights to members in some capacity other than that of member, could not in his view be enforced against the company. The view of Astbury J, therefore, is based on an interpretation of the relevant section in the Companies Act. In his view, the section permits the enforcement of general provisions in the articles, and prohibits the enforcement of rights therein contained in some capacity other than that of member.

Whether s 16 of the English Companies Act, 1948 or its predecessors, read literally, supports this interpretation is another matter.[3] The section says that, subject to the provisions of the act, the memorandum and articles shall when registered bind the company and its members thereof 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 of the articles.

There is certainly no reference to generality or capacity in this section. Nor is there any qualification of the term member, such as one would expect to find. For example the section does not describe the member 'in his capacity as such'. On the contrary, the section states that each member is bound to observe all the provisions of the constitution.

It is submitted, therefore, that a literal construction of the section in question would seem to contradict the judgment in Hickman's case and cast serious doubt on the validity of the outsider rule.

8. Conclusion

These criticisms, particularly the fact that the judgment is inconsistent with the relevant section, suggest that the outsider rule requires to be reconsidered by the courts. Their handling of the matter in subsequent cases, together with the views of English academic writers will form the subject of the next two chapters.

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1. Hickman's case supra 897.
2. Ibid 903.
3. See Chapter 9 at 213-218.

CHAPTER 9 - THE OUTSIDER RULE - THE ENGLISH CASES SUBSEQUENT TO HICKMAN'S CASE

1. Introduction

The cases subsequent to Hickman's case on the outsider rule will be dealt with in the following manner.

Firstly, there are cases which, without reference to the outsider rule, simply permit the enforcement by members of outsider rights embodied in the constitution.

Secondly, there is one case which applied and enforced the outsider rule, and at the same time suggested the basis of a possible exception to the rule, by way of permitting the enforcement of general rights contained in the constitution and common to all the members.

Thirdly, there are two cases which, in another context, deal with the member's rights to have the affairs of the company conducted according to the constitution. This has been interpreted, together with the case referred to secondly above, as permitting the indirect enforcement of outsider rights by members, qua members.

Finally, there are cases which deal with the outsider rule in relation to the contract in the constitution between the members inter se.

2. Two cases which enforced outsider rights

These cases in fact continue a line of cases which began prior to Hickman's case.[1] The first case in this category is Hayes v Bristol Plant Hire Ltd.[2]

In this case the plaintiff, a member and a director, raised two complaints; firstly, he had been wrongly expelled from his office of director; secondly, the defendants purported to fill the vacancy by appointing one of them as director in his place. The defendants took a preliminary point that

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1. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610;
   Bradford Banking Co v Briggs (1886) 12 AppCas 29
   Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339;
   Quin and Axtens Ltd v Salmon [1909] AC 442 HL;
2. [1957] 1 All ER 685 ChD.

the plaintiff did not have the requisite proprietary interest to seek the relief claimed.[1] This was so, because, so it was contended, the articles did not confer any direct right to a stipulated amount of remuneration to the directors.[2]

In dealing with this preliminary point, Wynn-Parry J noted that directors did not need to be shareholders under the articles in question but that the plaintiff was both a shareholder and a director as was the case in Pulbrook v Richmond Consolidated Mining Co.[3] He rejected the attempted distinction between the present case and the latter case, which rested on the fact that in the latter case the director was necessarily a shareholder. In his view, in the framework of the articles in the present case, if the director was also a shareholder he was entitled to the same degree of protection.[4] What is more, in the present case the directors were entitled, in terms of the articles to such remuneration for their services as might have been agreed on, or determined by the company in general meeting.[5] This was therefore a sufficient proprietary interest. The plaintiff was therefore in a position to maintain an action by himself in his own name.[6] Although he was a director, he was "in the position of a shareholder, of a managing partner in the affairs of the company" and he therefore had a right to receive remuneration for his services.[7] To contend that this was not a sufficient proprietary interest, would be a denial of justice. The preliminary point was accordingly dismissed.

It is submitted that the judgment is quite contrary to the outsider rule. Applying the rule to these facts, the director, who happened to be a member, could not rely on the provisions in the articles relating to director's remuneration, since the rights embodied therein could only be granted to the member in the capacity of an outsider. Furthermore, such rights were not of general application since not every member was a director. On either test,

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1. Supra 686F-G.
2. The point rests, of course, on the English law doctrine of consideration.
3. (1878) 9 ChD 610. See Chapter 8 at 194-195.
4. Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD 688D-E.
5. Ibid 686H-I.
6. Ibid 687I to end of page.
7. Ibid 688E-G.

the right would be unenforceable under the outsider rule. There could not, therefore, be a sufficient proprietary interest and the preliminary point would be upheld. The defendants would have won under the outsider rule, yet they did not rely on it.

The second case is Richmond Gate Property Co Ltd Re.[1] The applicant was a member, and one of two joint managing directors, of a company. He was appointed a managing director under one of the company's articles of association, which provided that a managing director should receive such remuneration as the directors may determine. The applicant did work for the company as a managing director. On its winding-up he claimed remuneration for such work, although there had been no determination of the board that the applicant should receive remuneration. Plowman J said: "The effect of art 9 of the articles, coupled with art 108 in Table A, coupled with the fact that the applicant was a member of the company, in my judgment, is that a contract exists between himself and the company for payment to him of remuneration as managing director... of such amount as the directors may determine."[2]

Since there had been no such determination, he was entitled to no remuneration and since there was an express contract in regard thereto, any quantum meruit was automatically excluded. Viewed from the perspective of the outsider rule, the following inference may be drawn: had there been such a determination there would have been a claim arising out of the contract for payment of remuneration for services rendered as a managing director. Such remuneration would be unenforceable under the outsider rule since it would have been a right granted in the capacity of an outsider and it would not have been a general right applicable alike to all shareholders. Seen in this light, the case is quite contrary to the outsider rule.[3]

Wedderburn, in writing on the case, noted that in the judgment the importance of the express contract between the member as such and the company

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1. [1964] 3 All ER 936 ChD.
2. Ibid 937F-H. (my deletion).
3. This is the view of Marshall Evans D: Quantum Meruit and the Managing Director (1966) 29 MLR 608 at 611. See also Chapter 10 at 236.

was stressed, as was the fact that both the member and the company were bound by the articles and s 20 of the Companies Act, 1948.[1] He noted that this argument ran counter to the outsider rule. In his view, the claim in question plainly concerned the plaintiff as a director and not in his capacity as a member. He sought to explain the matter on the basis that a shareholder had a personal right to have the company administered according to the terms of the articles.[2] It would be more accurate, it is submitted, to conclude that, in this case, no attention was paid to the outsider rule.[3]

Marshall Evans has commented on the case and on Wedderburn's view of it.[4] In his opinion the view, that the articles were an express contract between the applicant as managing director and the company, was untenable in the light of authority.[5] S 20 of the Companies Act, 1948 made the articles a contract but only in respect of the general regulations of the company applicable alike to all shareholders. Wedderburn had argued convincingly in favour of an indirect enforcement of such outsider rights as were in issue, on the basis that a member had a general right to see that the articles were observed. Nevertheless the member could not enforce these outsider rights since the articles were not a contract between him and the company governing his outsider rights directly. Therefore, the applicant had no express contract with the company in the articles governing directly his position as managing director.

It is submitted that Marshall Evans in effect supported the outsider rule, giving emphasis to the generality test to the detriment of the capacity test and at the same time rejected Wedderburn's "convincing argument" for the indirect enforcement of outsider rights contained in the constitution.

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1. Wedderburn K W : Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 348. See Chapter 10 at 235.
2. This raises the question of the indirect enforcement of outsider rights. See Chapter 10 at 235.
3. Marshall Evans supra 612. See Chapter 10 at 235.
4. Marshall Evans D : Quantum Meruit and the Managing Director supra.
5. Ibid 611. Marshall Evans used the words special rights instead of outsider rights. For the sake of consistency in this dissertation, the words outsider rights have been substituted. It is clear from the article under review that the meaning is the same.

Hayes' case and Richmond Gate's case, which enforced outsider rights, are in accord with a line of cases preceding Hickman's case which were inconsistent with the outsider rule.[1] As in the latter cases, in neither Hayes' case nor Richmond Gate's case is there any reference to the outsider rule. It seems that had it been applied to these two cases there would have been no enforceable contract between the member and the company. Astbury J clearly stated in Hickman's case that outsider rights were not part of the general regulations of the company, applicable alike to all shareholders. He also stressed that such rights, if contained in the articles, were unenforceable as between the shareholder and the company.[2]

3. A case which upheld the outsider rule

The case of Beattie v E and F Beattie Ltd was the first English reference to and support for the outsider rule.[3] This conclusion is clear, having regard to the view expressed by the judge in this case.[4] He said, "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 members in their capacity as members."

It is submitted that there is no room in this doctrine for the view that a member, in his capacity as such, is entitled to contract in the articles in respect of his right to be a director, or to participate in the management of the company, or a host of other matters germane to his membership, but which are, strictly speaking, outsider rights.

The facts of the case, briefly, were as follows: The plaintiff, a director and member holding a substantial but minority shareholding of a company, brought a representative action against the defendant company and against a fellow director and a substantial shareholder, alleging that the latter had a director committed certain irregularities. The defendant applied to have the action referred to arbitration relying on an article to the effect that any dispute between inter alia a member and the company should be so referred.

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1. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610
   Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339
   Salmon v Quin and Axtens Ltd [1909] 1 ChD 311; [1909] AC 442 HL
   Bradford Banking Co v Briggs (1886) 12 AppCas 29.
2. Hickman v Kent or Romney Sheepbreeders' Association [1915] 1 ChD 881 at 897.
3. [1938] 3 All ER 214 CA.
4. Ibid 218B-C.

The court noted that the claims against the director were made against him in his capacity as such and that the defendant opposed the referral to arbitration, on the ground inter alia that the article in question did not cover the disputant who happened to be a member but was disputing in his capacity as a director.[1] The defendant contended that a member was a member and that there was no distinction between his capacity as a member and his capacity as an individual; that in any event he was seeking to enforce a right as a member and not as a director; and that he had a right as a member to insist that the dispute go to arbitration, it being quite immaterial that the member demanding arbitration was himself the member involved in the dispute.[2] The court rejected these contentions on the basis that the director in question had to point to a written agreement of submission in the articles themselves and to do so, had to rely on s 20 of the Companies Act, 1948 in order to give the articles contractual force.[3] The article in question provided that the dispute between the company and the member be referred to arbitration.[4]

However, s 20 had the effect of limiting the contractual force of the articles to provisions which apply to the relations of members in their capacity as members.[5] The real matter was a dispute between the company and the director in his capacity as such. In referring that dispute to arbitration, he was not seeking to enforce a right common to himself and all other members but a different right, namely, to have the dispute to which he was a party referred to arbitration.[6] The two rights were perfectly distinct and quite different.[7] The one was the general right of a member to refer

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1. Ibidem.
2. Ibid 218.
3. Ibid 217D-E.
4. Ibid 217H.
5. Ibid 218B-C.
6. Ibid 218H.
7. Ibid 219F-G.

disputes to arbitration. The other was the right, which the director involved in the dispute was seeking to enforce. The latter right was qua director and therefore was unenforceable, since it had no contractual force following Hickman's case. In the result, the article read with s 20 did not constitute an agreement between the company and the director in his capacity as a director, even though he was a member of the company.[1] There was therefore no written submission to arbitration and the defendant failed.

On the other hand, the judgment in the case clearly recognised the possibility that in a dispute between the company and a director, any member would be entitled to call on the company, in terms of its contract with the member in the articles, to refer the dispute to arbitration.[2] That was the right and the only right common to all the members under this article. This is obviously a reference to Hickman's case, in particular to the statement by Astbury J that articles are enforceable which regulate the rights and obligations of the members generally.[3] Then the judge in Beattie's case said: "If that were the right which the appellants were seeking to exercise, there might be something to be said for that argument."[4]

Wedderburn has relied on these remarks by the judge in Beattie's case to support his view that a member could compel the company not to depart from the contract with him under the articles, even if that meant indirectly the enforcement of "outsider" rights vested either in third parties or in himself, so long as, but only so long as, he sued qua member and not qua outsider.[5] This view is inconsistent with the rule in Hickman's case, in terms of which, the right conferred in the article is the test of its enforceability and not the locus standi of the litigant.[6]

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1. Ibidem.
2. Ibid 218H-219D.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900.
4. Beattie's case supra 219A. The judge also said that enforcement of such a right would present great difficulty being a matter involving the internal management of the company (219C-D). The better view seems, however, to be that such rights are personal to the member and therefore outside the ambit of the rule in Foss v Harbottle. See Chapter 7 particularly at 164 and 169-170 and the references therein to Wedderburn's views.
5. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 213.
6. Hickman's case supra 897 and 900.

Nevertheless, according to the obiter dicta in Beattie's case mentioned above, this judgment is authority for Wedderburn's proposition, thereby providing the basis for an exception to the outsider rule. On the other hand Beattie's case upholds the outsider rule and in doing so points directly to the problem inherent in it. This is the strange contradiction that a member can as such have a say in the management of a company, as was the position in Salmon's case.[1] He can even demand that a dispute between the company and one of its directors be referred under the articles to arbitration. However, if he happened to be the director in question, he would be required, in formulating this demand, to avoid the pitfall that he appeared to be acting qua director and not qua member. He would be required to show, not only that he was acting qua member, but that he was seeking to enforce rights common to himself and all the other members.[2] Alternatively, he would be driven to rely on another agreement with the company outside the articles.

4. Two cases on the conduct of the affairs of a company in terms of its constitution

The dilemma referred to above is that a member can have a say in the management of a company and demand that its affairs be conducted in terms of the constitution, but he cannot enforce his own rights under the constitution, if they happen to be outsider rights, unless he formulates his claim qua member and not qua director. This dilemma arises in dealing with the outsider rule. It did not arise in regard to a petition for relief against oppression.

The case of Harmer (HR) Ltd Re dealt with s 210 of the English Companies Act, 1948.[3] Nevertheless it contained statements of company law which, as Wedderburn says, reach out far beyond the confines of that section.[4] Harmer senior, having founded and run a highly successful business, incorporated it and gave shares in the company to his sons. At the time of the action they

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1. Salmon v Quin and Axtens Ltd [1909] 1 ChD 311; [1909] AC 442 HL.
2. Beattie's case supra 218 H.
3. [1958] 3 All ER 689 CA.
4. Wedderburn K W : Oppression of Minority (1959) CLJ 37 at 40.

held about 4000 A shares and the father held 1000 A shares. The holders of these A shares were entitled to the residue of the profits. Certain B shares carried all the votes. The father held nearly 800 B shares, and the sons held 100 B shares. The sons and the father were directors for life and the father was the chairman of the board with a casting vote. Harmer senior, however, continued to run the company alone, as if nothing had changed. He assumed powers he did not possess, ignored the decisions of the board of directors and asserted throughout the matter that he had full power to do as he pleased while he had voting control. He dismissed employees, co-opted "safe" directors to the board, prohibited board meetings, negotiated sales and vetoed leases.[1] The sons objected to his "autocratic interference" and the court had no difficulty in confirming, on appeal, an order under s 210 restraining the father from continuing his course of conduct.[2] There was undoubtedly oppression within s 210, even though the father was unconscious of the fact and had no motive other than "an overwhelming desire for power and not with a view to his own pecuniary advantage."[3]

However, for present purposes, the significance of the case lies in one of the arguments advanced for the sons. It was contended that the sons had been oppressed, if at all, only as directors, not as members.[4] Jenkins L J proceeded to deal with this argument on the basis that the oppression complained of had to be complained of by a member of the company and had to be oppression of some part of the members (including himself) in their or his capacity as members or a member of the company as such.[5] The judge found that the sons, as members and not merely as directors, were oppressed by the singular conduct of their father.[6] There might well be oppression from the point of view of member-directors where a majority shareholder proceeds, on the strength of his control, to act contrary to the decisions of, or without the authority of the duly constituted board of directors of the company.[7] He also said that if the

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1. Harmer (HR) Ltd Re supra 709.
2. Ibid 710F.
3. Ibid 704E.
4. Ibid 703I.
5. Ibid 698F.
6. Ibid 703I.
7. Ibid 704A.

majority dispensed with the proper procedures and simply insisted on this or that being done, his conduct was oppressive because it deprived the minority of their right as members of the company "to have its affairs conducted in accordance with its articles of association".[1]

As far as the outsider rule is concerned, this case clearly illustrated that a member who is a director and who is preverted from functioning as a director,may nevertheless be aggrieved qua member and not simply qua director. In line with other cases, it upheld the member's right to participate in management.[2]

Wedderburn says that the member had a general contractual right to have the articles observed by the company and that this right extended to the enforcement of outsider rights. However, in enforcing this right the member had to make out his case as a member and might not appear in the capacity of "outsider".[3] The need to make out a case as a member and not as an outsider is, it is submitted, illustrated by the following case.

In Lundie Brothers Ltd Re the relief sought was a petition for relief under s 210 of the English Companies Act, 1948.[4] The company was a small printing company which the petitioner joined as a part-time working director. In due course he became a permanent director on a part-time pasis, and chairman of the board. Later he became a shareholder, holding one third of the voting shares and half of the shares carrying dividend rights.[5] There was in substance a partnership between the three shareholders of the company at the time, each being a working director.

Subsequently he was ousted as chairman and then it was made plain that his services as a working director were no longer required and by resolutions passed, his services were terminated. Later he was removed as a signatory on the company's cheques.[6]

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1. Ibid 704F-G. See also the remarks of Romer L J at 706F-G.
2. Quin and Axtens Ltd v Salmon [1909] AC 442 HL
   Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610
   Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD
   Richmond Gate Property Co Ltd Re [1964] 3 All ER 936 ChD.
3. Wedderburn supra 40.
4. [1965] 2 All ER 692 ChD.
5. Ibid 695.
6. Ibidem.

The petitioner's main grievance was that he was ousted as a working director. That, said Plowman J in giving judgment in the case, had nothing to do with his status as a shareholder at all.[1] In the result the petitioner failed to make out a case for relief under s 210.[2]

It might be argued that cases, such as these two, which arose under s 210, are not relevant in a discussion on the outsider rule, or for that matter on the concept of the contract in the constitution. The answer, is it is submitted, as follows :

Firstly, the relief sought under s 210 is, as Wedderburn points out, an action arising out of a breach of contract by the company.[3] In other words s 210 provides a means for the enforcement of the contract contained in the constitution.

Secondly, the breach consists of the failure by the majority to conduct the affairs of the company according to the articles and according to the degree of probity required of the majority.[4]

Thirdly, the scope of that contract is affected by the outsider rule, in the sense that, according to it, rights given in the articles in some capacity other than that of member are not enforceable.

If therefore, in the course of adjudicating on s 210 and thereby on the scope of the contract contained in the articles, the courts uphold "outsider" rights given to the members, this touches on the very issue raised by the outsider rule. If, unfortunately, the attention of the court was not drawn to Hickman's case, this certainly detracts from the value of the case in regard to the outsider rule. Nevertheless these two related propositions are juxtaposed and fall to be reconciled, if possible. Thus, in Harmer's case a right given to members to participate in the management as part of the general regulations was upheld. This serves to re-define the outsider rule and to limit its meaning accordingly. It seems to be for this reason that

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1. Ibid 699B-C.
2. Ibid 699H.
3. Wedderburn K W : Oppression of Minority supra 41.
4. Harmer (H R) Ltd Re supra 701A-C.

Wedderburn considered that such a result demanded a re-appraisal of many earlier cases, including Hickman's case. Of course, Lundie's case raises the question as to when the member who has been ousted as a director is affected in his status as a member and when he is not. It would appear that, in removing the petitioner, the majority were acting within their rights as prescribed by the articles. In other words, they were conducting the affairs of the company in terms of the contract contained in the constitution. The member could, therefore, have no complaint. Plowman J did not, however, put the matter in this way. He said that the petitioner's grievance, that he was ousted as a working director, had nothing to do with his status as a shareholder.[1] This leaves the question, of enforcing his right qua member to participate in the management, somewhat in the air.

5. Cases on the outsider rule in relation to the contract between the members inter se

It has already been submitted that the constitution, in addition to being a contract between the company and the members, is also a contract between the members inter se.[2] One case which dealt with this proposition also touched on the outsider rule in relation to such a contract. The case is London Sack and Bag Co Ltd v Dixon and Lugton Ltd.[3] It was there stated that while s 20 regulated the legal relations of shareholders in the same way as a contract, yet the statutory result might not be to constitute a contract between them about rights of action created entirely outside the company relationship, such as trading transactions between members.[4] This suggests that there is a distinction in principle between articles intended to be for company law purposes and other articles. Such a distinction is novel and by no means elucidated in the judgment. Nevertheless it is not unlike the distinction found in the outsider rule between rights given qua members and rights given qua outsiders.[5] In fact the proposition mentioned above, that the contract between the members does not extend beyond the

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1. Ibid 699 B-C.
2. See Chapter 3 at 51.
3. [1943] 2 All ER 763 CA.
4. Ibid 765F-G. See Chapter 3 at 39-40.
5. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900.

company relationship, was stated as a response by the judge in the case to to the contention by counsel that s 20 created a contract between the members of a company inter se and the reliance by counsel on Hickman's case, inter alia, as authority for this proposition.[1] The judge was not satisfied that counsel had interpreted this decision correctly.[2] Its effect might well be, he said, to limit the contract between the members to the company relationship.[3]

That the constitution is a contract between members inter se, was finally decided in Rayfield v Hands.[4] The case has been fully canvassed already.[5] It will be recalled that the judge confirmed the existence of the contract in the constitution between the members inter se.[6] In doing so, the judge relied on what he called the comprehensive review of the earlier authorities by Astbury J in Hickman's case.[7] Accordingly he he found that the articles were simply a contract between the members inter se in respect of their rights as shareholders.[8] Taken literally this judgment did not deal with the outsider rule at all. The judgment rested on the finding that the article was binding, on members qua members and not qua directors.[9]

However, this finding has been criticised by Wedderburn who is of the opinion that the obligation rested on the directors, qua directors and not qua members and was therefore, unenforceable under the outsider rule.[10] Gower was at first inclined to follow this criticism.[11] However, he later adopted the view that the article selected a category of members, namely those who were directors.[12]

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1. London Sack's case supra 765E-F.
2. Ibidem F.
3. Ibidem F-G.
4. [1958] 2 All ER 194 ChD.
5. See Chapter 3 at 30 et seq.
6. Rayfield v Hands supra 198A and C.
7. Ibid 198F-G. See Chapter 3 at 42. In regard to Hickman's case see Chapter 8 at 176 et seq.
8. Ibid 198G-H.
9. Ibid 198A. See Chapter 3 at 50 et seq.
10. Wedderburn K W : Effect of Articles as a Contract-remedy against Directors (1958) CLJ 148.
11. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 (the first note).
12. Gower L C B : Rayfield v Hands - A Postscript and a Drop of Scotch (1958) 21 MLR 657 (the second note).

Despite this slight difference of opinion, it is clearly the view of both Wedderburn and Gower that the outsider rule applies to the contract contained in the constitution as between the members inter se.[1] It has been submitted that this was probably the view of Astbury J having regard to his judgment in Hickman's case.[2]

6. A judicial comment from Australia on the outsider rule

Although the outsider rule in other jurisdictions which tend to follow English Company law, such as Australia, New Zealand and Canada, are beyond the present scope, a case from Australia contains an important criticism of the outsider rule. The case is Australian Coal and Shale Employees Federation v Smith.[3] In a limited company, whose shares were held by industrial organisations and by individuals, the board of directors consisted of eight members. Of these the four most senior in office were required to retire at the annual general meeting but were eligible for re-election. The company's articles prescribed a special method for the election of directors whereby votes were counted before the general meeting and the result was declared at that meeting. It was alleged that the secretary had incorrectly counted certain votes and had incorrectly refused to count other votes. As a result the true result of the poll did not emerge. Appropriate declarations were sought to ensure such result and to restrain the infringement of the rights of the shareholders of the company.

The plaintiffs were some of the shareholders who purported to sue on behalf of themselves and all other shareholders in the company,[4] except the defendants and the company.

The point taken on behalf of the defendants was that it was necessary to have all the shareholders before the court either actually or through representatives.[5]

The matter was first approached by the court in terms of the rule in Foss v Harbottle. Although as a general rule only the company could sue if a wrong was done to the company. However if the wrongdoers controlled the

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1. Wedderburn supra 150. Gower, the first note supra 401.
2. See Chapter 8 at 205-207.
3. (1937) 38 SR NSW 48.
4. Ibid 52.
5. Ibid 53.

company, an individual shareholder suing on behalf of himself and all other shareholders except the defendant might sue to remedy the wrong.[1]

Then the court reasoned that under the relevant section of the New South Wales Companies Act, 1936 the memorandum and articles were a contract binding the company and its members. As a result a breach of the articles was both a wrong to the company and also a wrong by the company in the nature of a breach of a shareholder's right to have the articles observed by the company.[2]

Consequently if a person who was entitled to act as director of the company was unlawfully prevented from acting this was a wrong both to the company and to the director.

In spite of the rule in Foss v Harbottle, said the judge, if the company permitted an unqualified person to act as a director its conduct might constitute a breach by the company of its obligation to its shareholders to abide by the articles.[3]

This would entitle the shareholder to bring an action against the company arising out of this breach. However, such an action by the shareholder faced another difficulty - that created by the outsider rule which extended to a right to act as a director. No right purported to be given by the articles to a person in any other capacity than that of member could be enforced against the company, including the right to act as director.

The judge then proceeded to criticise the rule in the following terms:

"Both upon principle and upon authority, I see no reason why a member who, by virtue of the articles and of things done thereunder, is also a director, cannot as against the company, at any rate while it is a going concern, insist on his right to act as a director."[4]

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1. Ibid 54.
2. Ibid 55.
3. Ibid 57.
4. Ibidem.

One of the authorities quoted was Pulbrook's case.[1] The judge was further of the opinion that there was no reason why a shareholder (presumably acting qua member) could not insist that a person entitled to act under the articles as a director, should not be prevented from acting as a director, and that the company should not employ someone as a director who was not entitled to be one.[2]

It followed that, as the plaintiffs were suing the shareholders, to enforce individual rights which were conferred on them by the articles severally and not jointly, there was therefore no need to join all the members. In addition, the plaintiffs purported to sue on behalf of all shareholders except the defendants. Furthermore, the company as a party was regarded as sufficiently representing all shareholders who were not parties to the action.[3]

The point taken by the defendants was therefore overruled. It is submitted that the judgment is to be welcomed. It clearly and on principle rejected the outsider rule, recognising the historical truth that provision for the appointment of directors was one of the essential features of the old deed of settlement[4] and has always been treated by statute as a matter to be provided by the articles.[5]

On the other hand, the outsider rule precludes the member from enforcing his own right to be a director. In this case the issue was whether a shareholder could compel the company to abide by the articles in appointing its directors. The question therefore was whether a member had a general right to enforce the articles. Had the person who was precluded from being a director, also been the plaintiff-member, then the question would have been whether the member's right to have the articles observed prevailed, even if it involved the indirect enforcement of an outsider right.[6]

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1. Ibid 57. See Chapter 8 at 194-195.
2. Ibid 57-58.
3. Ibid 59-60.
4. Ibid 57.
5. Ibid 57.
6. Further attention is given to the possibility of an indirect enforcement of outsider rights in Chapter 10 at 235.

7. A conclusion on the cases subsequent to Hickman's case

The emergence of cases, poles apart from each other, is apparent from a survey of the English cases, both before and subsequent to Hickman's case.

Of the cases subsequent thereto, two ignore and contradict the outsider rule entirely. They are Hayes' case[1] and Richmond Gate's case.[2] In both these cases the plaintiff, being a member, sought relief under the contract in the articles, in respect of his position as a director; in the former because he was expelled from office as a director; in the latter because he claimed remuneration. In both it was held that where the director was a member he was entitled to rely on the articles. This clearly contradicts the rule in Hickman's case.[3]

In contradistinction, Beattie's case, on the other hand, refers to and upholds the outsider rule.[4] The judgment in Beattie's case in effect precludes the enforcement of certain rights flowing out of the contract in the constitution and upholds others. In doing so it is consistent with the orthodox formulation of the outsider rule.

It would however, be an error to conclude that the effect of Beattie's case and of Hickman's case for that matter, is to divide the member and his intentions into two: one as a member and the other in his private capacity or some other capacity, such as a director. In fact, instead of looking at the member, the outsider rule, in its orthodox formulation, looks at the provisions of the articles, dividing them into those articles which create outsider rights and obligations and which are accordingly unenforceable, and those articles giving rights and creating obligations to the member qua member which are enforceable, as forming part of the general regulations of the company applicable alike to all shareholders.[5] It has already been submitted

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1. Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD.
2. Richmond Gate Property Co Ltd Re [1964] 3 All ER 936 ChD.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 897 and 900.
4. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA.
5. Hickman's case 897.

that, whether the test rests on the right, or on the member, it unavoidably turns to the other of these two tests, leaving a volatile and unsatisfactory criterion.[1] The question, therefore, which arises from Beattie's case is how to determine when a right is an outsider right and when it is an enforceable membership right.

Another case which causes difficulty in relation to the outsider rule is Harmer's case.[2]

The effect of this case is that a member may enforce his personal right to have the articles observed by the company. The result is that a member may indirectly enforce an outsider right in the process of enforcing his contractual rights as a member. This is in essence Wedderburn's theory of indirect enforcement of outsider rights.[3]

The overall result of these cases is, it is submitted, to raise difficulties in regard to the principle underlying the outsider rule and its accurate formulation, particularly having regard to the uncertainty which the conflicting judgments have generated.

On the other hand, the member's personal right to have the affairs of the company conducted according to the constitution is covered by the statement of Astbury J in Hickman's case, that articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively.[4] It would seem that, in enforcing his general rights as a member, the member may enforce an outsider right. This is undoubtedly an area of uncertainty.

There is the difficulty of discerning a basis for reconciling Hayes' case and Richmond Gate's case - which did not recognise the outsider rule - with Hickman's case and Beattie's case.[5]

Furthermore the scope of the outsider rule is uncertain, although it seems reasonably clear that the outsider rule has been held to encompass the

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1. See Chapter 8 at 208.
2. Harmer (H R) Ltd Re [1958] 3 All ER 689 CA.
3. See Chapter 10 at 235.
4. Hickman's case supra 900.
5. Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD.
   Richmond Gate Property Co Ltd Re [1964] 3 All ER 936 ChD.
   Hickman v Kent or Romney Marsh Sheepbreeders' Association [1951] 1 ChD 881.
   Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA.

contract contained in the constitution between the members inter se.

Before attempting to deal with these aspects, it is proposed to examine the views of English academic writers on the subject. Then a general assessment of the outsider rule in English law will be essayed. Thereafter, the outsider rule in South African cases and academic writings will be reviewed and an attempt made, by way of conclusion, to assess critically the outsider rule in South African law.

CHAPTER 10 - THE ENGLISH ACADEMIC VIEWPOINT ON THE OUTSIDER RULE

1. Introduction

It has been noted that the outsider rule seeks to inhibit the contractual effect of the constitution. That this is so, is reflected in the views of all English academic writers.

For example Gower stated that the "the memorandum and 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".[1] This view was repeated in both subsequent editions.[2] This was also the view of Pennington.[3] In support thereof Pennington relied on Hickman's case.[4] Halsbury, Palmer, Gore-Browne and Marshall Evans all adopted the same point of view.[5]

On the other hand, Goldberg offered a novel twist to the matter.[6] A member, he said, had no right to enforce a right or power bestowed by the constitution on a person otherwise than in his capacity as a member of the company, whether or not that person was in fact a member, unless the enforcement of that latter power or right was incidental to the enforcement of the member's contractual right to have the company's affairs conducted by the appropriate organ of the company specified in the Companies Act, 1948 or in the memorandum and articles.[6]

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1. Gower L C B : The Principles of Modern Company Law (First Edition London 1954) 252.
2. Gower L C B : Modern Company Law (Second Edition London 1957) 263 and (Third Edition London 1969) 263; The Contractual Effect of Articles of Association (1958) 21 MLR 401 and Rayfield v Hands - A Postscript and a Drop of Scotch (1958) 21 MLR 657-658.
3. Pennington 52.
4. Ibidem. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 897.
5. Halsbury Vol 7 par 117. Palmer 130; Gore-Browne 51 and 786; Marshall Evans D : Quantum Meruit and the Managing Director (1966) 29 MLR 608.
6. Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 MLR 362. It is proposed to deal with his theory in detail as a separate aspect of the English academic viewpoint on the outsider rule. See below at 238 et seq.

Wedderburn expressed the opinion that it was abundantly clear that the articles constituted a contract between the company and each member, in his capacity as member.[1] However, he propounded a theory permitting the indirect enforcement of outsider rights, as an exception to the outsider rule.[2]

It may be said, therefore, that the English academic writers unanimously accept the view that the contractual effect of the constitution is limited by the outsider rule, so that it is only binding to the extent that it affects members in their capacity as such.

2. The meaning of s 20(1) of the English Companies Act, 1948

It has been submitted that underlying the view of Astbury J on the contractual effect of the constitution was his interpretation of s 20(1), namely that the section permits the enforcement of general provisions in the articles, and prohibits the enforcement of rights therein contained in some capacity other than that of a member.[3]

In regard to this, Gower stated that it was settled as an overriding principle, that this section gave the memorandum and articles contractual effect only in so far as they conferred rights or obligations on the member in his capacity as member. This was true of the contract between him and his fellow members, as it was of his contract with the company.[4] Halsbury, Gore-Browne and Palmer expressed the same point of view.[5] Wedderburn also did so.[6] However, his theory of indirect enforcement of outsider rights would seem to require a different interpretation of this section.[7] Goldberg,

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 208.
2. Ibid 212. See also Wedderburn K W : Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347; Gower 264 (Wedderburn was a co-author of Gower). It is proposed to deal with Wedderburn's theory referred to above as a separate aspect of the outsider rule.
3. See Chapter 8 at 209-210. See also Chapter 9 at 213-218.
4. Gower 263. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401.
5. Halsbury Vol 7 pars 116-117; Gore-Browne 50-51; Palmer 130.
6. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 208 and 210; Gower 263.
7. See below at 235 et seq.

in putting forward this theory of the enforcement of outsider rights, recognised that one of the questions was the effect of this section.[1] Nevertheless, in his view the only legally enforceable obligations imposed by virtue of this section were imposed on members of the company qua members and not qua solicitor, director or any other outsider.[2] As with Wedderburn's theory, it would seem to require a different interpretation of this section.[3]

Pennington, on the other hand, stated that, read literally this section appeared to create a contract between the company and its members to observe all the provisions of the memorandum and articles, whatever they might relate to.[4] However, he noted that this section has been construed to create a contract only in respect of the rights and duties of members as such, so that if the memorandum and articles provided for other matters, those provisions did not form part of the contract. It will be submitted that such an interpretation of this section is in conflict with the literal meaning of the statute.[5]

Suffice it to say that apart from a reservation expressed by Pennington, the English academic writers unanimously have accepted the interpretation of this section underlying the judgment of Astbury J in Hickman's case, namely that it gives the constitution contractual effect only in so far as it conveys rights and obligations on the member in his capacity as such.

3. The outsider rule and the contract in the constitution between the members inter se

It has been submitted that, from the tenor of his judgment, Astbury J might have applied the outsider rule to the contract contained in the articles between the members inter se.[6]

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1. Goldberg G D : The Enforcement of Outsider Rights under Section 20 (1) of the Companies Act 1948 (1972) 35 MLR 362 at 364.
2. Ibid 373.
3. See below at 238.
4. Pennington 55.
5. See Chapter 9 at 213-218.
6. See Chapter 8 at 207.

In Gower's view while the memorandum and articles were a contract between the members inter se, this could only be the case in so far as this contract affected members in their capacity as members, and this was true also of the contract between the members inter se.[1] Halsbury[2], Pennington[3] and Wedderburn[4] have expressed the same view.

4. The Eley cases[5]

Astbury J took the view that the Eley cases purported to give specific contractual rights to persons in some capacity other than that of shareholder.[6] It was his attempt to reconcile this with other cases, that led to his formulation of the outsider rule.[7]

There can be little doubt that the learned judge's view of the Eley cases has been accepted without question in English law and, in particular, by English academic writers.

Thus Gower relied on Eley's case as support for the view that if an article provided that someone be the company's solicitor, he could not rely directly on that as a contract to enforce his right to be the solicitor, even if he was in fact also a member; for the article concerned him in his capacity as an outsider, not as a member.[8] This was also the view of Palmer, Gore-Browne and Pennington.[9]

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1. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 and 403.
   ——— : Modern Company Law (Second Edition London 1957) 254; Gower 263.
2. Halsbury Vol. 7 par 117.
3. Pennington 55.
4. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 208.
   ——— Effect of Articles as a Contract-remedy against Directors (1958) CLJ 148 et seq; Gower 263.
5. Reference has been made to the Eley cases in Chapter 8 at 177 and 179-184. The Eley cases are the following:
   Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956;
   Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503;
   Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88;
   Browne v La Trinidad (1887) 37 ChD 1.
6. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 902.
7. See Chapter 8 at 206.
8. Gower 263.
9. Palmer 14.10; Gore-Browne 51; Pennington 56.

Marshall Evans held the same view of the import of both Eley's case and Browne v La Trinidad.[1]

It has been submitted that the Eley cases merely decided that the articles are no more than an agreement between the members inter se.[2] This is not the view of the English academic writers, who have adopted the view of Astbury J, namely that in these cases contractual rights were given to persons in some capacity other than that of shareholders.[3]

5. Public policy underlying the outsider rule

There is no sign in the judgment of Astbury J of any consideration of public policy as a reason for formulating the outsider rule. Instead the basis seems to have been the necessity to reconcile two lines of cases.[4]

In only one of the English academic writings is there any attempt to justify the outsider rule on grounds of public policy. In Goldberg's view the court's restriction on the enforcement of outsider rights was warranted in commercial life.[5] He equated the controllers of a company, be they directors or the majority of shareholders in general meeting, with trustees in regard to the performance of their duties. It was inconsistent with the appointment of a trustee that the testator should give to some other person an irrevocable office of agent, receiver or manager. The law relating to trustees frequently afforded assistance in regard to companies.

It is submitted that Goldberg's analogy with trustees is obscure. If it relates to their fiduciary duties, then a distinction is to be drawn between directors and majority shareholders. The former are not parties to the constitution, although obviously they have fiduciary duties. The latter, while being parties to the constitution, are entitled to vote on selfish criteria, subject only to the rules relating to oppression of minorities.[6]

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1. Marshall Evans D : Quantum Meruit and the Managing Director (1966) 29 MLR 608 at 611; Eley's case supra; Browne v La Trinidad supra.
2. See Chapter 8 at 201.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association supra 896. See Chapter 8 at 177.
4. See Chapter 8 at 178.
5. Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 MLR 362 at 371. (This article will be referred to as Goldberg.)
6. Gower 562.

6. Wedderburn's theory

In Wedderburn's view a member could compel the company not to depart from the contract with him under the articles, even if that meant indirectly the enforcement of "outsider" rights vested either in third parties or himself, so long as, but only so long as, he sued qua member and not qua outsider.[1]

This view was first expressed in his article on Foss v Harbottle[2] as an explanation of Salmon's case.[3] There is no need to recapitulate in detail the reasons he advanced in relation to Salmon's case.[4] Salmon, he said, could not enforce a right vested in him qua managing director, since that would be enforcing a right given to him in the capacity of an outsider. It was obvious, therefore, that Salmon enforced the right of a member to have the articles observed by the company.[5]

This explanation of Salmon's case had not escaped later judges. In Beattie's case the judge expressed the opinion that a right to call upon the company to observe the articles was the right and the only right in this respect which was common to all the members under this article.[6]

In a later article, he noted with a certain satisfaction that all three judges in Harmer's case clearly recognised the general contractual right to have the articles observed by the company.[7] Subsequently, he considered that the reasoning in Richmond Gate's case provided interesting support for the validity of this approach.[8]

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212-213;
   ——— Effect of Articles as a Contract-remedy against Directors (1958) CLJ 148 at 150;
   ——— Oppression of Minority (1959) CLJ 37 at 40;
   ——— Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 348-349.
2. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle supra.
3. Quin and Axtens Ltd v Salmon [1909] AC 442 HL.
4. These are fully set out in Chapter 7 at 165 and Chapter 8 at 192.
5. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle supra 212
6. Beattie v E and F Beattie Ltd [1938] All ER 214 CA 219A.
7. Wedderburn K W : Oppression of Minority (1959) CLJ 37 at 40;
   ——— Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 350.
8. See Richmond Gate Property Co Ltd Re [1964] 4 All ER 936 ChD. See Chapter 9 at 213-214.

"It is true," he stated on one occasion, "that the proposition to which this conclusion gives rise apparently conflicts with the rule in Hickman's case that outsider rights can never be enforced by reliance upon the articles."[1]

On several occasions he acknowledged that, if this view was correct, the law surrounding Hickman's case was more complicated and more odd than had often been thought; but a line of authority, brooded over by Salmon's case supported the view.[2] He also recognised that its importance lay in extending the category of personal rights to a general right to have the articles observed and, therefore, that the propositions in Hickman's case were very seriously affected.[3]

Marshall Evans commented on Wedderburn's theory, en passant, in dealing with Richmond Gate's case.[4] Although Wedderburn had argued convincingly in favour of an indirect enforcement of outsider rights contained in the constitution, on the basis of the member's general right to have the articles observed, nevertheless these outsider rights were unenforceable since, in terms of the section, the articles embodying same were not a contract between the member and the company.[5]

Goldberg also commented on Wedderburn's theory. By way of an introduction to his own article on the enforcement of outsider rights under s 20(1) of the Companies Act, 1948, he expressed the following opinions.[6]

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 213.
2. Ibidem. See also:
   Wedderburn K W : Effect of Articles as a Contract - remedy against Directors (1958) CLJ 148 at 150;
   ——— Oppression of Minority (1959) CLJ 37 at 40.
3. Wedderburn K W : Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 349.
4. Marshall Evans D : Quantum Meruit and the Managing Director (1966) 29 MLR 608 at 611-612. See Richmond Gate Property Co Ltd Re supra. See also Chapter 9 at 213-214.
5. Marshall Evans D : Quantum Meruit and the Managing Director supra 611-612. See Chapter 9 at 214.
6. Goldberg 362.

Wedderburn's theory contained an inherent exaggeration.[1] It was in direct contradiction to the view set out in Gower that the memorandum and articles had no direct contractual effect in so far as they purported to confer rights and obligations on a member otherwise than in his capacity of a member.[2] The views put forward in Gower left the conflict unanswered. Gower's view was too narrow, while that of Wedderburn was too wide.[3]

Goldberg did not state explicitly his reasons for advancing these criticisms of Gower or Wedderburn. Instead he proceeded to expound his own theory, which by implication would disclose the shortcomings in the opinions of these two eminent authorities. Nevertheless, at the conclusion of his article, Goldberg expressed the view that Wedderburn had revealed an important truth, namely that the typical formulation of the second principle postulated by Astbury J was in such need of refinement as to be quite misleading.[4] Goldberg was, of course, referring to the classic statement of Astbury J in Hickman's case, namely "that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as for instance, as solicitor, promoter, director, can be enforced against the company."[5]

Having regard to his views set out above, it is submitted that Wedderburn would no doubt add to this the following: "save where the member, qua member, exercises his personal right to have the constitution observed by the company." In Goldberg's view, Wedderburn pointed the way and took the first step.[6] Goldberg advocated another addition to the aforesaid second principle of Astbury J.[7]

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1. Ibidem.
2. Ibidem; This reference to Gower was in fact a reference to Gower L C B : Modern Company Law (Second Edition London 1957) 252.
3. Goldberg supra 363.
4. Goldberg supra 374.
5. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900.
6. Goldberg supra 374.
7. As is set out in Goldberg summarised below at 238 et seq.

7. Goldberg's theory

Goldberg's starting point is s 20(1) of the Companies Act, 1948 as the only source of the binding effect of the constitution.[1] Proceeding from this unassailable point he reviewed the cases whose ratio decidendi supported the following construction.[2]

A member of a company had a contractual right under s 20(1) to have the affairs of the company conducted by the particular organ of the company specified in the articles, even if this involved the enforcement of an outsider right in a person, be he member or not. On the other hand, a member could not enforce an outsider right conferred on a person, be he member or not, unless such enforcement was incidental to the enforcement of a member's contractual right to have the affairs of the company conducted by the particular organ specified in the constitution, or in the Act. Outsider rights would only be enforced if, and only if, two conditions were fulfilled. The first was that a member was entitled to compel the company not to depart from the contract with him even if that meant indirectly the enforcement of outsider rights vested in either third parties or himself, so long as, but only so long as, he sued qua member and not qua outsider. The second was that the enjoyment of the outsider right was incidental to the exercise by a particular organ of the company of a power vested by the Act or by the company's memorandum or articles in that organ.[3]

Goldberg then proceeded to review the cases, including those usually cited as supporting the outsider rule, testing them both against his own organic theory, set out in the second condition above, and against the right of the member to have the company's affairs conducted in terms of the first condition mentioned above. He also, incidentally, judged these cases in the light of Wedderburn's repudiation of the line of authority led by Hickman's case.[4]

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1. Goldberg 363.
This is the first review herein of Goldberg's theory. It is necessary, therefore, to present it in some detail. In contrast to the précis given of Wedderburn's theory presented above. Although this causes a change in style, it is submitted that this is unavoidable, if one is to do justice to Goldberg's theory.
2. Ibidem.
3. Supra 365.
4. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194.

The first of these cases was Eley's case.[1] In Goldberg's view, despite the provision in the articles on which the suit was founded, the court held that on a proper construction of the articles when read as a whole, the power to appoint the company's solicitors still resided in the board of directors and it was the board which had appointed the new solicitors.[2] In the result, the board had exercised a power of appointment given to it as an organ of the company. Therefore, the exercise by the plaintiff of his outsider right to be the company's solicitor was contrary to the member's right to have that part of the company's affairs conducted by the board as the appropriate organ.[3]

However, it has been submitted above that the judgment in Eley's case rested on the finding that there was no agreement between the plaintiff and the company because the articles were not a contract between the members and the company, but only between the members inter se.[4] As for Browne v La Trinidad, Goldberg said that the plaintiff did have an enforceable contact with the company which was embodied in the articles.[5] In fact, Lindley L J in the the case had expressly found that there was no contract between the members and the company but only between the members inter se.[6] However, the plaintiff sought an injunction preventing the company from acting in breach of the agreement with him. Such an injunction would in effect be an amendment of the articles. It would deprive the organ vested by the articles with the power to amend same, the organ being the general meeting. Thus the remedy sought was not incidental, but contrary to the members' right to have the company's affairs conducted by the organ referred to in the Act. The refusal of the injunction was therefore inevitable.

Goldberg also referred to Dale and Plant Ltd Re.[7] The only issue was whether or not the plaintiff was entitled to enforce the outsider right bestowed on him by the articles to be the company's secretary for a specific period. That issue could not be incidental to any question of the company's secretarial work being carried out by the appropriate organ of the company, because the company had ceased to exist. The claim was, therefore, disallowed.[8]

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1. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88. See Chapter 8 at 177 and 179-184.
2. Goldberg supra 366.
3. Ibidem.
4. See Chapter 8 at 183 and 207.
5. Browne v La Trinidad (1887) 37 ChD 1 at 14-15; Goldberg supra 366 et seq. See Chapter 8 at 182-184.
6. Browne v La Trinidad supra 13.
7. (1889) 61 LT 206. See Chapter 8 at 198. Goldberg supra 367.
8. Goldberg supra 367.

It is submitted that difficulties arise from the elevation by Goldberg of the company secretary to the status of an organ of the company, on a par as it were, with the board of directors or the members in general meeting.[1] Apart from this, Goldberg's interpretation of the case is nowhere to be found in the judgment. The case was decided on two grounds. Firstly, a company could not ratify a pre-incorporation contract. Secondly, the articles being merely a contract between the members inter se, were not binding on the company.[2]

Goldberg also referred to Beattie v E and F Beattie Ltd.[3] His interpretation of this case was that the defendant could claim the right to go to arbitration only in his capacity of outsider (that is, director) because it was in that capacity that he was being sued. The enforcement of this outsider right would not have been incidental to ensuring that a particular organ of the company performed the task entrusted to it, since an arbitrator, who had to be independent, could not be considered a part of the company at all. It seems strange,indeed, to conceive of an arbitrator as an organ of a company.

It has been submitted that Beattie's case, while supporting the outsider rule, also set out by way of obiter dicta, the basis for Wedderburn's principle of the indirect enforcement of outsider rights.[4] There is, however, no sign in the judgment of any support for Goldberg's "organic" theory.

In regard to Salmon's case, Goldberg explained it on the basis that the organ charged by the articles with acquiring or letting premises was the board of directors, acting with the consent of both managing directors.[5] Since the plaintiff was seeking to uphold this article, his injunction was granted.

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1. Gower 142-143. A secretary is considered to be an officer of the company, whose functions are purely ministerial and administrative.
2. Dale and Plant Ltd Re supra 207.See Chapter 8 at 198.
3. [1938] 3 All ER 214. See Chapter 9 at 215-218. Goldberg supra 367.
4. See Chapter 9 at 217-218.
5. Quin and Axtens Ltd v Salmon [1909] AC 442 HL. See Chapter 8 at 190-192.

Since it incidentally enforced the plaintiff's outsider rights, it refuted Gower's view that articles containing outsider rights cannot be enforced. On the other hand, because a question of the division of powers among the company's organs was an essential part of the plaintiff's case, the judgment did not support Wedderburn's view that the indirect enforcement of outsider rights is possible in the course of enforcing the members' general right to have the company's affairs conducted in terms of the articles, that is to say, it did not support Wedderburn unless his views were modified as suggested by Goldberg.

It is submitted that the fallacy in Goldberg's reasoning is apparent from a reading of Salmon's case.[1] There is no mention in the case of outsider rights or that these could be enforced if this was incidental to the work of an organ of the company. On the contrary, the judges apparently took it for granted that Salmon, as a member, had the right to contract in the articles for his right of veto as a director; and that such a right formed part of the general regulations of the company, applicable alike to all members. This is borne out by the judgment of Loreburn L C in Salmon's case, in which he dealt with the contract in the constitution by saying that the bargain of the shareholders contained in the articles amounted to this - that the directors should manage the business of the company but they could not manage it in a particular way - they could not do things if Salmon or Axtens objected.[2] Consequently, the case is no authority for Goldberg or Wedderburn or Gower on this point.

Goldberg then proceeded to make like observations on two other English cases. The first is Pulbrook v Richmond Consolidated Mining Co.[3] The second is Hayes v Bristol Plant Hire Ltd.[4] Goldberg says that both cases involved a question of organic organisation of the companies: they entrusted certain powers to their respective boards of directors but they also defined who should be members of the boards. In each case the plaintiff was seeking to ensure that the organ so specified should be properly constituted; and incidentally in each case the plaintiff's outsider rights as a director were upheld.[5]

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1. Quin and Axtens Ltd v Salmon supra.
2. Ibid 443.
3. (1878) 9 ChD 610. See Chapter 8 at 194-196 and 203.
4. [1957] 1 All ER 685 ChD. See Chapter 9 at 211-213. This case is on all fours with Pulbrook's case, supra, except in the fact that in Hayes' case the director did not have to be a member. The director being a member was nevertheless entitled to the same protection. Accordingly, the principle in Pulbrook's case was applied.
5. Goldberg supra 369.

If Goldberg is correct, then there would be much merit in the contention by counsel in Pulbrook's case that, if there was a wrong, the action should be in the name of the company. It would then be necessary to argue that, as Wedderburn has suggested, the members have a personal right to have the company's affairs conducted in terms of the articles.[1] However, Jessel M R, in giving judgment in Pulbrook's case, found that the plaintiff, who was necessarily a shareholder in order to be a director, had suffered an individual wrong since he had been deprived of the right given to him in the constitution to take part in its management.[2] There was no hint in the judgment of the concept of outsider rights, or any doubt as to their enforceability. The "organic organisation of the company" was neither canvassed nor considered.

These comments apply equally to Hayes v Bristol Plant Hire Ltd which followed Pulbrook's case.[3] In the view of the judge in Hayes' case, if the director was also a shareholder he was entitled to invoke the articles to protect his office as director.[4] The judgment is quite contrary to the outsider rule and is silent on any rights incidental to the working of company organs.

Goldberg also commented on Harmer (H R) Ltd Re[5]. In his view, in according to the prayer in the case, the court was only incidentally maintaining the outsider rights of the petitioners, who were directors as well as members. The court was concerned rather that those powers conferred on the board were exercised by the organ specified in the articles. If a decision under s 210 might by analogy be used in the construction of s 20(1), the case still fitted his modifications of Wedderburn's stance.[6]

It is submitted, however, that Goldberg has taken this judgment out of its context and fitted it into a mould conceived by himself. Contrary to Goldberg's view, it is submitted that the effect of the judgment in Harmer's case was to uphold the members' contractual rights as set out in the constitution.

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212.
2. Pulbrook's case supra 613.
3. Hayes' case supra and Pulbrook's case supra.
4. Hayes' case supra 688D-E.
5. [1958] 3 All ER 689 CA. See Chapter 9 at 218-220.
6. Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 MLR 362 at 370 ("Goldberg").

In terms of the judgment in Harmer's case, the members were entitled to have the affairs of the company conducted according to the constitution.[1] This had nothing to do with protecting the board in its powers. It was only fortuitous that the members' complaint was that the majority had interfered with the board. Had the majority refused to keep books of account, assuming by way of an example they were required to do so under the articles, this may also have been oppressive in terms of s 210. In a word, therefore, Harmer's case had nothing to do with the enforcement of outsider rights.

Goldberg also sought to re-state the case of Richmond Gate Property Co Ltd Re, so as to fit his proposition.[2] In his view, the plaintiff's case was based on his having been an organ, namely the managing director, so that his criterion had been fulfilled.[3]

The criticism of this, is the same as in previous cases. The judgment made no reference to organs. It simply found that the effect of the articles coupled with the applicant's membership of the company was to create a contract between the member and the company as to his director's fees.[4] This directly contradicts Hickman's case and offers no support for the theory of either Wedderburn or Goldberg. Furthermore, a managing director, deriving his authority from the board, can hardly be an organ in his own right.

8. An assessment of the English academic viewpoint on the outsider rule

There is unanimity among these writers on some aspects of the matter. They all agree that the outsider rule is an integral part of English law and that its result is to inhibit the contractual effect of the constitution, so that it is only binding to the extent that it affects members in their capacity as such.[5] Likewise, there is no doubt in their minds that s 20(1) of the English Companies Act, 1948 permits the enforcement of general provisions in the articles and prohibits the enforcement of rights therein contained in some capacity other than that of member and that this is true of the contract between the members

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1. Harmer's case supra 704F-G and 706G-H.
2. [1964] 3 All ER 936 ChD.
3. Goldberg supra 370-371.
4. Richmond Gate Property Co Ltd Re supra 937F-H. See Chapter 9 at 213.
5. See above at 230.

and between the members and the company.[1] By the same token, they all agree that the outsider rule applies to the contract between the members inter se.[2] Furthermore, there is no doubt among them that the Eley cases purported to give specific contractual rights to persons in some capacity other than that of shareholders.[3] In other words, the view of Astbury J on these cases has become the view of the English academic writers.[3]

There are, on the other hand, aspects of the outsider rule raised herein, which have received no attention from the English academic writers referred to. Nothing is said by them regarding the question whether the outsider rule looks solely at the provisions in the articles in order to test the enforceability of a right or obligation, or whether it looks only or also at the relationship of the member to the company, or to the other members.[4] Apart from Goldberg, nothing is said of considerations of public policy which may or may not justify the outsider rule.[5]

As for the twin tests laid down by Astbury J for the outsider rule, namely that of capacity and generality, the tendency seems to be to stress the criterion of capacity, although Marshall Evans stated the test in terms of the general regulations applicable alike to all shareholders, in other words, the generality test.[6]

As to the fact that there are conflicting cases, some upholding the outsider rule and others ignoring it, or by implication contradicting it, there is some comment. Wedderburn, in particular, noted the inconsistency between the outsider

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1. See above at 232.
2. See above at 233.
3. See above at 234.
4. See Chapter 3 at 209.
5. See above at 234.
6. Marshall Evans D : Quantum Meruit and the Managing Director (1966) 29 MLR 608 at 611.

rule on the one hand and Salmon's case and Richmond Gate's case on the other.[1] He, of course, sought to reconcile the position in terms of his theory.[2] Marshall Evans, in commenting on Richmond Gate's case, took the view that the case was wrongly decided in the light of the outsider rule.[3]

Three is to be noted among the English academic writers an undercurrent of disquiet regarding the outsider rule. Thus Goldberg stated that the typical formulation of the second principle of Astbury J was quite misleading and in need of refinement.[4] Gower spoke of the "unnecessarily restrictive rules laid down in the earlier authorities."[5] Wedderburn stated that if his view of Salmon's case and Beattie's case was correct, the law surrounding Hickman's case was "more complicated and more odd than has often been thought."[6] He also said that the orthodox formulae usually derived from cases like Hickman's case did not represent the full story[7] and that his rather heterodox proposition demanded a re-appraisal of many earlier cases, such as Hickman's case.[8]

Both Wedderburn and Goldberg sought to overcome the binding force of Hickman's case as a precedent and the obvious shortcomings of the outsider rule, by means of theories which acknowledged the validity of the rule while seeking to modify its effects.[9]

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1. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212.
   ——— : Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 348.
2. See above at 235 et seq.
3. Marshall Evans D : Quantum Meruit and the Managing Director supra 610-611.
4. Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 MLR 362 at 374.
5. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 at 404.
6. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212.
7. Wedderburn K W : Effect of Articles as a Contract - remedy against Directors (1958) CLJ 148 at 150.
8. Wedderburn K W : Oppression of Minority (1959) CLJ 37 at 40.
9. On Wedderburn's theory, see above at 235 et seq ; on Goldberg's theory, see above at 238 et seq.

To a certain extent Wedderburn sought to interpret the cases in terms of his theory. For example, in regard to Salmon's case, there is no sign in the judgments of the outsider rule, or of an exception to it arising from the members' personal right to have the articles observed.[1] The same may be said of his views on Richmond Gate's case.[2] On the other hand, it is submitted that Beattie's case is strong authority for his view, since the judgment clearly recognised the possibility that in a dispute between the company and a director, any member would be entitled to call on the company in terms of its contract with the member in the articles to refer the matter to arbitration in terms of the articles.[3] Furthermore, Harmer's case, in another context, re-iterated this personal right of the members.[4]

Although Wedderburn's theory commends itself as a way out of the dilemma, for which there is judicial authority, particularly in Beattie's case, nevertheless it does present some difficulties. Firstly, it contradicts the outsider rule itself, which Wedderburn concedes.[5] Secondly, it assumes that there are provisions in the articles which are unenforceable in terms of the outsider rule, whereas s 20(1) of the Companies Act, 1948 provides that all the provisions of the constitution are binding as a contract.

Thirdly, as with the outsider rule itself, Wedderburn restricted the indirect enforcement of outsider rights to those rights which arose qua member and not qua outsider. The difficulty is that the precise distinction is not clear. The dividing line could be said to be a question of fact, to be determined having regard to the circumstances of each case. This,however, does not provide a substitute for a test formulated on principle and applicable to all circumstances.

Goldberg's theory is entirely novel and has no backing in any of the cases. On the contrary, it rests on an ex post facto rationalisation of the cases to which he refers. It is submitted that his explanation of these cases is quite unrelated to either the facts or the judgments. It is further submitted that there seems to be no reason in principle, why members' rights, arising from the

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1. See 235 above and Chapter 8 at 192.
2. See 236 above and Chapter 9 at 213.
3. See 236 above and Chapter 9 at 217 and Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 219A.
4. See 236 above and Chapter 9 at 218-220 and Harmer (HR) Ltd Re [1958] 3 All ER 689 CA 704F-G.
5. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle supra 213. See 236 above.

contract contained in the constitution, may be rendered unenforceable or not, depending on whether the company's affairs are being conducted by the appropriate organ. This is so, whether the rights in question are outsider rights or not.

9. Conclusion

In accepting the outsider rule as an integral part of English law,[1] the English academic writers have not given due weight to the cases which have ignored and have contradicted the outsider rule;[2] or to the literal meaning of s 20(1) of the English Companies Act, 1948 which gives a contractual effect to all the provisions of the constitution;[3] or the fact that, in none of the cases preceding Hickman's case, are any of the elements of the outsider rule to be found.[4]

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1. See above at 236 and Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 213.
2. See Chapter 8 at 204-205.
3. Ibid 209-210 and Chapter 9 at 213 et seq.
4. See Chapter 8 at 205.

CHAPTER 11 - THE OUTSIDER RULE IN ENGLISH LAW : A GENERAL ASSESSMENT

1. Introduction

Having traced the outsider rule from its origin, as well as the cases preceding and subsequent to Hickman's case and the views of the English academic writers relating to it, it is now proposed to offer a restatement of the rule in its modern form, as well as some criticisms of it.

2. A restatement

The classic statement of the outsider rule is as follows.[1]

> "No right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as, for instance, as solicitor, promoter, director, can be enforced against the company.
>
> "Articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively."

The outsider rule has also been described as follows.[2]

> "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 members in their capacity as members."

Another statement of the rule is as follows.[3]

> "It may well be, even as between ordinary members of a company who are also in the nominal way shareholders, that s 20 adjusts their legal relations inter se in the same way as a contract in a single document would if signed by all; and yet the statutory result may not be to constitute a contract between them about rights of action created entirely outside the company relationship, such as trading transactions between members."

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1. Per Astbury J in Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900. See Chapter 8 at 176 et seq.
   Astbury J introduced this statement by stating that no article could constitute a contract between the company and a third person (ibidem). While this re-affirms the English rule prohibiting the enforcement of a stipulatio alteri, it is not a part of the outsider rule. Nevertheless, Astbury J re-introduced this prohibition into the statement quoted above by the phrase "whether a member or not". It is submitted that this phrase has no proper place in a rule which only deals with the rights of members and not with the rights of non-members at all.
2. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 218B-C. See Chapter 9 at 215 et seq.
3. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G See Chapter 3 at 39-40 and Chapter 9 at 222.

3. Comments on the outsider rule

The following comments are offered to elucidate the rule.

Firstly, it could be said that the rule does not divide the member and his intentions into two and that it looks instead at the contract in the constitution, dividing the articles into those which confer rights in the capacity of a member and which are enforceable and those which confer rights in some other capacity and which are unenforceable.[1] However, either statement is both partly true and partly false. This is so because it is impossible to judge the member and his intentions without looking at the rights conferred in the articles. Likewise, in order to examine the nature of the right contained in the articles, it is necessary to examine the member and his intentions. On the other hand, those articles which regulate the rights and obligations of the members generally as such are enforceable. All that may be said is that the outsider rule limits the contractual force of the articles by referring to members in their capacity as such or as outsiders. Precisely how this works is uncertain.

Secondly, it lays down twin criteria of enforceability: capacity and generality.[2] Yet neither is adequately defined. In regard to capacity, it is illuminated by no more than a few examples, namely rights given to a person as a solicitor, promoter, or director are given in a capacity other than that of members.[3] It is therefore a question of fact in each case, depending on the interpretation of the article in question.

In regard to generality, this also is illustrated only by example and, not by any statement of principle.[3] It, too, must be regarded as a question of fact in each case, depending on the interpretation of the article in question.

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1. Hickman's case supra 897 and 900. See Chapter 8 at 208 and Chapter 10 at 244.
2. Hickman's case supra 897 and 900. See Chapter 8 at 208.
3. Ibid 900.

There is, therefore, no all-embracing test to distinguish between articles which confer membership rights, or outsider rights on the one hand and general rights on the other.

Thirdly, it is possible to observe one development in the outsider rule, namely a theory permitting the indirect enforcement by a member of outsider rights by enforcing his general right to have the affairs of the company conducted in terms of the constitution. This derived from judicial statements in Beattie's case.[1] Based thereon, the theory is expounded by Wedderburn.[2] It derived support from Harmer's case, albeit indirectly.[3]

Fourthly, the outsider rule, as has been previously demonstrated, applies to the contract contained in the constitution between the members inter se as well as to the contract therein between the company and its members.[4]

Finally, the effect of the outsider rule is not to render the contract totally unenforceable. Instead, it renders it divisible, with those parts which offend the outsider rule being unenforceable, while the remainder remains binding.[5]

4. Some criticisms of the outsider rule in English law

Various criticisms have been offered of the outsider rule in the course of the preceding chapters. It is proposed to re-state these briefly and to offer some others.

Firstly, the view which Astbury J took of the Eley cases on the one hand, and the other cases, was erroneous.[6] He regarded the Eley cases as having refused to uphold the contract between the member and the company because the articles in question purported to give specific contractual rights to persons in some capacity other than that of shareholders and in none of them were members seeking to enforce or protect rights given to them as members in common with the

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1. Beattie's case supra 218H-219D. See Chapter 9 at 215 et seq.
2. See Chapter 9 at 217-218 and Chapter 10 at 235 and 246.
3. Harmer (HR) Ltd Re [1958] 3 All ER 689 CA. See Chapter 9 at 218-220.
4. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G. Hickman's case supra 890 and 903; Chapter 3 at 39-40; Chapter 9 at 222.
5. Hickman's case supra 897 and 900. See Chapter 8 at 205.
6. The Eley cases are those set out in Chapter 8 at 177 footnote 1. The other cases are those referred to ibidem footnote 4.

other corporators.[1] In fact the Eley cases reached their conclusion without reference to the capacity in which the right was given in the articles, or the generality of the rights and obligations therein created.[2] They did not apply the tests of generality or capacity. They simply denied the existence of an agreement between the company and the member. The other cases undoubtedly upheld rights and obligations as between the company and the member, which were general in character and related to the member in his capacity as such, as Astbury J held. However, they did so, quite oblivious of the outsider rule or any of its elements.

Secondly, the twin tests of generality and capacity are vague and produce uncertain results. The most that can be said of them is that whether or not a right complies with either test, depends on the facts in each case.[4] Astbury J gives a few examples of capacity, but these do not permit of the formulation of an exhaustive test.[4] Likewise the meaning of generality is vague. One example illustrates the problem. A special class of shares, giving preferential voting and dividend rights would not confer a general right, common to all members. The obligation to pay the dividend rests on the company, while the burden falls indirectly on all the other members. Yet nowhere is it suggested that such articles as create this preferential class of member are unenforceable as contradicting the outsider rule.

Thirdly, the basis of the outsider rule is not illegality or immorality or public policy, but a view of the meaning of s 16 of the English Companies Act, 1862 and therefore of its successors.[5] Astbury J stated in Hickman's case : "A company cannot in the ordinary course be bound otherwise than by statute or contract and it is in this section that its obligation must be found."[6] He also expressed the view that general articles which deal with the rights of members "as such" ought to be treated as a statutory agreement.[7] It is to be inferred, therefore, that in the view of Astbury J this section permits the enforcement of general provisions in the constitution, but not of provisions containing outsider rights. As a result of this view, it has come to be taken

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1. Hickman's case supra 896. See Chapter 8 at 178.
2. See Chapter 8 at 198 ; Chapter 10 at 233-234.
3. The other cases are those set out in Chapter 8 at 177 footnote 4.
4. See Chapter 8 at 208.
5. S 16 of the English Companies Act, 1862 is of course identical to s 20 of the English Companies Act, 1948. See Chapter 2 at 18.
6. Supra 897.
7. Ibid 903.

for granted that the constitution is a contract between the company and the members and between the members inter se, but only in their capacity as such.[1] Since the contractual basis is derived from s 20, it may also be inferred that the section uses the term member in the limited sense of a member as such, connoting thereby that the contract does not confer outsider rights on the member.

The validity of this view of s 20 depends on an interpretation thereof. The cardinal rule for the construction of all statutes is that they should be construed according to the intention expressed in the Act itself.[2] This is derived from the words employed, taken in their literal and simple meaning.

S 20 declares that the 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 to observe all the provisions.

Pennington observes that read literally, s 20 appears to create a contract between the company and its members to observe all the provisions of the memorandum and articles, whatever they might relate to.[3] The same reasoning, it is submitted, applies to the fact that in terms of s 20 the articles bind the members to the same extent as if they had signed the constitution. But, as Pennington points out, the section has been construed as a contract in respect of the rights and duties of members as such and other matters do not form part of the contract.[4]

To justify a limited interpretation of the section which excludes from its scope outsider rights, is to give a limited meaning to general words, such as "bind" and "members" and "to the same extent" and "all the provisions". Yet it is a well established rule of interpretation that general words are to be given a general meaning, that is to say a comprehensive meaning, one that does not support an exception to the generality of their meaning.[5]

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1. Gower 263.
2. Craies 66.
3. Pennington 55
4. Pennington 56.
5. Craies 177.

To render the outsider rule consistent with the section it becomes necessary to say that, although the member is bound to observe all the articles to the same extent as if he had signed them, nevertheless the scope of the constitution is limited to those provisions which confer membership rights and that those which confer outsider rights are pro non scripto. It is submitted that such a proposition contradicts the ordinary literal meaning of the section.

The question may be asked whether there are other provisions in the English Companies Act, 1948 which indicate a general policy, one way or the other in relation to the enforcement of outsider rights contained in the constitution. Such a general policy would affect the interpretation of s 20 and an assessment of the view of Astbury J on that section.

There are, however, only a few indications. Firstly, in the case of a company limited by guarantee and not having a share capital, every provision in the memorandum and articles purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member is void.[1]

Secondly, members are described in the English Companies Act, 1948 as: those subscribers who become members; directors who undertake their qualification shares; and every other person who agrees to become a member and whose name is entered on the register of members.[2] The term member is used in these sections as a general word, having a comprehensive meaning. No attempt is made to qualify the notion of membership by reference to "capacity as such", or to limit the concept of membership as contemplated by Astbury J. Nor may such a limit be inferred, since as a matter of interpretation, words of general import, in the absence of some convincing indication to the contrary, are given their ordinary meaning, without limiting their scope.[3]

It is submitted, therefore, that these other provisions do not alter the ordinary literal meaning of s 20, nor do they support an inference that the policy of the English Companies Act, 1948 is to prohibit the enforcement of outsider rights embodied in the constitution.

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1. S 21.
2. S 26(1) s 181(2) and s 26(2).
3. Craies 177.

If this argument were not conclusive, one could examine the section by reference to the mischief it may be said to remedy. It is a recognised canon of interpretation to discern and consider the common law before the passing of the statute, including the defect for which the common law did not provide. From this one might be able to infer the intention of the legislature. It is proposed to apply this test to the earliest English Companies Act which contained this section, namely the Joint Stock Companies Act, 1856. The reason for doing so is that the statute preceded Hickman's case. The section has been retained intact in all subsequent company legislation.[2] The effect of Hickman's case on subsequent English company legislation will then arise for consideration.

Attention has been drawn to the rule of the English common law which prohibits contracts entered into by an agent on behalf of a non-existent principal and contracts by two principals for the benefit of a stranger.[3] Bearing in mind that the agreement leading to the formation of a company is concluded prior to its incorporation, it has been submitted that, at common law, the company cannot be a party to its own constitution. It is, therefore, necessary to declare that the memorandum and articles shall when registered bind the company and the members thereof. This, it is submitted, is the purpose of s 20 and the purpose of similar sections of English companies acts, since 1856.

This purpose negatives any interpretation limiting the contract in the constitution to articles which do not confer outsider rights. It is submitted that this is a valid inference in regard to the earliest English companies acts and to the English Companies Act, 1948.

It may, of course, be argued that the latest English Companies Act, 1948 was promulgated against the background of the common law at that time, which included Hickman's case and the outsider rule. However, the English cases are by no means consistent in their standpoint towards the outsider rule.[4] Furthermore, there is no sign in the wording of the 1948 Act that its purpose had changed from that of previous acts, and that its new purpose is to prohibit outsider rights in the constitution. Furthermore, the mischief to be remedied remained as real in 1948 as it was in 1856, namely the prohibition against

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1. Craies et seq 125.
2. See Chapter 2 at 8.
3. See Chapter 2 at 13 et seq.
4. For the two lines of cases see Chapter 8 at 177 et seq.

pre-incorporation contracts, which makes it impossible in common law for a company to be a party to its own constitution.[1]

The matter may also be approached in the following way. In general, the mischief sought to be cured is to be found in the act itself, but there are cases in which the court has referred to the history of the act in question and the reasons which led to its being passed.[2] For present purposes, therefore, a glance at the history of English companies legislation would not be out of place.

The modern English company evolved from the unincorporated partnership which was based on mutual agreement.[3]

The earliest English Companies Act adopted the existing method of forming a joint stock company by agreement.[4] It merely added the power to acquire separate corporate existence by means of registration.[5] It is therefore submitted that the purpose of the English legislature was a limited one, namely to give companies a framework, and leave them to manage their own affairs, without imposing any particular constitution on them or restricting them unnecessarily.[6] It is, today, a trite proposition that a company may regulate its affairs according to its needs, as long as it does not act in conflict with the law in general and the relevant Companies Act, in particular.

Thirdly, the English cases are by no means consistent in their treatment of the outsider rule. As a result its place in English law cannot be taken for granted, despite its universal acceptance by English academic writers.[7]

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1. Chapter 2 at 13 et seq.
2. Craies 127 and the authorities therein quoted.
3. Gower L C B : Some Contrasts between British and American Corporation Law (1956) 69 HLR 1369 at 1371-1372.
4. Joint Stock Companies Act, 1844 par VII.
5. Gower 261.
6. In a speech in the English parliament by Loew on the Law of Partnership, 1856, he set out this purpose. (English Hansard CXL 134). This is not offered as a method of interpretation of the section, but merely as of historical interest.
7. See Chapter 10 at 231.

The English cases preceding Hickman's case display no sign of its existence, nor of any of its elements, nor the twin criteria of capacity or generality, nor any attempt to limit the scope of the contract contained in the articles by means of the outsider rule or any of its elements.[1] It has, in fact, been submitted that the outsider rule is a departure from the previous cases.[1]

There are only two English cases subsequent to Hickman's case which recognise its existence.[2] On the other hand, there are English cases, both before and after Hickman's case which, without reference to the outsider rule, simply permit the enforcement by members of outsider rights embodied in the constitution.[3]

The fact remains, however, that the decision in Hickman's case has the binding effect of precedent.[4] The outsider rule was enunciated as the principle on which the judgment rested. As such, it has the force of law. As a decision of the Chancery Division, it is binding on courts of first instance and on other divisional courts. It is, however, to be noted that the Chancery Division ignored its own decision in two subsequent decisions.[5]

On the other hand, the rule has been considered on two occasions by the court of appeal. It was referred to by this court with approval in Beattie's case, where Greene M R considered it to be good law that the contractual force given to the articles by the section was limited to such articles as applied to the members in their capacity as members.[6] Approval was accorded to the rule by the same court in London Sack's case.[7] There the same point was made in the judgment in regard to the contract contained in the articles as between the members inter se. The court of appeal would normally consider these decisions

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1. See Chapter 8 at 205.
2. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 218B-C; London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G.
3. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610; Bradford Banking Co v Briggs (1886) 12 AppCas 29; Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339; Quin and Axtens Ltd v Salmon [1909] AC 442 HL; Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD; Richmond Gate Property Co Ltd Re [1964] 3 All ER 936 ChD.
4. The binding effect of English judicial precedents, on which the following is based, is drawn from the text of Halsbury Vol 22 pars 796-807.
5. Hayes v Bristol Plant Hire Ltd supra; Richmond Gate Property Co Ltd Re supra.
6. Beattie v E and F Beattie Ltd supra.
7. London Sack and Bag Co Ltd v Dixon and Lugton Ltd supra.

to be binding on itself, until a contrary determination has been arrived at by the House of Lords. On the other hand, it seems clear that the outsider rule is in conflict with the decision of the House of Lords in the case of Quin and Axtens Ltd v Salmon.[1] Consequently the Court of Appeal might refuse to be bound by these two decisions, because, although they have not been overruled, they cannot stand with this decision of the House of Lords.

As far as the House of Lords is concerned, the outsider rule has not received its attention. There would seem to be reason to believe that if the matter comes before the House of Lords, it may be rejected, both on its merits, and because it is in conflict with its own decision in Salmon's case.[1] It may be noted, in support of this view, that the rule, although enunciated more than sixty years ago, has not been consistently followed, nor acted upon by persons, in the formation of their contracts, in the disposition of their property or in any other way. On the contrary, it has been more honoured in the breach than in the observance.

Fourthly, the fact that a member has a personal right to enforce the terms of the constitution is in conflict with the outsider rule. Wedderburn clearly recognised the existence of this right.[2] He relied on the high authority of the decision of the House of Lords in Quin and Axtens Ltd v Salmon.[3] It will be recalled that Salmon, a member, had a right of veto on the board of directors. In exercising this right he was enforcing a right common to all the members to have the articles observed by the company. Wedderburn had no doubt that this decision was in conflict with the outsider rule.[2] His conclusion was reinforced by the judgments in Harmer (HR) Ltd Re.[4] It was stated in that case that members of a company were entitled to have its affairs conducted in accordance with its articles of association.[5] Wedderburn concluded that the shareholder had a general contractual right to have the articles observed, and this included "outsider-rights" which the articles bestowed on himself or upon others, provided he made out his case qua member, and not qua outsider.[6] Wedderburn sought to reconcile the outsider

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1. [1909] AC 442 HL
   Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212. See Chapter 8 at 191-192.
2. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle supra 213.
3. Ibidem. Quin and Axtens Ltd v Salmon supra.
4. [1958] 3 All ER 689 CA
5. Ibid 704F-G and 706G-H.
6. Wedderburn K W : Oppression of Minority (1959) CLJ 37 at 40.

rule with this general contractual right.[1] Instead, it is submitted that there is no room for such reconciliation. On the contrary, this general right overrides the outsider rule. The latter cannot stand with the former.

The following example is offered as an illustration of the point. A dispute arises between a company and one of its directors. A member, not being the director in question, seeks to compel the company to refer the dispute to arbitration in terms of the articles. He ought to succeed, having regard to his general right to have the company's affairs conducted according to its articles. If the member happens to be the director engaged in the dispute, it ought to make no difference, in terms of this general right. Yet in terms of the outsider rule he ought, in the latter situation, to fail in his suit.[2]

The two conclusions are irreconcilable. Once a member can compel the company to observe the constitution, he should be able to do so even if he enforces his own rights, and even if his own rights are capable of being described as outsider rights. This proposition is borne out by the fact that, in several English cases, members have successfully enforced their own outsider rights arising from the articles. In Pulbrook's case a member relied on the articles to enforce his claim for directors' fees,and to be included as a director and a member of the board.[3] In another case, rights and duties relating to the ownership of fishing boats by members of a company were regulated by the company's articles, and such rights and duties were enforced by the court as a direct contract between the member and the company.[4] In Salmon's case a member's right of veto of certain directors' decisions were upheld.[5] In Hayes' case, a member enforced his right to be a director, and to perform his duties as such.[6] Finally, in Richmond Gate's case, the existence of a contract contained in the articles between a member and his company, regulating his right to

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1. Wedderburn supra. See Chapter 10 at 235-237.
2. This example is based on the facts in Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA. See Chapter 9 at 215 et seq. The facts are, however, not identical.
3. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610. See Chapter 8 at 194-195.
4. Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339 at 356. See Chapter 8 at 195-196.
5. Quin and Axtens Ltd v Salmon supra. See Chapter 8 at 190-192.
6. Hayes v Bristol Plant Hire Ltd [1957] 1 All ER 685 ChD. See Chapter 9 at 211.

remuneration as a director, was confirmed by the court.[1] In doing so, the court rejected a claim by this member-director, based on a quantum meruit, since the existence of an express contract automatically excluded such a claim.

Fifthly, there are no policy considerations justifying the outsider rule. On the contrary, all articles which are not in conflict with the general law, or with any express or implied provision or underlying assumptions of the companies acts,ought to be binding in terms of s 20. There is no suggestion of an illegal or immoral taint to an article conferring a right to a member in some capacity other than that of member, or which is not of general application and is common to all members. The closest one comes to this is an attempt to justify this curtailment of outsider rights on the basis of an analogy with trustees.[2] There is an obvious flaw in this parallel, since members of companies, unlike trustees, have no fiduciary duties, and are entitled to exercise their rights on selfish criteria, subject only to the rule against fraud on the minority.[3]

Far from attempting to justify the outsider rule, it is submitted that there is no reason of public policy to support it. On the contrary, public policy ought to frown on the rule. It is in the interests of members of the public that they be permitted to protect their investments in a company, by virtue of their membership, through its constitution. To shroud those constitutional rights in the uncertainty of a yardstick such as the outsider rule, is to deprive the member of protection. There seems to be no reason why the constitution cannot be used to protect a member's rights, whatever they may be. His right embodied in the constitution, to be a director and to be paid fees as such has been upheld.[4] An article regulating the transport by members of a company's fish catch has been upheld.[5] Likewise a member's

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1. Richmond Gate Property Co Ltd Re [1964] 3 All ER 936 ChD 937F-H. See Chapter 9 at 213-215.
2. Goldberg G D : The Enforcement of Outsider Rights under Section 20(1) of the Companies Act 1948 (1972) 35 MLR 362 at 373. See Chapter 10 at 238 et seq.
3. Gower 562.
4. Pulbrook v Richmond Consolidated Mining Co (1878) 9 ChD 610.
5. Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339 at 356.

right, contained in the articles, of veto over decisions by directors has been upheld.[1] There seems no reason why members should not provide in the constitution for the arbitration of their trading disputes, although this right has been denied.[2] Other examples come to mind, such as the right to occupy the company's apartments or parking bays, in terms of the articles; or an article providing for a compulsory loan by a member to the company.

It might be argued that these seem to be normal incidents of membership, easily catered for by a more flexible definition of outsider rights. This argument is open to the criticism of vagueness and uncertainty mentioned above. It rests on the premise that, as a matter of public policy, outsider rights should not be found in the articles.

Along the same lines, it might be said that matters which are "clearly extraneous" to company purposes ought to be excluded from the constitution.[3] It is however equally difficult to determine what is "clearly extraneous", even if such a definition were desirable. The following is an example. The problem of including a marriage settlement in a company constitution illustrates both the difficulty of definition and the lack of clear public policy guidelines.

In the case of a large public company, a marriage settlement seems totally out of place. A vague sense of unease leading to a suggestion of inequitable results accompanies the notion of a marriage settlement in a public company. It might not appear to be so incongruous in a small family company in which husband and wife are the only members.

However a closer examination indicates that, apart from questions related to the formalities attendant on a marriage settlement, there are no principles of company law justifying the exclusion of such a contract from a company

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1. Quin and Axtens Ltd v Salmon [1909] AC 442 HL.
2. London Sack and Bag Co Ltd v Dixon and Lugton Ltd [1943] 2 All ER 763 CA 765F-G. See Chapter 3 at 40 footnote 5.
3. London Sack and Bag Co Ltd v Dixon and Lugton Ltd supra 765H. See Chapter 3 at 39.

constitution, other than the outsider rule. Nor is there any reason to distinguish between public and private companies in this regard.[1] S 20 certainly does not differ in its effect as between private and public companies. Its wording does not lend any support to such a distinction.[2]

A variation on the same theme, of seeking to justify the outsider rule on principle, asserts that the special nature of the company constitution justifies a limitation of its use to one type of contract, for example, for company purposes only.[3] The company constitution has, of course, been frequently described as being sui generis.[4] If this merely conveys that the company is a unique invention of nineteenth century English capitalism, making possible the harnessing of large quantities of risk capital, it is a harmless encomium. If it forms the basis of limiting the freedom of members to contract with the company and each other, through the medium of the constitution, then more is required. Then the special nature of the constitution must be such that harm would be done by its use for any extraneous purpose. It is submitted that no such harm is apparent and that there is nothing in the special nature of the company to justify this intrusion into the basic freedom of contract of its members.

It may be argued that there is nothing to stop members from contracting for matters extraneous to the company relationship, by entering into contracts outside the constitution. It is submitted that there is no justification for such formalism. On the contrary, there are advantages in using the company constitution as a vehicle for contracts between a member and the company, and

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1. The English Companies Act, 1948, s 28(1), lays down the requirements of a private company. The other distinguishing features of public and private companies are set out by Pennington 643-645.

2. In Rayfield v Hands [1958] 2 All ER 194 ChD 199I it was suggested in the judgment that the finding, namely that in terms of s 20 the articles were an agreement between the members, might not be of general application since the company in question was a private company. Gower's comment was that if this meant that s 20 differed in its effect as between private and public companies, the wording of the section lent no support to such a conclusion. See Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 at 403. See Chapter 3 at 47-48.

3. This is the view of Scott L J in London Sack and Bag Co Ltd v Dixon and Lugton Ltd supra 765F-G.

4. Gower 263 noted that it has been called a contract of the most sacred character. He described it as having various special characteristics.

between the members inter se. For example, its terms and conditions are a matter of public record. It is more flexible than an underhand agreement, since it can be changed by special resolution, given the requisite majority.[1]

5. Conclusion

Wedderburn has acknowledged that the outsider rule is both complicated and odd, and has called for its re-appraisal. Gower has described the rule as unnecessarily restrictive.[3] It is submitted that cogent reasons have been advanced for rejecting the outsider rule in its entirety. In its place is the simple submission that articles which do not contradict the general law or any express or implied provision of the Companies Act, 1948, are valid and enforceable.

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1. See s 143 of the English Companies Act, 1948.
2. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle supra 21: Oppression of Minority (1959) CLJ 37 at 40.
3. Gower L C B : The Contractual Effect of Articles of Association (1958) 21 MLR 401 at 404.

CHAPTER 12 - THE OUTSIDER RULE IN SOUTH AFRICA

1. Introduction

The outsider rule in English law has received extensive attention in this dissertation. Many of the rules of the English common law of companies apply in South African law, with little or no modification.[1] The reason for dealing with the outsider rule in English law has been stated: it seeks to inhibit the contractual nature of the constitution, by limiting its enforceability to rights conferred on the parties to this contract in their capacity as members and in no other capacity.[2] The same reason compels an enquiry into the outsider rule in South African law.

It is proposed, by and large, to follow the pattern of treating the subject adopted in regard to English law, namely to review the cases, then the views of academic writers, and then to offer a general assessment and some criticisms of the outsider rule in South African law. The conclusion following thereafter is based both on this general assessment and on these criticisms.

2. The South African cases on the outsider rule

2.1 A review of the cases

The case of De Villiers v Jacobsdal Saltworks has been dealt with at length.[3] There is therefore no need to traverse it once again.

Potgieter J in his judgment in the case held that the articles constituted a contract between the company and the members, and between the members inter se, but only in their capacity as members. They did not, for instance, constitute a contract between the company and a director in his capacity as such.[4]

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1. Cilliers Benade De Villiers 11.
2. See Chapter 8 at 176.
3. 1959 (3) SA 876 (O). See Chapter 3 at 55-58.
4. Ibid 876H - 877A.

The judge also held that it was clear from Eley's case,[1] Browne v La Trinidad,[2] Hickman's case[3] and Beattie v E and F Beattie Ltd[4] that the articles of association of a company did not create a contract between the company and a member except in his capacity of a member.[5]

Botha J P held that it was clear that, while in terms of s 16 of the Companies Act, 1926 a company's articles of association bound the company and the members thereof to the same extent as if they had been signed by each member, nevertheless no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as for instance as solicitor or director, could be enforced against the company.[6] This is, of course, the classic statement of the outsider rule.

This case, therefore, permitted the reception of the outsider rule into South African law, albeit without investigation or critical analysis.

In the case of Grundling v Beyers the Mine Workers' Union, a registered trade union, dismissed its general secretary.[7] The latter sought an order declaring, inter alia, that his dismissal was invalid and setting it aside.[8]

It was contended on his behalf, inter alia, that, because the general secretary had not been given a proper hearing, prior to his dismissal, this was null and void as being contrary to the constitution of the union.[9] It was further contended that the post of general secretary was indeed a statutory or constitutional one, and that therefore the union was obliged to adhere to its constitution in dealing with him.[10]

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1. Eley v Positive Government Security Life Assurance Company (1876) 1 ExD 20 and 88.
2. (1887) 37 ChD 1.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881.
4. [1938] 3 All ER 214 CA.
5. De Villiers' case supra 876H.
6. De Villiers' case supra 873-874A. In support of this proposition he quoted the following cases:
   Hickman's case supra 900
   Beattie's case supra.
7. 1967 (2) SA 131 (W).
8. Ibid 136A.
9. Ibid 137A-B.
10. Ibid 137B.

Trollip J as he then was, considered that there were two fallacies in these contentions.[1] The first was that the legal relationship between the general secretary and the union depended upon or was derived from the Industrial Conciliation Act, 1956, under which the union was registered, and was therefore statutory or quasi-statutory. The second was that any act by the union which was contrary to the provisions of the union's constitution was null and void.[1]

The judge, having considered both the aforementioned Act and the union's constitution, concluded that they did not render the general secretary a statutory or quasi-statutory official.[2] They merely enabled the union to be registered and then, as a corporate body, to enter into a contract with someone to be general secretary. Even if the latter was a member, the constitution did not form any legal relationship between the union and the general secretary as such. The only legal relationship it created was that between the union and its individual members in their capacity as members; it created none between the union and its members in their capacity as outsiders. The legal relationship, therefore, between the union and the general secretary as such was purely contractual, namely that of master and servant.[2]

These views, said the judge, were fully supported by Eley's case, by De Villiers' case and by Halsbury.[3]

The position was "the same as that between a company registered under the Companies Act, 46 of 1926 and its secretary or any other official".[4]

Trollip J then continued as follows. The union and general secretary, in so contracting might expressly or impliedly make certain provisions of the constitution part of their contract.[5]

On the other hand the general secretary was, as he was obliged to be, a member of the union too, and the constitution was legally binding on the union and its members in their capacity as such.[6] It was unnecessary to determine whether such legal relationship was contractual or statutory or both, but it was clear that if the union acted or proposed to act contrary to its constitution,

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1. Ibid 137D-F.
2. Ibid 138F-G.
3. Ibid 138-139. The full references to the authorities referred to by Trollip J are Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88. See Chapter 8 at 181-182; De Villiers' case supra 874A and 876H. Halsbury: Laws of England Vol 6 (Third Edition by Lord Simonds London 1954) pars 267-268 and 270.
4. Grundling v Beyers supra 138H.
5. Ibid 139A.
6. Ibidem D-E.

the law afforded the member, as such, certain remedies limited by the rule in Foss v Harbottle.[1] If, therefore, the general secretary's dismissal was unconstitutional, he as a member might also claim relief on that ground. But the two kinds of remedy, contractual and constitutional, were entirely different and each was governed by its own rules and were not to be confused.[2]

The judge then dealt with the contention that any act by the union in breach of its constitution was null and void. In the view of the learned judge only an act which was ultra vires the company's powers was null and void; but if the act was within its powers, but the manner of doing it deviated from or was contrary to the constitution, it was at most voidable and capable of ratification.[3]

In terms of its constitution the control of the affairs of the union vested in its general council, and subject to that body the management of its activities was in the hands of an executive committee and a management committee.[4] A circuitous process was adopted whereby the union dismissed its secretary.[5] The executive committee passed two resolutions, which appeared to be mutually contradictory. Firstly, the general secretary was given seven days within which to answer charges, but in the meanwhile he was suspended. Secondly, and in addition, the executive committee decided to dismiss him for inefficiency, and pending the general council's confirmation of his dismissal, he was forthwith suspended. All this was done instead of simply dismissing him, and tendering to pay his salary and other financial benefits in lieu of a month's notice.[5]

It was argued for the general secretary that he was not given a hearing by the executive committee of the general council before his dismissal.[6] In dealing with this, the audi alterem partem issue, the judge held that in a statute empowering an official to give a decision adversely affecting the rights of liberty or property of an individual, there was a presumption that the rule applied.[7] There was, however, no such presumption in a contract unless there was an express or implied term to that effect in the contract.[8]

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1. Ibidem E-F.
2. Ibidem F-G.
3. Ibid 140A-B.
4. Ibid 133C-D.
5. Ibid 140C-H.
6. Ibid 137A-B.
7. Ibid 141D-E.
8. Ibid 141E.

Although portions of the constitution had been incorporated into the general secretary's service contract, none of them expressly created the obligation to give him a hearing. Nor could such a term be implied.[1] Consequently there was no obligation on the union to give him a hearing.[2]

Nevertheless his summary dismissal for inefficiency was unlawful since it had been found by the industrial court that he was competent.[3] Even it the failure to give him a hearing was a breach of his contract, this would simply be an additional ground for holding that his dismissal was a breach of contract.[4]

The judge proceeded to deal with matters which are irrelevant to the present enquiry.[5] So far he had only considered the general secretary's rights vis a vis the union, as an outsider in regard to his dismissal, that is to say, in terms of his contract with the union.

However, even as a member he did not think the events in question enabled him to invoke the aid of the court. If his dismissal by the executive committee was unauthorised or irregular for any reason, it was not ultra vires and void and was duly validated by the general council.[6]

The significance of the case for the present enquiry is the judicial analysis of the relationship of the general secretary to the trade union and of the role of the union's constitution in forming that relationship. The general secretary was both an official and a member of the union. He did not derive his rights or obligations in any way from the Industrial Conciliation Act. As far as the union's constitution was concerned, it was the constitution of a body corporate, created under the enabling statute aforementioned, giving the union the power to enter into a contract with someone to be its general secretary.[7] The legal relationship between the union and its general secretary as such did not derive from the constitution, but from a contract outside the

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1. Ibid 142A.
2. Ibid 143A-B.
3. Ibid 143B-C.
4. Ibidem F-G.
5. Ibid 143-147
6. Ibid 147E-F.
7. Ibid 138F-G.

constitution. On the other hand, he was a member and the constitution was legally binding on the union and its members in their capacity as such.[1] This would give him rights as a member, if the general secretary's dismissal was unconstitutional, rights which were entirely different from those flowing out of the general secretary's contract with the union.[2]

This reasoning is analogous with that in the classic statement of Astbury J in Hickman's case.[3] The effect of both is that no rights were given by the articles to a person, whether a member or not, in a capacity other than as a member.

The reasoning is also analogous to that in Beattie's case.[4] There, too, the member could not rely on the articles as constituting a contract between himself and the company.[5] The member could, but did not, seek to enforce a right common to himself and all other members, namely to have the affairs of the company conducted according to the constitution.[6] Both in Grundling's case, and in Beattie's case, the court recognised that the member had a right to have the affairs of the corporate body conducted according to the constitution.

It was this which led Wedderburn to postulate his theory that in exercising this right, a member might well be enforcing indirectly an outsider right, and that this could occur despite the outsider rule.[7]

It is tempting, therefore, to view Grundling v Beyers as throwing light on the outsider rule and as authority for the reception of Wedderburn's theory of the indirect enforcement of outsider rights, in South African law. However, this conclusion would not be valid because a distinction is to be drawn between a trade union and a company incorporated under the Act. The former is a body

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1. Ibid 139A.
2. Ibid 139F-G.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900.
4. Beattie v E and F Beattie Ltd [1958] 3 All ER 214 CA.
5. Ibid 216G-H.
6. Ibid 219A.
7. Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 213.

corporate under the Industrial Conciliation Act, which has no section such as s 65(2) of the Act. There is therefore no reason to assume that the trade union's constitution is a statutory agreement between the company and its members, or between the members inter se. Consequently the reasoning of Trollip J cannot be applied to a company formed under the Act. He found that the legal relationship between the union and the general secretary as such, was purely contractual, and was the same as between a company and its secretary.[1] This is a far cry from importing this reasoning, appropriate to a trade union formed without reference to a section such as s 65(2) of the Act, into an enquiry into the concept of the company constitution as a contract.

Therefore Grundling v Beyers is of limited significance for the purposes of the present enquiry.

The case of Gohlke and Schneider v Westies Minerale (Edms) Bpk has also been dealt with at length.[2]

The court was concerned with the validity of an agreement between the company and its members which, it was contended, was contrary to and sought to amend the articles of that company.[2] According to Trollip J A, the agreement meant that a party's nominee would become a director of the company merely on his nominating him as such.[3] It was contended that, on this construction of the agreement it was contrary to the articles, and was unenforceable against the company, since it had not been incorporated in the articles.[4]

Trollip J A examined the proposition in the light of s 16 of the Companies Ordinance, 19 of 1928 (SWA).[5] As far as the articles were concerned, it was immediately apparent that the section did not render them absolutely binding on the company and its members, as though they were statutory enactments.[6]

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1. Ibid 138H.
2. 1970 (2) SA 685 (A). See Chapter 4 at 78-80.
3. Ibid 691D-E.
4. Ibid 692B.
5. Which is identical to s 16 of the Companies Act, 1926 and to s 65(2) of the Act.
6. Gohlke's case supra 692E-F.

Then the judge referred to Hickman's case and De Villiers' case, in support of his view that "the company and its members are bound only to the same extent as if the articles had been signed by each member, that is, as if they had contracted in terms of the articles. The articles, therefore, merely have the same force as a contract between the company and each and every member as such to observe their provisions."[1]

Since that contract was not made immutable of indefeasible by the Ordinance in any relevant respect, the judge could see no reason why, as with any other contract, it could not be departed from by a bona fide agreement concluded between the company and all its members to do something intra vires the company's memorandum but in a manner contrary to the articles, and why that agreement should not bind them, at least for as long as they remained the only members.[2]

It may be argued that this case was not concerned with the outsider rule at all. The purpose of the enquiry was whether or not the members could depart from the terms of the constitution by means of a unanimous agreement, not supported by a special resolution altering the constitution.[3] Accordingly, the issue was not the enforceability of outsider rights embodied in the constitution. The issue was the right to appoint a director effectively by merely nominating him in terms of the aforementioned agreement.[4]

In addition it may be said that the reference to Hickman's case and to De Villiers' case was for the purpose of proving the contractual rather than the statutory nature of the constitution, and therefore of proving their changeable, instead of their immutable qualities.[5]

It may, therefore, be argued that the Appellate Division did not in this case, consider the outsider rule as such.

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1. Gohlke's case supra 692F-G.
2. Ibidem G-H.
3. Gohlke's case supra 692G-H.
4. Ibid 688C-D and 689A.
5. Ibid 692F-G.

On the other hand, Trollip J A, in describing the articles as merely having the same force as a contract between the company and the members, referred to the members as "each and every member as such".[1] These words are - as is the phrase "in their capacity as members" - part of the terminology and the reasoning of the outsider rule.

In support of this statement, Trollip J A referred to both Hickman's case and De Villiers' case.[2] He did not refer directly to the classic statement of Astbury J formulating the outsider rule.[3] However, he did refer to the statement of Potgieter J in De Villiers' case , in which the latter judge unequivocally held that the contract in the constitution was limited to that between the company and the members in their capacity as such.[4]

It is, therefore, submitted that there is support in this case, by way of an obiter dictum, for the outsider rule as part of South African law.[1] On the other hand there is no assessment of the validity of the rule, any justification for its reception, or its meaning or ramifications.

The case of Isaacs, Geshen and Co (Pty) Ltd v Ellis has also been dealt with.[5] No reference was made in the judgment of Caney A J P to the outsider rule. Hickman's case was referred to both in support of the right of each member to enforce the articles as against the company, and in support of the proposition that a stranger has no enforceable rights under the articles.[6] However, the statement of Astbury J in regard to the outsider rule was not mentioned.

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1. Gohlke's case supra 692F-G.
2. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O).
3. Hickman's case supra 897 and 903.
4. De Villiers' case supra 876-7.
5. 1964 (2) PH A59. See Chapter 3 at 58 and 66-68.
6. Ibid 298. Caney A J P (ibidem) also queried this proposition in our law having regard to the rule that a stipulatio alteri may be accepted by him for whose benefit it is made. See Chapter 3 at 66-68.

The significance of the case in the present context is that it was held that each holder of a share in a company, who was entitled to a parking space on the company's premises in terms of the articles, could enforce the right against the company.[1] Yet, it is submitted, in terms of English law, the right to occupy a parking bay is the same as the right to be a solicitor or a promoter or a director and as such is an unenforceable "outsider" right. It would appear that Caney A J P, in omitting to comment on the outsider rule, nevertheless permitted a member, qua member, to enforce an outsider right.

In the case of Rosslare (Pty) Ltd v Registrar of Companies[2] the applicants sought a declaratory order against the registrar, arising out of his refusal to register certain articles amended by the applicant in terms of a special resolution.[3] The case is the only one in which the outsider rule was considered in depth, if not explicitly by name, in South African law.

It also touched on a basic principle which illuminates the notion that the company constitution is a contract, in the following sense. The articles are formed by agreement and amended by special resolution, both followed by registration.[4] Registration is fundamental to the process of formation and change. It is not merely a procedural matter, but involves questions of substantive law, that is to say, even if the procedures are immaculately performed, the registrar may refuse to register amended articles. On what basis may he do so? As Milne J pointed out in this case, a company may validly amend its articles of association provided it complies with the procedural requirements laid down, and the registrar is obliged to register them if they are in accordance with the Act.[5] It was contended for the applicants that, provided the articles were not in conflict with the Act, and did not provide for some illegality, the registrar was obliged to register them.[6] The registrar, on the other hand, took the view that anything which the Act did not provide for would be illegal, and therefore not registrable.[7] His counsel conceded that the registrar could only decline to register articles either expressly prohibited by, or inconsistent with the Act, and which were inconsistent with certain fundamental

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1. Ibidem.
2. 1972 (2) SA 524 (D).
3. Ibid 525A-B.
4. See s 32 - s 63 in re formation; s 55 - s 56 in re alteration of memorandum; s 62 in re alteration of articles.
5. Rosslare's case supra 525C-D.
6. Ibidem.
7. Ibidem D-E.

assumptions in the Act.[1]

Milne J formulated the test as follows. "Articles which are not in conflict with the general law, nor with any express or implied provision of or underlying assumption in the Act, are registrable and the Registrar of Companies is obliged to register them."[2]

Milne J then proceeded to consider the articles before him, and the validity of the registrar's refusal to register them.

The amended articles of association sought to be registered were in the form commonly encountered where the company owned a block of flats, and individual flats in the building were "sold" on the basis that ownership of a particular number or block of shares entitled the owner of those shares to occupation of a particular flat.[3] The articles also made provision for levies and compulsory loans by shareholders to the company.[4] Article 4 made provision for the share capital to be divided into a number of ordinary shares which would be apportioned between twelve "share blocks". Each of these blocks entitled the holder thereof to "the exlusive use, occupation and enjoyment in perpetuity, free of rent, of a definite flat or garage in the company's building".[5] In addition, the articles declared that the said holder had no such rights in respect of any other flat or garage.[6] The detailed rights given to such holders were set out in an agreement annexed to the articles.

The registrar raised several objections to these articles.

Firstly, they ignored the principle that a company is a separate legal entity, since thereby the members would have the sole and exclusive rights to certain portions of the company's assets.[7]

Secondly, the occupation agreement annexed to the articles was not a complete agreement, nor included in the memorandum.[8] In developing this objection it was

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1. Ibidem E-F.
2. Ibidem G-H.
3. Ibid 525H-526A.
4. Ibid 526A.
5. Ibid 526C-E.
6. Ibidem G.
7. Ibid 527C.
8. Ibid 527D.

contended that while it was "possible for the company to enter into arrangements of this nature with third parties or even with persons who were in fact members of the company, it was not permissible for the company to enter into such arrangement with members in their capacity as members," since the permanent right of occupation amounted to a return of capital to shareholders and therefore an unauthorised reduction of capital.[1]

The judge regarded this as a "somewhat startling" proposition, one which, if correct, would have far reaching consequences.[2] He then dealt with this submission, namely that it was the fact that the amended articles gave the shareholders rights to the company's property in their capacity as members which rendered the article objectionable.[3] It endeavoured, so it had been submitted to the court, to promote a purely personal arrangement into an arrangement with persons as members.[3]

The judge continued as follows. There was a well recognised distinction between contracts made by a company with a member in his private capacity and those made with him in his capacity as a member.[4] In support of this he quoted the words of Potgieter J in De Villiers' case, namely that the articles constituted a contract between the members inter se and between the company and the members but only in their capacity as members, and that they did not, for instance, constitute a contract between the company and a director in his capacity as such.[5]

This passage had been approved by the Appellate Division in Gohlke's case.[6]

A member of a company had no separate legal personality "in his capacity as a member" which was distinct from him in his private capacity.[7] What was meant by a contract with a member "in his capacity as such" was a contract between him and the company which was connected with the holding of shares and which conferred rights which were part of the general regulations of the company

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1. Ibid 527E-G.
2. Ibidem.
3. Ibid 528A.
4. Ibid 528A-B.
5. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O) 876-7.
6. Rosslare's case supra 528C. See Gohlke and Schneider v Westies Minerale (Edms) Bpk 197C (2) SA 685 (A) 692F-G.
7. Rosslare's case supra 528D.

applicable alike to all shareholders.[1] For this proposition he relied on Hickman's case.[2]

The rights given to the shareholders, in the articles before the court, were part of the general regulations of the company applicable alike to all shareholders, and therefore they were contracting in their capacity as members.[3] The rights in question were the rights of occupation of a definite flat or garage in the company's building.[4]

If members could contract outside the articles for such rights, there was no reason why they could not do so in the articles.[5] This was, of course, a direct response to counsel's submission that these arrangements could be made with third parties, or even with persons who were in fact members, but not with members in their capacity as members.[6]

It, therefore, made no difference in law whether the contract embodying such provisions was contained in an agreement outside the articles, or whether it arose from the terms of the articles themselves.[7] There followed a careful analysis of the question of a reduction of capital.[8] The conclusion arrived at was that the mere grant of rights to the company's property without actually returning the property itself to shareholders did not appear to amount to a reduction of capital.[9] Accordingly this objection to the amended articles was not well-founded.[10]

The judge then turned to consider the objection that the articles authorised the directors to make levies upon the holders of shares to meet company expenses, and the obligation placed on shareholders in the articles to effect loans to the company.[11] In essence these objections amounted to this, that these levies had

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1. Ibid 528D-E.
2. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 896-897.
3. Rosslare's case supra 528F-G.
4. Ibid 526D-E.
5. Ibid 528G-H.
6. Ibid 527E-F.
7. Ibid 528H.
8. Ibid 529D-532.
9. Ibid 532D-F.
10. Ibid 532F-G.
11. Ibid 532G-533H. As to the obligation to make loans see 276 below footnote 4. See also the proviso to s 59(2) of the Act.

the effect of increasing the liability of a shareholder towards the company, which would be contrary to the concept of limited liability, and that no provision was made in the Act to compel shareholders to lend money to the company.[1]

In support of these contentions, counsel for the respondent relied on the remarks of Buckley L J namely, that the purposes of the memorandum and articles was to define the position of the shareholder as shareholder, not to bind him in his capacity as an individual.[2]

However, said Milne J, it was clear from Hickman's case that articles regulating the rights and obligations of the members generally did create rights and obligations between them and the company respectively.[3] The obligation to make loans to the company would not be subject to any contribution on a winding-up, but apart from this there seemed to be nothing in s 107(g) of the Companies Act, 46 of 1926 or in any other section nor was there any underlying assumption of the said Act, which prevented members from being bound by the articles of association to make loans to the company.[4]

In the result, the court held that the objections of the registrar were unfounded and ordered that the amended articles be registered accordingly.[5]

The judgment of Milne J in Rosslare's case is the only judgment in South African law dealing in any depth with the contract embodied in the constitution of a company between it and a member in his capacity as such. In doing so the learned judge dealt with a subject which is an integral part of the outsider rule.[6] What is more, in his references to Hickman's case, he introduced those portions of the judgment in the latter case which contain the reasoning

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1. Ibid 532G-H.
2. Rosslare's case supra 533H. Reference had been made in Rosslare's case at 525F-G to these remarks of Buckley J in Bisgood v Henderson's Transvaal Estates Ltd [1908] 1 ChD 743 at 759.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900 and 903.
4. Rosslare (Pty) Ltd v Registrar of Companies 1972(2) SA 524 (D) 534C-E. This case was decided prior to the promulgation of the Act under which, in terms of the proviso to s 59(2) of the Act, a condition in the articles that the members are obliged to make loans to the company is of no force or effect.
5. Ibid 534F.
6. See Hickman's case supra 900.

and the classic statement of the outsider rule.[1] The views of Milne J are therefore of great importance in defining the meaning of the outsider rule in our law.

The judgment was concerned with a "somewhat startling proposition" that it was possible for the company to enter into the arrangements before the court with members but not with members in their capacity as such.[2] Viewed in the context of the outsider rule, one would expect this to mean that the contractual force of the articles was limited to those articles which apply to the relationship of the company to the members in their capacity as such.[3] But this was not the proposition before the court. Instead, the reason advanced in argument why these arrangements were with the members in their capacity as such, and were therefore objectionable, was that these arrangements resulted in a reduction of capital.[4] Such a contention, it is submitted, appears to be a non sequitur. There are presumably many articles which do not result in a reduction of capital, and which could be said, in terms of the outsider rule, to be other than in the capacity of a member, such as for example, articles appointing a member to be a director or a solicitor of the company.

Milne J referred to a "well-recognised" distinction between contracts made by a member in his personal capacity, and those made by him in his capacity as a member.

That there is a distinction between persons who have contractual capacity and those who do not, and between contracts by a person in his personal capacity and in a representative capacity, is trite law. Apart from this, there is no room for doubt that, as Milne J says, a member has no separate legal personality in his capacity as a member, as distinct from him in his private capacity.

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1. There are two references to Hickman's case in the judgment of Milne J in Rosslare's case, to be found therein at 528E and 533H. In the latter, 533H, reference is made to Hickman's case at 869 and 897, in which two lines of cases are set out, the reconciliation of which was effected through the outsider rule. See Chapter 8 at 178.
2. Rosslare's case supra 527E-G and 528A.
3. See Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 218B-C.
4. Rosslare's case supra 527F-G.

What then is the meaning of the"well-recognised distinction" to which Milne J refers ? It is submitted that it relates only to contracts in the company constitution. It may be traced directly to the classic dictum of Astbury J in Hickman's case. What has become well recognised is his view that "no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member ..... can be enforced against the company."[1] This is, of course, the outsider rule.

Milne J offered two tests of a contract with a member "in his capacity as such". The first is that such a contract is connected with the holding of shares. For the present purposes, this test is to be examined only in regard to the contract in the constitution, and not to any other contracts outside the constitution. The second test is that such a contract confers rights which are part of the general regulations of the company, applicable alike to all members.

In regard to the first test, the following submissions are offered.

Firstly, Astbury J in Hickman's case did not examine rights, given in an article, according to whether these were connected to the holding of shares or not.[2]

Secondly, in formulating this test Milne J, it is submitted, clearly contemplated that there are two types of contract contained in the constitution: those which are connected with the holding of shares, which are enforceable if they also comply with the second criterion; and those which are not so connected, and are therefore unenforceable. It is doubtful whether there are two such types of contract. As Jansen J A said in Utopia's case, in seeking to ascertain the nature of rights connected with the holding of shares, the source is normally the constitution of the company.[3] Furthermore, s 65(2) provides that all provisions in the constitution are binding. This serves to eliminate the distinction between contracts in the constitution which are enforceable because they are connected with the holding of shares, and those which are not.

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1. Hickman's case supra 900. My deletion. See Chapter 8 at 178.
2. Ibidem .
3. Utopia Vakansie-Oorde Bpk v Du Plessis 1974 (3) SA 148 (A) 163B-C. See below at 284 et seq.

Thirdly, this formulation of the outsider rule is self-contradictory. On the one hand, only those portions of the constitution are enforceable which create rights and obligations between the company and its members in their capacity as such.[1] On the other hand, a test of such capacity is whether or not such rights and obligations are connected to the holding of shares.[2] Furthermore, the source of rights and obligations connected with the holding of shares is the constitution of the company.[3]

Finally, s 65(2) clearly lays down that all the provisions of the constitution are binding. This effectively destroys any limit imposed by the outsider rule on the scope of the contract contained in the constitution.

It is submitted that this conclusion is consistent with all relevant propositions, excepting only the first test of Milne J and the outsider rule. It is the only reasonable inference which may be drawn from the authorities, read together. It is, therefore, submitted that to say of a contract between the company and its members, be it in or out of the constitution, that it is a contract with the member in his capacity as such if it is connected with the holding of shares, takes the matter no further.

It might be added in passing that the holding of shares and membership are co-extensive notions. In a company having a share capital the member is the person whose legal relationship with the company arises by virtue of his shareholding in the company.[4] Since holding shares in such a company is

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1. Rosslare's case supra 528C.
2. Ibid 528D-E.
3. Utopia's case supra 163B-C. It is submitted below at 286 footnote 5 that even where shares are issued or allotted by the directors, nevertheless, the ultimate source of such rights is the constitution, since it is the source of the directors' right to issue such shares. It is submitted further that s 221 of the Act is not the source of such authority.
4. Cilliers Benade De Villiers 118; s 103(2) and s 105(1)(a).

synonymous with membership it cannot, it is submitted, be a guide to distinguishing contracts with a member in his capacity as such from contracts with him in some other capacity.

In regard to the proposition that a contract with a member in his capacity as such, is one which is connected with the holding of shares, one may assume that the judge was dealing with a company limited by shares.[1] In regard to a company limited by guarantee, it is submitted that the learned judge would formulate the test as follows: it is a contract between him and the company connected with his membership of the company.[2] Such a test would also depend on a division of the constitution of a company into that portion which is enforceable, and the other which is not. It would require an analysis of rights and obligations in the constitution according as they confer rights in the capacity of member or not. Such an enquiry would be identical to that of Astbury J in Hickman's case, and would be subject to the observations in regard thereto.[3]

It is now proposed to deal with the second test put forward by Milne J in Rosslare's case, in respect of a contract with a member in his capacity as such, namely, that it confers rights which are part of the general regulations of the company, applicable alike to all members.[4] In support of this proposition Milne J referred to Hickman's case at 896 and 897.[5] These references are to the comments of Astbury J in regard to the "Eley" cases.[6] In these cases Astbury J found that the articles in question purported to give specific contractual rights to persons in some capacity other than that of shareholder, and in none of them were members seeking to enforce or protect rights given to them as members in common with other members.[7] The decisions, said Astbury J, amounted to this that an outsider to whom rights were given in the

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1. As defined in s 19(1)(a).
2. S 19(1)(b).
3. See Chapter 8 at 208 et seq.
4. Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 528E.
5. See Chapter 8 at 177-179.
6. Ibidem. The "Eley" cases are:
   Tavarone Mining Co Re, Pritchard's Case (1873) 8 ChApp 956;
   Melhado v Porto Alegre Rail Co (1874) LR 9 CP 503;
   Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88;
   Browne v La Trinidad (1887) 37 ChD 1.
7. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 896.

articles could not sue on them as contracts between himself and the company, because they were not part of the general regulations of the company applicable alike to all shareholders.[1]

There were, of course, other cases referred to by Astbury J in which the company was entitled to enforce its regulations as against its members. In these cases Astbury J found that the rights in question related to the rights and obligations of the members generally as such.[2]

In order to reconcile these two classes of decisions Astbury J formulated the outsider rule, restated the English rule against the enforcement of rights contained in a contract between two persons in favour of a third person, and postulated that articles regulating the rights and obligations of the members generally as such did create rights and obligations between them and the company respectively.[3]

The second test of Milme J, therefore, it is submitted, rests firmly on the wording and reasoning of the judgment of Astbury J in Hickman's case.[4]

Like the dictum of Astbury J it pre-supposes that there are regulations in the constitution which are not general, and are therefore unenforceable.

The meaning of such general regulations according to Astbury J, is that they do not confer specific rights to persons in some capacity other than that of shareholder. According to the view he took of Eley's case, Astbury J was of the opinion that Eley's right to be the company's solicitor was a specific right given to him in some capacity other than that of member.[5] Furthermore, it was not applicable alike to all members.

If one examines the right in issue in Rosslare's case, namely the right to the exclusive use of a definite flat or garage, it is submitted that this was an outsider right.[5] It was specific, it was applicable to only one shareholder

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1. Ibid 897.
2. Ibid 899-900. See Chapter 8 at 184-194; 202-203 and 208.
3. Ibid 900.
4. Ibidem.
5. Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 525H-526A; See 272 above.et seq.

and it was in some capacity other than that of member. It could, therefore, not be part of the general regulations of the company. It might be argued that similar rights were given to all members and that, therefore, it was a membership right and part of the general regulations. It is submitted, however, that such an argument distorts the ordinary meaning of the terms "specific rights" and "general regulations". It also ignores the fact that in this case the obligation rested on the company, and not the members generally, while the rights in question were not enjoyed by all the members alike.

Apart from this, it is submitted that it is not an "underlying assumption in the Companies Act", that all rights and all obligations contained in a company constitution are to be held alike by all members.[1] It is well recognised, on the contrary, that classes of members may enjoy rights, or carry obligations which are specific to a class and not to members of another class.[2] There is no obstacle, it is submitted, to a class consisting of one member or to a member enjoying specific rights unlike those of other members.

There seems, therefore, no valid reason why a member cannot contract with a company in the constitution for a specific right, be it for dividends, or to be a director or to occupy a specific flat or garage.

Having formulated the two tests aforementioned, and having applied them to the articles in question, Milne J in Rosslare's case expressed his support for counsel's submission, that if it would be permissible for persons who were members of the company to contract outside the articles for such rights, it was equally permissible for them to do so in the articles.[3] If the articles gave rights which amounted to a return of capital to shareholders, it made no difference in law whether the contract embodying such rights was contained in agreement outside the articles or in terms of the articles.[4] It is submitted

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1. According to the dictum of Milne J in Rosslare's case at 525H this is one criterion for the registrability of articles.

2. See s 52(2) and Table A art 3; s 194; s 311; Cilliers Benade De Villiers 83-92.

3. Rosslare's case supra 528G-H.

4. Ibidem. Such an agreement would, it is submitted, be unenforceable if it did not provide for due compliance with ss 83-90 of the Act, if, for example, it provided for a reduction by means other than a special resolution where this is appropriate, or if it sought to avoid confirmation thereof by the court where this is necessary. See Cilliers Benade De Villiers 95-102.

that there can be no objection to this in the context of the rule against the reduction of capital. Any agreement, in or out of the constitution, resulting in an unauthorised reduction of capital would be unenforceable.

However, in the context of the outsider rule, it is submitted that no comparison can be made between contracts in the constitution and those outside it. It certainly would be a fallacy to argue that, if an agreement would be valid if entered outside the constitution, it would be valid if contained in the articles. The differences are too basic to permit of such a comparison. It is the contract embodied in the constitution and the effect thereof which is to be interpreted. An underhand agreement between the company and its members and between the members inter se is not subject to s 65(2) of the Act. It need not be registered.[1] It is not capable of being varied by a prescribed majority following the requisite formalities.[2] In none of the cases has it been suggested that an agreement outside the constitution is invalid if it confers outsider rights. On the contrary, in Beattie's case, the judgment contemplated the possibility that if the outsider could not show that he was acting qua member, and was seeking to enforce rights common to himself and all the other members, he would be driven to rely on another agreement with the company outside the articles.[3] Such formalism is, indeed, one of the defects of the outsider rule.

In a word, to judge the validity of an article between the company and a member in his capacity as such, by reference to an agreement outside the constitution, would hardly be an acceptable yardstick.

Finally, for the reasons which emerge below, the two tests of capacity formulated by Milne J may be examined by the criterion which the learned judge laid down for "registrable articles". It will be recalled that he held that, notwithstanding compliance with the requisite formalities, in amending articles, and presumably also in the formation of companies, the registrar was only obliged to register same in certain circumstances.

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1. S 32 requires registration of the constitution.
2. S 62(1) permits the articles to be so altered.
3. Beattie v E and F Beattie Ltd [1938] 3 All ER 214 CA 218H. See Chapter 9 at 215-218.

"Articles", he said, "which are not in conflict with the general law, nor with any express or implied provision of or underlying assumption in the Companies Act, are registrable and the Registrar of Companies is obliged to register them."[1]

As far as the phrase "general law" is concerned, it presumably encompasses the whole body of the law, both common and statute, as well as the Act. It is submitted that, apart from the outsider rule, there is no rule of law which precludes the enforcement of a contract entered into in a company constitution with a member other than qua member.

Nor are there any considerations of public policy which might justify such a proposition.[2] Nor did Astbury J suggest anything other than a need to reconcile his view of the "Eley" cases with other cases before him.[3]

As far as the Act is concerned there are, it is submitted, no "express or implied provisions of or underlying assumptions" in the Act which justify a refusal to enforce such a contract. In fact, it will be submitted that the outsider rule is in conflict with the ordinary literal meaning of s 65(2) of the Act.[4]

The case of Utopia Vakansie-Oorde Bpk v Du Plessis is of interest to the present enquiry, albeit only indirectly.[5] Firstly, it is authority for the proposition that in seeking to ascertain the nature of rights connected with the holding of shares - one of the criteria put forward in Rosslare's case for a contract between the company and the member in his capacity as such - the source is normally the constitution of the company.[6] Secondly, on the facts, the rights of occupation attached to the preference shares in question could be described as outsider rights.[7] Yet this aspect was not argued or

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1. Rosslare's case supra 525G-H.
2. See Chapter 10 at 234 and Chapter 11 at 251.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881 at 900. See Chapter 8 at 178.
4. See 291 below.
5. 1974 (3) SA 148 (A).
6. Ibid 163B-C.
7. Ibid 179F.

dealt with by the court, even though the nature of those rights was an essential element in deciding on the voting rights of these preferent shareholders. This silence is eloquent testimony to the uncertain place of the outsider rule in our law.

It is not necessary to traverse all the facts and conclusions contained in this leading case.[1] For the present purpose the following salient features are to be noted.

A company had issued 100 000 preferent shares which conferred certain rights on each holder thereof, inter alia, the right to certain dividends, and the right to occupy a particular bungalow at a holiday resort in the Rustenburg district.[2] A special general meeting of the company was held, which passed a special resolution which was duly registered, increasing the ordinary share capital of the company. The purpose was to ensure that the ordinary shareholders would retain control of the company instead of the preferent shareholders.[3]

An objection was raised to the validity of the special resolution for such increase, on the ground that the effect thereof and the reasons were not mentioned in the notice of the meeting, as required by law.[4] A further general meeting was called to pass the said resolution again. An urgent application was brought to the Transvaal Provincial Division for certain declaratory orders, and an interim interdict.[5] An order was granted entitling the preferent shareholders to vote at this meeting as long as their preferent dividends were in arrear, and in regard to certain resolutions which directly affected their rights or interests. An appeal was brought to the Appellate Division.

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1. For which see Cilliers Benade De Villiers at 6; 91; 93; 213; 311 and 370.
2. Utopia Vakansie-Oorde Bpk v Du Plessis supra 179F.
3. Ibid 172A-B.
4. Ibidem.
5. Ibid 174A.

In considering whether the proposed resolutions would amount to a variation or modification of the rights of preferent shareholders, the Appellate Division had to describe what it regarded to be such rights. In casu the preferent shares were held to confer the series of rights comprehensively formulated in the memorandum of association.[1] These included the right to occupy a particular stand for ninety-nine years for holiday purposes and for letting to bona fide holiday-makers.[2]

The court, by a majority of three judges to two, held that the proposed resolutions could not fail to affect the interests of the preferent shareholders and therefore the judgment of the court a quo, declaring that the preferent shareholders were entitled to vote, was upheld.

The reasoning which led to this conclusion is set out in the judgment of Jansen J A, one of the majority judges.[3]

The relevant provision of the statute safeguarded the full exercise of voting rights by preferent shareholders in regard to any resolution proposed which directly affected any of the rights attached to such shares or the interests of the holders thereof including any resolution for the winding-up of the company.[4] The judge said : "The concept 'a right attached to such shares' can generally cause no difficulty - normally such rights would be defined in the memorandum of association and the articles of the company concerned."[5]

"Interests" was a wider concept than rights, covering a wider sphere, bearing, however, some relationship with the rights.[6] These rights and interests extended much further than what they would receive on liquidation. They also included the right of enjoyment and occupation for ninety-nine years

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1. Ibid 179E.
2. Ibidem F.
3. Ibid 163 et seq.
4. S 62 quat (4)(a)(iii) of the Companies Act, 1926 as amended, corresponding to s 194 of the Act.
5. Ibid 163B-C. It may be argued that, since directors have the authority to issue or allot shares at their discretion subject to the provisions of s 221 that therefore, the source of rights attached to shares so issued, is not the constitution, but the directors' resolution. It is submitted, however, that the authority of the directors, and the powers of the general meeting to approve of such issue or allotment of shares, derives from the constitution, albeit circumscribed by s 221 of the Act.
6. Ibid 165E-F.

(with an option to renew). This would be completely nullified if the resort and equipment were sold.[1] The learned judge then analysed the income and expenditure of the company and concluded that the losses on this account might very soon have affected the occupation rights of the preferent shareholders.[1] Therefore, a proposed loan to be raised would directly affect their interests. The company would be required to bind itself as principal debtor, and if anything went wrong the company "would have to face the music".[2] This was exactly par excellence a case where the preferent shareholders through their voting rights should have a say on the advisability of the proposed loan.[2]

As regards the election of directors, while in an ordinary trading company it would hardly concern the preferent shareholders who the directors were, in this case the position was different.[3] The conditions in regard to the occupation rights placed the holders thereof in a particular personal relationship with the directors, since they were subject to the decisions of the directors as far as their occupation was concerned, particularly in regard to the observance of the resort and camp rules, on the breach of which their rights could be suspended.[4] For these and other reasons, the rights of occupation accorded to the preferent shareholders made the election of directors an important matter as far as they were concerned.[5] Consequently, they were held entitled to vote.

It is submitted that, seen in the context of Hickman's case, the right of each preferent shareholder to occupy a particular bungalow on the company's property, could only be regarded as a specific right, given in some capacity other than as a member, not applicable alike to all members, and therefore an outsider right and unenforceable as such.[5] Had the point been taken, it is submitted, that it would have gone to the root of the contentions of the preferent shareholders. It could only have been countered by an argument that the outsider rule is not part of our law.

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1. Ibidem.
2. Ibid 168H-169A.
3. Ibid 169.
4. Ibid 169C-D.
5. These rights are set out in Utopia's case supra 179E.

2.2 Conclusion on the cases

There are but half a dozen cases in South African law touching on the outsider rule. These are subject to a four-fold classification.

Firstly, in three cases there is support for the famous dictum of Astbury J in Hickman's case - that no right in an article which is given to a member in a capacity other than that of a member can be enforced against the company. These cases are De Villiers' case, Gohlke's case and Rosslare's case.[1]

Secondly, in Isaacs, Geshen's case, rights which would be outsider rights in terms of Hickman's case were upheld, without in any way considering the outsider rule.[2] The judgment of the Appellate Division in Utopia's case is in the same category, subject to one important proviso.[2] The preferent shareholders were held to have interests which were dependent on rights. These interests could not be viewed in isolation from those rights. These rights could be interpreted as outsider rights. In upholding those interests, the court may be said to have given tacit approval to outsider rights, even though the court held that the resolution in question did not affect the rights themselves.

Thirdly, in only one case is there to be found an in-depth investigation into the meaning of the concept of a contract with a member in his capacity as such. This is Rosslare's case.[3]

Fourthly, there is the case of Grundling v Beyers.[4] In this case, consideration was given to the right of its members to insist that a trade union, incorporated under the Industrial Conciliation Act, 1956 treat an outsider in a manner consistent with the member's rights under the constitution. The

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1. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O) 873-874A; Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) 692F-G; Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 528E and 533H.
2. Isaacs, Geshen and Co (Pty) Ltd v Ellis 1964 (2) PH A59 (N); Utopia Vakansie-Oorde Bpk v Du Plessis 1974 (3) SA 148 (A).
3. Supra.
4. 1967 (2) SA 131 (W).

possibility then emerges, although it is not canvassed in the case, that a member may, in enforcing such rights as he may have in this context, also enforce his own outsider rights. However, because the Industrial Conciliation Act, 1956 has no section equivalent to s 65(2) of the Act, the case is of limited value for the present enquiry.[1]

It is proposed to return to these cases in the general assessment of the outsider rule in South African law, which will be attempted after summarising the views of South African academic writers on the outsider rule.

3. The views of South African academic writers on the outsider rule

There are no journal articles on the subject. The authors of the standard works of reference on company law deal with the matter in the following manner.

Cilliers Benade De Villiers, in dealing with the legal relationships created by the constitution, observe that it was generally accepted today that the memorandum and articles constituted a contract between the company and its members to the extent that the provisions thereof affected the members in their capacity as members.[2] In support of this, reliance was placed on Hickman's case.[3]

Likewise the learned authors, in dealing with s 36, note that this section did not operate between the company and its insiders.[4] Members, (in their capacity as such, they submit), would still be able to assert among themselves and against the company the contract between them as contained in the memorandum.

Henochsberg states that the articles by themselves could not constitute a contract binding the company to any person other than a member as such.[5] This view is expressed in relation to s 65(2) of the Act, in regard to the provision that the constitution "shall bind the company and the members to the

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1. See 268-269 above.
2. Cilliers Benade De Villiers 35.
3. Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915] 1 ChD 881; De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O).
4. Cilliers Benade De Villiers 56.
5. Henochsberg 122.

same extent as if they respectively had been signed by each member." Both Hickman's case and De Villiers' case,[1] and Gohlke's case are relied on in support of this proposition.[2]

Hahlo, in dealing with the effect of the articles as between the company and the members, notes that they constituted a contract, but that even a member could not enforce provisions which did not concern him as a member.[3] In support of this Hahlo relies on Eley's case, Welton v Saffery, Hickman's case and Rayfield v Hands.[4]

Naude in dealing with the binding effect of the constitution, considers that the articles were a contract between the company and its members qua members.[5] In addition he regards the articles as binding between the members inter se in their capacity as such.[6]

It is apparent that these learned authors have accepted the proposition that in our law the memorandum and articles constitute a contract between the company and its members, to the extent that the provisions thereof affect the members in their capacity as members.[7]

Apart from the aforementioned, there seems to be a dearth of learning on the outsider-rule in South African law.

4. A general assessment

Both the cases and the academic writings confirm that, in South African law, no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as for instance as solicitor or director can be enforced against the company.[8] It is frequently stated in the converse, namely that the articles merely have the same force as a contract between the company and each and every member as such to observe their provisions.[9]

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1. Hickman's case supra; De Villiers case supra.
2. Gohlke and Schneider v Westies Mineral (Edms)Bpk 1970 (2) SA 685 (A) 692.
3. Hahlo 89.
4. Eley v Positive Government Security Life Assurance Co (1876) 1 ExD 20 and 88; Welton v Saffery [1897] AC 299 HL; Hickman's case supra; Rayfield v Hands [1958] 2 All ER 194 ChD.
5. Naude 57.
6. Ibid 58.
7. Cilliers Benade De Villiers 35; Henochsberg 122; Hahlo 89; Naude 57-58.
8. De Villiers' case supra 873-874A.
9. Gohlke's case supra 692F-G. Cilliers Benade De Villiers 35.

These propositions have been received into South African law almost without analysis. The solitary exception is the judgment of Milne J in Rosslare's case, which, it is submitted, is the leading case on the topic in our law.[1]

As the rule has been formulated in Rosslare's case, the articles are enforceable as a contract between the company and its member only insofar as the member contracts in his capacity as such.[2] Such a contract is one which confers rights which are part of the general regulations of the company applicable alike to all members.[3]

This then is the doctrine known as the outsider rule. It divides the articles into two parts, one which complies with this yardstick and is enforceable, and the other which is accordingly unenforceable. In this sense it goes to the root of the concept that the constitution of a company is a contract, since it must follow that according to the outsider rule only a portion of the contract contained in the constitution is enforceable, namely that portion in which the member contracts with the company in his capacity as such.

The following are a number of submissions to be made in regard to this doctrine.

4.1 The outsider rule is in conflict with the Act

S 65(2), as does its English counterpart, provides that the memorandum and articles shall bind the company and the members to the same extent as if they had been signed by each member, to observe all the provisions of the memorandum and articles, subject to the provisions of the Act.

This section declares that the parties to the constitution are bound to observe all its provisions, whereas the outsider rule postulates that the parties are only bound to observe some of them.

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1. Rosslare's case supra 527-529.
2. Ibid 528A-B.
3. Ibidem D-E.

The section uses general terms throughout, of which the most general is the phrase "all its provisions". It is a basic rule of interpretation that general words are to be given a general meaning.[1] The outsider rule, it is submitted, contradicts the ordinary literal meaning of this section, construed in this manner, since in terms of the outsider rule, all the provisions of the constitution are not binding on the company and the members. It is submitted that the only valid interpretation of the section is to ascribe to its words, their literal and therefore their general meaning. Reference to other sections of the Act does not alter the general meaning of this section. For example, a member is, apart from the subscribers, every person who agrees to become a member, and whose name is entered in the company's register of members.[2] The only section which might suggest a limited rather than a general interpretation of s 65(2) is the proviso to s 59(2), which declares that any condition in the articles which provides for compulsory loans by members is of no force or effect. Whether such loans are outsider obligations, is by no means clear. It may be that it is no more than an obligation placed on members qua members, and which is rendered of no force by the statute. It might also be argued that, if the outsider rule applied in South African law, the obligation to lend money would be unenforceable as an outsider obligation, and therefore s 59(2) would have been unnecessary. It is submitted that no policy can be extracted from this proviso, which would change the ordinary meaning of s 65(2).

It is submitted that, in testing whether this is the correct interpretation of the section, the courts are permitted in our law as in English law, to examine the mischief which the section was intended to remedy.[3] This mischief is the fact that a company cannot at common law, be a party to its own constitution, since it is a contract which was concluded before the company's incorporation.[4] Nor can it adopt or ratify the constitution, in the event that it was entered into on its behalf by an agent prior to its incorporation.[4]

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1. Steyn 7.
2. S 103.
3. Steyn 24.
   Hleka v Johannesburg City Council 1949 (1) SA 842 (A) 852.
4. Chapter 2 at 14; 26 and 27-29.

It can, however, adopt its constitution if it was formed by the agreement of two principals prior to its incorporation, provided such an agreement was a stipulatio alteri, and complied with the requirements thereof.[1] Unless s 65(2) of the Act declared that the memorandum and articles were binding on the company and its members, it is submitted that the constitution would, in the vast majority of cases, not be binding, simply on the basis that it is a pre-incorporation contract.[2] In addition, it serves to regulate subsequent transfers of shares between members, rendering the constitution binding between the company and new members, and between existing and new members, as if the new members had signed the constitution. This, it is submitted, is the mischief which the section serves to remedy, and not that of rights given in the constitution to members in some capacity other than that of members.

It may be argued that the Act is to be construed against the background of the common law, as at the date of its promulgation, that is in 1973, and that therefore s 65(2) is to be interpreted bearing in mind De Villiers' case, Gohlke's case, and Rosslare's case.[3] In the result, the binding effect of the constitution would be limited to those portions which constitute a contract with the member in his capacity as such. On the other hand, s 65(2) is identical to s 16 of Act 26 of 1926. It is submitted that, in interpretating s 65(2) of the Act, the courts will look at the history of the section, and at the common law, as it stood when it was first introduced. The South African Companies Act, 1926 repealed various provincial ordinances and became the first company legislation of the Union of South Africa. As far as the common law stood at that time, there was no case law on the nature of the constitution, except the case of Ross and Co v Coleman.[4] In that case Innes C J expressed the view that "articles of association are, in themselves, merely an agreement between the shareholders inter se."[5] Consequently s 16 could not be read in any sense except its literal, and therefore its general sense. This remains true, it is submitted, of s 65(2) of the Act.

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1. Chapter 2 at 27.
2. Ibid 28.
3. Supra.
4. 1920 AD 408.
5. Ibid 418.

It might be argued instead that the Act is to be interpreted against the background of English law.

The South African s 65(2) is the same as s 20(1) of the English Companies Act, 1948. That this is so, was confirmed by the Appellate Division in Gohlke's case.[1]

South African company law is, of course, independent of English law, being governed by its own act. The English common law is part of our company law to the extent that it is not inconsistent with our common law. Where sections of the Act have obviously been taken over from the English statute, our courts will, as a rule, follow the meaning as laid down in an English Court.[2] This is the case where the terms are identical.[3] This is particularly so where an English court has authoritatively decided a question and the decision has been quoted and followed in a number of subsequent cases.[4] In that event, the adoption of an English enactment is considered to be with full recognition of the sense which judicial interpretation has given to it.[4]

However, the English courts are far from consistent in their views on the outsider rule or on the meaning of s 20(1) of the English Companies Act, 1948. As a result their judicial interpretations are by no means authoritative, nor are these supported by long lines of cases.[5] Consequently it cannot be said that these interpretations will be fully recognised by South African courts.

On the other hand, it is illuminating to trace s 20(1) of the English Companies Act, 1948 to its origins. This clearly indicates the nature of the mischief for which it was a remedy. It was first introduced in the Joint Stock Companies Act, 1856 and has been retained intact in all subsequent company legislation, embodying as it does the statutory sanction for the legal nature of the company's

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1. Gohlke and Schneider v Westies Minerale (Edms)Bpk 1970 (2) SA 685 (A) 692D-E. See Chapter 2 at 21-22.
2. Estate Wege v Strauss 1932 AD 76 at 81.
3. Buckingham v Combined Holdings and Industries Ltd 1961 (1) SA 326 (E) 331D-E. Roodepoort United Main Reef GM Co Ltd (In Liquidation) v Du Toit NO 1928 AD 66 at 71. This is, however, not always the case, See for example Albert v Papenfus 1964 (2) SA 713 (E) 721.
4. Osaka Mercantile Steamship Co Ltd v South African Railways and Harbours 1938 AD 146 at 173-174.
5. See Chapter 2 at 19.

constitution in English law.[1] As such it has been consistently viewed as a difficult section to construe.[2]

On the other hand, the English Joint Stock Companies Act, 1844 provided that the constitution should contain undertakings by every shareholder with a trustee on behalf of the company to pay for his shares and "to perform the several engagements in the Deed contained on the part of the shareholders".[3] Furthermore this statute provided that on its incorporation these covenants, which were recognised as pre-incorporation contracts, could be enforced in all respects as if they had been entered into with the said company after incorporation thereof.[4]

It is submitted that this clear proof of the mischief, for which the section and its predecessors was intended as a remedy in English law, will be taken into account in determining whether to construe s 65(2) in general terms or not. Since the mischief was the pre-incorporation contract, and not the fact that all the provisions of the constitution have a general binding effect, there is no need to construe the section in any way other than its literal, and therefore general sense.

It is submitted for these reasons, that the outsider rule is in conflict with the provisions of s 65(2) taken literally. Furthermore, there is no way to reconcile the statutory rule that all the provisions of a constitution are binding, with the rule that only those provisions are binding which affect the members in their capacity as such.

4,2 The tests formulated in Rosslare's case are unsatisfactory[5]

To judge a contract in the constitution, as having been concluded between the company and a member in his capacity as such, according to whether such contract is connected with the holding of shares, is to advance the matter no further.[6] In a company limited by shares, the source of all rights connected

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1. See Chapter 2 at 8.
2. See Chapter 2 at 9 et seq and the authorities therein quoted.
3. Joint Stock Companies Act, 1844 par VII.
4. Ibid par XXV. See Chapter 2 at 7-8.
5. These tests are set out above at 274 et seq. See Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 528D-E.
6. See the submissions in this regard at 279 above et seq.

to the holding of shares is the constitution. S 65(2) states that all the provisions of the constitution are binding.[1] This is no way, therefore, in which to divide the constitution into its enforceable and unenforceable portions. In a company limited by guarantee, where there are no shares, the source of all membership rights is, it is submitted, the constitution, including all its provisions. The result is, it is submitted, the same.

The second test in Rosslare's case is, unlike the first, based on Hickman's case and is subject to the same comments.[2] According to this test an article constitutes an enforceable contract if it is part of the general regulations, applicable to all members alike.[3] As in the test of generality laid down in Hickman's case, there is no statement setting out the meaning of "general regulations" or of the phrase "applicable alike to all members". On the contrary, if one examines the rights contained in the articles before the court in Rosslare's case, namely the sole and exclusive right to occupy a particular flat or garage, this appears to be a specific right given to a particular shareholder. Accordingly, such a right appears to be the antithesis of "general regulations applicable alike to all shareholders".[4]

In order to resolve the difficulty, it becomes necessary to argue that, if the company bears an obligation, for example to provide the accommodation, this is sufficient to make it part of the general regulations.[5] It is also necessary to argue that if all members enjoy a right to accommodation, even if each member has an exclusive right to a particular flat, then this is "applicable alike to all members". There is the immediate difficulty that this argument plainly contradicts the ordinary meaning of specific rights, as opposed to general rights, and also the ordinary meaning of rights which are peculiar to one shareholder, as opposed to rights applicable alike to all members.

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1. See the submissions in this regard at 277 above et seq.
2. See Chapter 8 at 208.
3. Rosslare's case supra 528E. See 280 above.
4. Ibid 525H-526A. See 272 and 281 above.
5. This submission has also been made herein in regard to Hickman's case. See Chapter 8 at 208-209.

A more basic difficulty is that this "generality" test ignores, in fact contradicts, the existence of classes of members, each enjoying rights and bearing obligations which are by no means applicable alike to all members.[1] For example, in Utopia's case, each member of the class of preferent shareholders was given the specific right to occupy a particular bungalow.[2] There seems to be no way to reconcile the existence of classes of members with the generality test. It would be quite inconsistent with the outsider rule or the generality test to apply it only to the members of a class. It may be said that this test only applies to outsider rights, namely those given in some capacity other than that of members, and not to membership rights, such as the right to a dividend, to notices of meetings, to vote and such like. It was not, it is submitted, the intention of Milne J to say that membership rights need not apply to all members alike. The judge said that rights are given to members in their capacity as such if they are part of the general regulations, applicable to all members alike. In other words, he was dealing with membership rights. All other rights were in his opinion unenforceable. What is more, such a distinction begs the question as to which are membership rights, and which are outsider rights.

The result, it is submitted, is a strange convoluted pair of criteria, the effect of which is that all rights contained in the constitution are enforceable, whether they be outsider rights or not.

On the other hand, having regard to the support given to the rule in De Villiers' case,[3] Gohlke's case,[4] and Rosslare's case,[5] and by all the South African academic writers,[6] there seems to be no doubt that it has the binding effect of precedent and will remain so, until the Appellate Division makes a decision to the contrary.

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1. For the rights of classes of members see Cilliers Benade De Villiers 83 et se
2. Utopia Vakansie-Oorde Bpk v Du Plessis 1974 (3) SA 148 (A) 179E.
3. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O).
4. Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A).
5. Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D).
6. Cilliers Benade De Villiers 35 and 56.
   Henochsberg 122.
   Hahlo 89.
   Naude 57-58.

4.3 Its application to the contract embodied in the constitution as between the members inter se

The outsider rule applies to the contract contained in the constitution between the members inter se, as well as that between the company and its members. Authority for this, it is submitted, is found in the statement of Potgieter J in De Villiers' case, to the effect that the articles are "a contract between the members inter se ... but only in their capacity as members."[1] This statement was referred to with approval in both Rosslare's case, and Gohlke's case.[2] There seems to be no ground for submitting that the outsider rule should not apply between the members inter se.

4.4 The effect of the rule in relation to the stipulatio alteri

The outsider rule may also be examined in the light of the South African rules on the stipulatio alteri, which upholds a contract between two principals for the benefit of a third.[3] It has been submitted that there is no obstacle in principle to the enforcement thereof, provided the recognised requirements are present.[4]

What is the position if the outsider is also a member ? The rule permitting a stipulatio alteri in the constitution may seem to be inconsistent with the outsider rule, since the stipulatio alteri in effect gives rights to an outsider arising from the constitution.

It is submitted, however, that it is at least arguable that, by permitting a stipulatio alteri to be embodied in the constitution, a right is given to members qua members, to confer a benefit on a third party, namely to enter into an agreement with the company, or conceivably with other members.[5]

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1. De Villiers v Jacobsdal Saltworks supra 876-877A (my deletion)
2. Rosslare (Pty) Ltd v Registrar of Companies supra 528B-C.
   Gohlke and Schneider v Westies Minerale (Edms) Bpk supra 692F-G.
3. See Chapter 2 at 27; Chapter 3 at 64 et seq.
4. See Chapter 3 at 65.
5. Assuming that the requirements of a valid stipulatio alteri are present. See Chapter 3 at 65.

As far as the tertius is concerned he remains an outsider, even if he is a member, because the right is accorded to him qua outsider. It is a right to enter into a contract with the company, or with other members, on the terms set out in the articles, but by means of a new contract separate and apart from the constitution. He does not thereby become a party to the constitution. His relationship with the company, if he is a member, is governed by two documents: the constitution, insofar as he is a member and another agreement, dehors the constitution in respect of his outsider or tertius rights and obligations. In practice this can only be a rare and unusual situation, not often encountered. In theory the outsider's rights are not embodied in the constitution.

This argument avoids a clash with the outsider rule. Nevertheless, if the outsider rule itself did not exist, there would be no need for such formalism or such minute distinctions.

4.5 Wedderburn's theory

It is necessary to enquire whether, in South African law, the outsider rule has been, or may be, modified in the manner suggested by Wedderburn.[1]

Reference has been made to Wedderburn's theory permitting the indirect enforcement by a member of outsider rights by enforcing his general rights to have the affairs of the company conducted in terms of the constitution.[2] This theory remains untested in English law, although it has received indirect support in obiter dicta.[2]

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1. See Wedderburn K W : Shareholders' Rights and the Rule in Foss v Harbottle (1957) CLJ 194 at 212-213
   ——— Effect of Articles as a Contract-remedy against Directors (1958) CLJ 148 at 150
   ——— Oppression of Minority (1959) CLJ 37 at 40
   ——— Contractual Rights under Articles of Association - an Overlooked Principle Illustrated (1965) 28 MLR 347 at 348-349.
   ——— Going the whole Hogg v Cramphorn ? (1968) 31 MLR 688.
2. See Chapter 9 at 217, 220 and 222.

Likewise in South African law, the possibility of an indirect enforcement of outsider rights remains uncharted territory. However, the judgment of Trollip J (as he then was) in Grundling v Beyers suggests an approach to the subject.[1]

It will be recalled that in that case, Trollip J held that the general secretary's contract arose from an agreement outside the constitution of the trade union. This gave him no rights under the constitution which only created a legal relationship between the union and its members in their capacity as members.[2] At the same time he was a member.[3] As a result, if the union acted "contrary to its constitution the law afforded the member as such certain limited remedies, limited that is, by the rule in Foss v Harbottle.[4] If, therefore, the general secretary's dismissal was unconstitutional he, as a member might also be able to claim some relief on that ground.[5]

If this is so, the converse is equally true. In other words, the member has a personal right to have the affairs of the company conducted according to the constitution. Trollip J expressly quoted the example of the general secretary's unconstitutional dismissal as affording the member, qua member, relief. This was so in respect of outsider rights which arose outside the constitution. A fortiori, this would also be true of outsider rights which arose in terms of the constitution, that is to say, from rights derived from the agreement between the company and its members. Furthermore, it is submitted, that it ought to make no difference whether the member seeks to enforce his own, or someone else's outsider rights.

This approach, which has the effect of giving the outsider remedies arising from his membership, is not unlike that of Wedderburn, since it is a cornerstone of his theory that the member has such a personal right, provided only that he makes out his case qua member, and does not appear in the capacity of an outsider.[6]

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1. 1967 (2) SA 131 (W) 138-139 and 147.
2. Ibid 138G-H.
3. Ibid 139D-F.
4. On the rule in Foss v Harbottle see Chapter 7.
5. Grundling v Beyers supra 138G-H.
6. See Chapter 9 at 217, 220 and 222.

On the other hand it has been submitted that there are basic differences between the law governing a trade union and the Act. The former is governed by the Industrial Conciliation Act, 1956 in which there is no equivalent of s 65(2) of the Act. While doctrines of company law, such as the rule in Foss v Harbottle or the outsider rule, may be imported into the law governing a trade union, the reverse process is not justified since the constitution of the trade union does not derive its sanction from any statutory section akin to s 65(2) of the Act. The analogy with Grundling v Beyers, where by a parallel of reasoning a member qua member might have a personal right under the constitution, arising out of a wrong done to him qua outsider, has therefore only a limited application to the present enquiry.

4.6 Severability of articles having regard to the outsider rule

It is submitted that, as in English law, the constitution which contains outsider rights does not become totally unenforceable. It may be divisible or severable.[1]

Since there is no taint of illegality in regard to outsider rights, there is a strong probability that the law will enforce the unobjectionable part of the agreement, while rejecting the other.[2] However, in order to permit of severance, the two parts of the contract must be expressed in such a way as to show that the notion of separate undertakings was present to the parties' minds. This is a question of fact in each case. It is submitted, however, that the likelihood is that questions regarding outsider rights in the articles are usually remote from the minds of corporators, let alone the possibility of such separate undertakings.

5. Conclusion

The importance of the outsider rule for the concept of the company constitution as a contract, is that it limits the enforceability of that contract to rights therein conferred on the members in their capacity as members.

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1. See Chapter 8 at 205 and Chapter 11 at 250.
2. Middleton v Carr 1949 (2) SA 374 (A) 391.

Its reception into South African law has been largely an uncritical one, since no attempt has been made to assess its validity.

This is amply illustrated by the manner of its treatment in De Villiers' case[1] and in Gohlke's case.[2] In both these cases, the matter was taken largely for granted. In the same way, no South African court has challenged the erroneous view taken by Astbury J in Hickman's case of the Eley cases.[3] For example, Hahlo has cited Eley's case in support of his view that the constitution is only enforceable as a contract insofar as it contains provisions which affect him as a member.[4] The actual basis of the case, it has been submitted, is that Eley had no contract with the company, although he became a member, because the articles were construed as being no more than a contract between the members inter se, and not between the company and the members.[5]

It has been submitted that the tests in Rosslare's case for determining whether rights are given qua member or qua outsider, are unsatisfactory.[6] The effect of these tests is that, in all cases, the matter will depend on the circumstances.

Finally, the most powerful argument against the outsider rule, is that it contradicts the ordinary literal meaning of s 65(2) of the Act, namely that all the provisions of the constitution are binding on the parties thereto.[7] This can only mean that all rights and obligations contained in the constitution are enforceable, and not merely those conferred on members in their capacity as members.

It is submitted that, as in English law, so too in South African law, the outsider rule ought to have no place. Instead the rule, it is submitted, is as stated in Rosslare's case that all rights contained in the constitution are binding on the company and its members, unless they contradict the general law or any express or implied provision of the Act.[8]

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1. De Villiers v Jacobsdal Saltworks 1959 (3) SA 873 (O).
2. Gohlke and Schneider v Westies Minerale (Edms)Bpk 1970 (2) SA 685 (A).
3. See Chapter 8 at 199 and 207.
4. Hahlo 89.
5. See Chapter 8 at 201 and 207.
6. See above at 295-297.
7. See above at 291-295.
8. Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D) 525H.