2. If the company cannot fetter the exercise of *its* powers, *who*, precisely, has to be left free to act, since a company can only act by human agents?

3. The contractual clause binding the company in *Russell v Northern Bank Development Corpn Ltd* was held to be 'unenforceable'. Does this mean it was void (as against the company)? What, if anything, is the difference? Also see the Notes following *Punt v Symons & Co Ltd* **[4.21]**, pp 221ff.

4. By contrast, the contractual clause binding the shareholders in *Russell v Northern Bank Development Corpn Ltd* was enforceable. The House of Lords declined to order an injunction in the circumstances. Would the court *ever* order an injunction to restrain a breach by shareholders, or would it only ever order damages on breach? If it would order an injunction, what impact would this have on fettering the company's exercise of its statutory powers? If it would not order an injunction, what is the value of a shareholders' agreement?

(p. 249) ***A shareholders' agreement may alter the orthodox corporate law rules that govern amendments to the company's constitution and enforcement of directors' duties.***

Read *Wilkinson v West Coast Capital* **[7.28]**.

The shareholders' agreement in *Wilkinson* provided that certain corporate actions could only be pursued with the consent of more than 65% of the shareholders (Clause 5), and that each shareholder should use all reasonable and proper means to promote the interests of the company (Clause 7). Warren J held that Clause 7 must be read subject to Clause 5, and that, therefore, Clause 5 enabled controlling shareholders who were also directors to use their vote to decide that the company should not pursue a new business opportunity, with the result that the opportunity would not then be regarded as a 'corporate opportunity', and so pursuit of it by the directors would not constitute a breach of the conflicts rule (see *Bhullar v Bhullar* **[7.25]**). A minority shareholder unsuccessfully sought a remedy under the unfair prejudice provisions of the Act (CA 1985 s 459; now see CA 2006 s 994). Also see *Brecknland Group Holdings Ltd v London & Suffolk Properties Ltd* [1989] BCLC 100 (Ch).

➢ Note

This decision confirms that shareholders exercising their rights under a shareholders' agreement can use their votes as they wish. Applying general contract law principles, such a conclusion is unsurprising. However, in the context of this case, the finding ensured that the directors (as controlling shareholders) could effectively determine changes to the company's business objects without the constraints inherent in cases such as *Allen v Gold Reefs* **[4.22]**, and could ensure that they were not caught by the fiduciary conflicts rule in pursuing new corporate opportunities.[61]

➢ Questions

1. There are good commercial reasons for shareholders' agreements in this form, allowing the shareholders to limit the future business direction of the company. But if this right is unqualified, what protection exists for the dissenting minority? (Here, the dissenting minority was unsuccessful in claiming 'unfair prejudice'—CA 2006 s 994.) Is the response simply that the minority should not have submitted themselves to the terms of the shareholders' agreement?

2. Should *all* exercises of majority power—that is, *all* cases where a majority can compel a dissenting minority to conform to a decision that they have not consented to—be constrained by the (fairly minimal) requirements that the power should be exercised in good faith and for proper purposes (a subjective test) and for proper purposes (an objective test)? In this case, there would then be serious assessment of whether the directors voted as they did in good faith and for proper purposes (see this issue assessed at 'Limitations on the free exercise of members' voting rights', pp 213ff, and at 'Duty to promote the success of the company:

CA 2006 s 172', pp 339ff, and at 'Duty to act within powers: CA 2007 s 171', pp 331ff). Would the *practical* effect of this be the unacceptable conclusion that the majority appeared to owe onerous *fiduciary* duties in that they, of all the people in the world, would be the only people who could not pursue any attractive new ventures that might be of interest to their company? *Is* this the practical effect?

(p. 250) 3. In this case, Clause 5 provided that 'unless the shareholders holding in excess of 65% of the issued shares otherwise agree in writing the shareholders shall exercise their power in relation to the company so as to ensure that … the company does not acquire or invest in another company or business or incorporate any subsidiary'. This effectively gave *both* groups an individual veto over any further ventures. Does this formulation suggest that the (proper) purposes for which this power might be exercised include preventing the company pursuing an opportunity *so that* (ie for the *purpose* of allowing) the vetoing group can pursue the venture on their own?

4. Could the exercise of powers under shareholders' agreements *ever* fall foul of CA 2006 s 994?

Members' personal rights

It might seem strange to be looking at members' individual and personal rights in a chapter devoted to the collective rights of members as an organ of the company. But the role of the members as such an organ is defined in the articles, and the members may need to enforce the rights granted there in order to exercise the constitutional powers they see as theirs. Of course, members may also seek to make claims under the articles to obtain purely personal remedies for wrongs allegedly done to them in breach of specific provisions in the articles. These latter claims generally have nothing to do with the exercise of members' constitutional rights. Whether the same approach is warranted in both types of case is a moot point.

The articles constitute a contract binding on the company and each of the company's members (CA 2006 s 33). It follows, therefore, that the articles will be interpreted according to general rules of contractual interpretation: *Cream Holdings Ltd v Davenport* [2010] EWHC 3096 (Ch), mentioned in Note 4 following *Equitable Life Assurance Society v Hyman* **[4.03]**, p 186. It might also seem to follow that the shareholders, as members, have personal rights under this contract and can sue the company, or other members, to enforce those rights. Two impediments lie in the face of such claims:

(i) The courts have imposed an enormously restrictive interpretation on the types of rights that are protected under the contract, reading into the statutory provision limitations that, prima facie, are nowhere suggested. So, a member must sue 'as member',[62] and 'mere irregularities' cannot be remedied.[63]
(ii) In addition, where the same facts give rise to a potential claim by the *company* against the wrongdoers, the member's claim may be disallowed because his or her losses are merely '*reflected losses*' that will be remedied once the company recovers its losses. This rule is applied as a substantive rule, not merely a procedural rule that (very properly) denies double recovery.[64]

CA 2006 s 33: Effect of company's constitution

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

(p. 251) CA 1985 s 14: Effect of memorandum and articles

(1) Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles. …

Despite the seemingly clear words, this provision has been an endless source of varying interpretations and conflicting analyses. The least of the problems with the 1985 Act was whether the company was a party to the contract. CA 2006 makes it clear that it is. But, beyond that, the words in the new provision largely duplicate its predecessor, so the same uncertainties seem destined to plague this area. The following extracts are all likely to remain relevant.

Any member has the right*[65] *to enforce observance of the terms of the constitution, by virtue of the contractual effect given to the constitution by CA 2006 s 33.

[4.35] Wood v Odessa Waterworks Co (1889) 42 Ch D 636 (Chancery Division)

The articles empowered the directors, with the sanction of a general meeting of members, to declare a dividend 'to be paid' to the shareholders. The company passed an ordinary resolution proposing to pay no dividend but instead to give the shareholders debenture-bonds (in effect, obliging them to lend back to the company the money which could have been paid as dividends, for anything up to 30 years). Wood, a shareholder, sought an injunction to restrain the company from acting on the resolution. It was held that the proposal was inconsistent with the articles, and the injunction was accordingly granted.

> STIRLING J: It was not disputed that profits available for the payment of a dividend by the company had been actually earned … Neither was it disputed that the company had power to create a charge on the assets of the company, or to raise money by means of such a charge, or to apply the money so raised in payment of a dividend. The question, simply, is whether it is within the power of a majority of the shareholders to insist against the will of a minority that the profits which have been actually earned shall be divided, not by the payment of cash, but by the issue of debenture-bonds of the company bearing interest at £5 per cent and repayable at par by an annual drawing extending over thirty years. It is to be inferred from the terms in which the bonds are offered for subscription that the company cannot issue them in the open market except at a discount of at least £10 per cent. Now the rights of the shareholders in respect of a division of the profits of the company are governed by the provisions in the articles of association. By s 16 of the Companies Act 1862 [CA 2006 s 33] the articles of association 'bind the company and the members thereof to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in such articles contained a covenant on the part of himself, his heirs, executors, and administrators, to conform to all the regulations contained in such articles, subject to the provisions of this Act'. Section 50 of the Act [CA 2006 s 21] provides the means for altering the regulations of the company contained in the articles of association by passing a special resolution, but no such resolution has in this case been passed or attempted to be passed; and the question is, whether this is a matter as to which the majority of the shareholders can bind those shareholders who dissent. The articles of association constitute a contract not merely between the shareholders and the company, but between each individual shareholder and every other; and **(p. 252)** the question which I have just stated must in my opinion be answered in the negative if there be in the articles a contract between the shareholders as to a division of profits, and the provisions of that contract have not been followed … That then brings me to consider whether that which is proposed to be done in the present case is in accordance with the articles of association of the company. Those articles provide … that the directors may, with the sanction of a general meeting, declare a dividend to be paid to the shareholders. Prima facie that means to be paid in cash. The debenture-bonds proposed to be issued are not payments in cash; they are merely agreements or promises to pay: and if the contention of the company prevails a shareholder will be compelled to accept in lieu of cash a debt of the company payable at some uncertain future period. In my opinion that contention ought not to prevail …

Where the rights of an individual member have been infringed, personal action to enforce such rights individual loss is possible, even though the conduct complained of may also constitute a wrong to the company itself.

See *Pender v Lushington* **[13.19]**. However, any claim for loss or damage is likely to face the '*reflective loss*'

arguments discussed at ‘The “no reflective loss” principle’, pp 673ff.

The articles do not constitute a contract between the company and someone who is not a member.

[4.36] Eley v Positive Government Security Life Assurance Co Ltd (1876) 1 Ex D 88 (Court of Appeal)

Article 118 of the company’s articles provided: ‘Mr William Eley, of No 27, New Broad Street, in the City of London, shall be the solicitor to the company, and shall transact all the legal business of the company, including parliamentary business, for the usual and accustomed fees and charges, and shall not be removed from his office except for misconduct.’ Eley, the plaintiff, who had himself drafted the company’s documents for registration, and who became a member several months after its incorporation, sued the company for breach of contract in not employing him as its solicitor. In the Exchequer Division, it was held that the articles did not create any contract between Eley and the company. Eley appealed, but the Court of Appeal affirmed the decision.

> LORD CAIRNS LC: This case was first rested on the 118th article. Articles of association, as is well known, follow the memorandum, which states the objects of the company, while the articles state the arrangement between the members. They are an agreement inter socios, and in that view, if the introductory words are applied to article 118, it becomes a covenant between the parties to it that they will employ the plaintiff. Now, so far as that is concerned, it is res inter alios acta, the plaintiff is no party to it. No doubt he thought that by inserting it he was making his employment safe as against the company; but his relying on that view of the law does not alter the legal effect of the articles. This article is either a stipulation which would bind the members, or else a mandate to the directors. In either case it is a matter between the directors and shareholders, and not between them and the plaintiff. …
>
> LORD COLERIDGE CJ and MELLISH LJ concurred.

➢ Notes

1. The judgments do not deal with the question whether it was relevant that Eley did take shares in the company at a later stage and so would then have become entitled to enforce whatever rights his membership conferred on him.

(p. 253) 2. This case is commonly cited as authority for the proposition that the articles could confer rights on Eley only in his capacity as a member and not as the company’s solicitor. But this reasoning forms no part of the *ratio decidendi*, and was first put forward in *Hickman*’s case **[4.37]**.

3. The Contracts (Rights of Third Parties) Act 1999 abrogates in part the traditional doctrine of privity of contract, by providing that a term in a contract which purports to confer a benefit on a person who is not a party to it may in stated circumstances be enforced by that person. Theoretically, this provision might now have enabled a person in the position of Mr Eley to enforce a term such as art 118, but s 6(2) of the 1999 Act expressly excludes the CA 2006 s 33 contract from its scope.

The effect of s 33 is to bind the company itself, as well as the members, by the terms of the articles. But the contract which s 33 creates affects the members only in their capacity as members, and not in any special or personal capacity (eg as director).

[4.37] Hickman v Kent or Romney Marsh Sheep-Breeders’ Association [1915] 1 Ch 881 (Chancery Division)

The defendant association was incorporated as a non-profit-making company. Article 49 of its articles of association provided that disputes between the association and any of its members should be referred to arbitration. Hickman, a member, brought this action complaining of various irregularities in the affairs of the association, including the refusal to register his sheep in its published flock book, and a threat to expel him from

membership. The association was granted a stay of proceedings on the ground that the statutory provision corresponding to the present s 33 made art 49 an agreement to arbitrate, enforceable as between the association and a member.

ASTBURY J: This is a summons by the defendants to stay proceedings in the action pursuant to s 4 of the Arbitration Act 1889 [now Arbitration Act 1996 s 9]. The action is against the defendant association and their secretary Chapman, and the plaintiff, who became a member in 1905, claims certain injunctions and a declaration and other relief in respect of matters arising out of and relating solely to the affairs of the association. In substance he claims to enforce his rights under the association's articles … [After stating the objects of the association and reading art 49 as to arbitration, his Lordship continued:] This is a common form of article in private companies, and the objects of this association being what they are, it and its members might be seriously prejudiced by a public trial of their disputes, and if this summons fails, as the plaintiff contends that it should, these arbitration clauses in articles are of very little, if any, value.

It is clear on the authorities that if there is a submission to arbitration within the meaning of the Arbitration Act 1889, there is a prima facie duty cast upon the court to act upon such an agreement …

In the present case the defendants contend, first, that article 49, dealing as it does with the members of the association, in their capacity of members only, constitutes a submission within the meaning of the Arbitration Act, or, secondly, that the contract contained in the plaintiff's application for membership and the association's acceptance of it amounts to such a submission. The plaintiff contests both these propositions, and independently of the particular dispute in this case, the arguments, especially upon the first of these contentions, have raised questions of far-reaching importance.

I will first deal with the question as to the effect of article 49. [His Lordship read s 14(1) of the 1908 Act (equivalent to the present CA 2006 s 33), and referred to the long-standing dispute among leading textbook writers as to its precise effect. He continued:]

(p. 254) The principal authorities in support of the view that the articles do not constitute a contract between the company and its members are *Pritchard's Case*,[66] *Melhado v Porto Alegre Rly Co*,[67] *Eley v Positive Life Assurance Co* **[4.36]** and *Browne v La Trinidad*.[68]

In *Pritchard*'s case the articles of association of a mining company provided that the company should immediately after incorporation enter into an agreement with De Thierry the vendor for the purchase of the mine for £2,000 and 3,200 fully paid shares. The articles were signed by the vendor and six other persons, and the directors allotted the 3,200 shares to the vendor or his nominees, but no further agreement was made with him. It was held, affirming the decision of Wickens V-C, that the articles of association did not constitute a contract in writing between the vendor and the company within s 25 of the Companies Act 1867, and that the shares could not therefore be considered as fully paid.[69] Mellish LJ in giving judgment said: 'I am of opinion that the articles of association cannot be considered as a contract in writing between De Thierry and the company for the sale of the mine to them. It may, no doubt, be the case, if no other contract was entered into, and if De Thierry signed these articles and they were acted upon, that a court of equity would hold that as between him and the company—from their acting upon it—there was a binding contract; but in themselves the articles of association are simply a contract as between the shareholders inter se in respect of their rights as shareholders. They are the deeds of partnership by which the shareholders agree inter se.'

[The discussion of *Melhado v Porto Alegre Rly Co* and *Eley v Positive Life Assurance Co* is omitted.]
In *Browne v La Trinidad* before the formation of the company an agreement was entered into between B and a person as trustee for the intended company, by which it was stipulated (inter alia) that B should be a director and should not be removable till after 1888. The sixth clause of the articles provided that the directors should adopt and carry into effect the agreement with or without modification, and that subject to such modification (if any) the provisions of the agreement should be construed as part of the articles. The agreement was acted upon, but no contract adopting it was entered into between the plaintiff and the company. It was held that treating the agreement as embodied in the articles, still there was no contract

between B and the company that he should not be removed from being a director, the articles being only a contract between the members inter se, and not between the company and B … Lindley LJ said: 'Having regard to the construction put upon [s 33] in the case of *Eley v Positive Live Assurance Co* and subsequent cases, it must be taken as settled that the contract upon which he relies is not a contract upon which he can maintain any action, either on the common law side or the equity side. There might have been some difficulty in arriving at that conclusion if it had not been for the authorities, because it happens that this gentleman has had shares allotted to him, and is therefore a member of the company. Having regard to the terms of [s 33], there would be some force, or at all events some plausibility, in the argument that, being a member, the contract which is referred to in the articles has become binding between the company and him. Of course that argument is open to this difficulty that there could be no contract between him and the company until the shares were allotted to him, and it would be remarkable that, upon the shares being allotted to him, a contract between him and the company, as to a matter not connected with the holding of shares, should arise.'

Now in these four cases the article 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. The actual decisions amount to this. An outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles treating them as 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 **(p. 255)** 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 alios acta and not part of the general rights of the corporators as such …

The wording of [s 33] is difficult to construe or understand. 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. As far as the members are concerned, the section does not say with whom they are to be deemed to have covenanted, but the section cannot mean that the company is not to be bound when it says it is to be bound, as if, etc, nor can the section mean that the members are to be under no obligation to the company under the articles in which their rights and duties as corporators are to be found. 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.

It seems clear from other authorities that a company is entitled as against its members to enforce and restrain breaches of its regulations. See, for example,*MacDougall v Gardiner* **[13.20]**, *Pender v Lushington* **[13.19]** and *Imperial Hydropathic Hotel Co, Blackpool v Hampson* **[4.04]**. In the last case Bowen LJ said: 'The articles of association, by [s 33], are to bind all the company and all the shareholders as much as if they had put their seals to them.'

It is also clear from many authorities that shareholders as against their company can enforce and restrain breaches of its regulations, and in many of these cases judicial expressions of opinion appear, which, in my judgment, it is impossible to disregard.

[His Lordship referred to a number of other cases, including *Wood v Odessa Waterworks Co* **[4.35]** and *Salmon v Quin & Axtens Ltd*.[70] He continued:]

In all these last mentioned cases the respective articles sought to be enforced related to the rights and obligations of the members generally as such and not to rights of the character dealt with in the four authorities first above referred to.

It is difficult to reconcile these two classes of decisions and the judicial opinions therein expressed, but I think this much is clear, first, 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. …

In the present case, the plaintiff's action is, in substance, to enforce his rights as a member under the articles against the association. Article 49 is a general article applying to all the members as such, and, apart from technicalities, it would seem reasonable that the plaintiff ought not to be allowed in the absence of any evidence filed by him to proceed with an action to enforce his rights under the articles, seeing that the action is a breach of his obligation under article 49 to submit his disputes with the association to arbitration. …

➢ Notes

1. It is apparent that for a considerable period before *Hickman*'s case there had been uncertainty about the scope and effect of the statutory provision which is now CA 2006 s 33. The controversy centred on three related questions:

(i) Who were the parties to the 'statutory contract'—the members and the company, or just the members?

(ii) Were the members deemed to have covenanted with each other, or with the company, or both?

(iii) Could one member sue another directly on the contract, or could the member enforce the statutory rights only through the company?

(p. 256) 2. It is now settled that the company should be treated as a party to the contract contained in its own articles: see *Hickman*'s case **[4.37]**. Indeed, this question has been conclusively resolved in the 2006 Act, which makes explicit mention of both the company and its members and provides that the contract may contain rights which are directly enforceable by one member against another. Also see *Rayfield v Hands* **[4.38]**, although on the question of one member enforcing rights against another, much may depend on what it is exactly that the right purports to confer.

3. But in his attempts to reconcile the decisions—or at least the results reached—in the earlier cases, it has to be conceded that Astbury J paid little regard to the actual *ratio decidendi* of some of them, and added a gloss to CA 1908 s 14(1) which appears to contradict its express wording ('*all* the provisions of the memorandum and articles of association').[71] It is really quite remarkable that so shaky a first-instance decision was tacitly accepted for the greater part of a century in relation to CA 1908 s 14(1) and CA 1985 s 14, and endorsed without any discussion by the Court of Appeal in *Beattie v E & F Beattie Ltd* [1938] Ch 708. In that case the defendant, a director, also sought to invoke an arbitration clause contained in the articles, when he was sued by his company for the return of certain sums which it was alleged had been improperly paid to him. The court ruled that since he was being sued in his capacity as a *director* and not that as a *member*, he could not rely on the 'statutory contract'.

4. *Hickman*'s case may have laid some earlier controversies to rest, but it has generated several new ones of its own.

5. First, there are a number of cases which it is not easy to reconcile with the '*qua* member' rule: for example, *Pulbrook v Richmond Consolidated Mining Co* **[6.01]**,*Imperial Hydropathic Hotel Co*, *Blackpool v Hampson* **[4.04]**, *Quin & Axtens Ltd v Salmon* **[4.06]**. In each of these, rights more in the nature of management-rights than member-rights were enforced.

6. Secondly, there is an inherent conflict in the two propositions which may be deduced from the cases: (i) that any member has a right to have the provisions of the corporate constitution duly observed; and (ii) that s 33 cannot be relied on to enforce the rights of a non-member, or the 'outsider-rights' of one who is a member (but also a director, solicitor, etc), which the articles purportedly confer.

7. Some commentators (eg Lord Wedderburn [1957] CLJ 194 at 212) have sought to resolve the problem by saying that a member can sue under s 33 to enforce his right to have all the provisions of the corporate constitution observed, even where this would have the consequence of indirectly enforcing 'outsider-rights', so long as he*sues* in his capacity as a member. So, for instance, a disinterested member of the Positive Life company could have sued for an injunction to restrain the company from employing any solicitor other than the constitutionally appointed Mr Eley, and by the same argument Mr Eley himself, suing *qua* member, could have obtained similar relief.

8. Others would argue that a solution to the conflict lies in a narrowing of proposition (i) in Note 6, to say that it is not *every* provision of the articles that can be enforced by a member, but only those which are of a 'constitutional' character. (This requires us to beg the question, for example, by saying that the stipulation that Mr Eley should be the solicitor was not part of the corporate constitution but peripheral to it.) More specifically, GD Goldberg (1972) 35 MLR 362,[72] would confine the members' statutory contractual right to that of having the company's affairs conducted by the particular *organ* of the company which is specified as the appropriate body in the Act or in the articles of association. GN Prentice (1980) 1 Co Law 179, **(p. 257)** considers that it is necessary to go further, and ask whether the provision in question affects the power of the company to *function*: only then can a member sue to enforce a non-member right.

9. None of these arguments is really convincing, however far they may go towards reconciling the inconsistent decisions. Each of them involves writing even more by way of gloss into CA 1985 s 14 (now CA 2006 s 33) than Astbury J did, and reading more into some of the judgments than the judges themselves said. Section 14 (and now s 33) was enacted to cover a gap which was thought to have been created when the memorandum and articles replaced the deed of settlement in 1856, and in particular to ensure that a company could enforce a member's liability to pay calls. Its relevance in today's conditions may be regarded as questionable, for it perpetuates the notion that the only 'constituents' of a company are its members (ignoring the claims of employees, management and other 'stakeholders' whose interests in the company and its constituents are arguably quite as significant), and it also puts the relationship between members and company into a contractual straitjacket—a characteristically nineteenth-century approach to many difficult legal questions—which is far from appropriate. (It is also evident that the 'contract' created by s 33 departs radically in a number of respects from the contract of classic tradition: see Note 11.)

10. A similar gloss was put by the courts on CA 1948 s 210, the early precursor of CA 2006 s 994 (the 'unfair prejudice' provision, see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff): a member bringing a complaint to the court under that section had to show that the conduct in question affected him *qua* member. CA 2006 s 994, and CA 1985 s 459 before it, has been reworded so as to meet many of the criticisms which were levelled at s 210, but no attempt was made to deal with this point. The judges have accordingly been obliged to construe the new section in the same way; but (at least in cases where the company is a 'quasi-partnership') some flexibility has been achieved by giving a fairly broad meaning to the concept of a 'membership' interest. In *Ebrahimi v Westbourne Galleries Ltd* **[16.13]**, the House of Lords did not feel constrained to put the same restriction on the statutory provision which allows a member to petition to have the company wound up.

11. Thirdly, it is not possible to say that every 'right' which the memorandum or articles purport to confer on a member is enforceable in an absolute sense.[73] The statutory contract which these documents are deemed to create is very different from the classical stereotype, such as a contract for the sale of goods. It is a 'relational' contract,[74] intended to establish a framework for an ongoing set of relationships, rather than one containing a discrete set of obligations which, once performed, will come to an end. Relational contracts necessarily embody an underlying element of 'give and take', rather than outright right and wrong. Moreover, many constitutional irregularities are curable by a majority resolution of the members, or even capable of being condoned by acquiescence or inertia. In *MacDougall v Gardiner***[13.20]**, for instance, a member's undoubted right to call for a poll was denied him, but the court declined to come to his aid because the matter could be put right (if anyone wanted to) by the company's own internal mechanisms. Even irregularities which the majority have no power to condone may be defeated by the procedural rule known as *Foss v Harbottle* **[13.01]**, under which the member may find that he has no access to the court unless he can carry the majority along with him **[13.17]**. Any claim that s 33 gives a member a 'right' to have the terms of the

constitution observed is defective unless it acknowledges that the right is qualified in these senses.

(p. 258) ***One member may sue another on the contract created by the articles without joining the company as a party.***

[4.38] Rayfield v Hands [1960] Ch 1 **(Chancery Division)**

Article 11 of the articles of association of Field-Davis Ltd provided: 'Every member who intends to transfer shares shall inform the directors who will take the said shares equally between them at a fair value …'. Rayfield, a member, sought to compel the defendants, the three directors of the company, to purchase his shares in accordance with this provision. The court declared that they were bound to do so.

VAISEY J dealt first with a question of construction, and continued: The next and most difficult point taken by the defendants, as to which it would appear that there is no very clear judicial authority, is that article 11, as part of the company's articles of association, does not do what it looks like doing, that is, to create a contractual relationship between the plaintiff as shareholder and vendor and the defendants as directors and purchasers. This depends on s 20(1) of the Companies Act 1948 [CA 2006 s 33]. [His Lordship read the section and passages from various textbooks. He continued:]

Now the question arises at the outset whether the terms of article 11 relate to the rights of members inter se (that being the expression found in so many of the cases), or whether the relationship is between a member as such and directors as such. I may dispose of this point very briefly by saying that, in my judgment, the relationship here is between the plaintiff as a member and the defendants not as directors but as members.

In *Re Leicester Club and County Racecourse Co*,[75] Pearson J, referring to the directors of a company, said that they 'continue members of the company, and I prefer to call them working members of the company,' and on the same page he also said: 'directors cannot divest themselves of their character of members of the company. From first to last … they are doing their work in the capacity of members, and working members of the company …'. I am of opinion, therefore, that this is in words a contract or quasi-contract between members, and not between members and directors.

I have now to deal with the point for which there is considerable support in the cases, that the notional signing and sealing of the articles creates a contractual relation between the company on the one hand and the corporators (members) on the other, so that no relief can be obtained in the absence of company as a party to the suit. The defendants' case in so far as it is based on this point seems to be met by two recent decisions of the Court of Appeal. I refer first to *Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board*,[76] and to the judgment of Denning LJ in that case, which was a case of a covenant made, not by or with but for the benefit of the plaintiffs, and thereby enabling them to sue without the intervention of the covenantee. Section 56 of the Law of Property Act 1925 was referred to in terms which it is not necessary for me to repeat here. This same principle is further exemplified by the case of *Drive Yourself Hire Co (London) Ltd v Strutt*,[77] see especially the judgment of Denning LJ as there reported.[[78]] The case of the plaintiff may also be said to rest upon the well-known decision of *Carlill v Carbolic Smoke Ball Co*,[79] to which I need not refer except to say that it seems to me to be relevant here. To the like effect is *Clarke v Earl of Dunraven*,[80] upon which the plaintiff here also relied …

[His Lordship discussed a number of other cases, including *Hickman*'s case **[4.37]** and continued:]

(p. 259) The conclusion to which I have come may not be of so general an application as to extend to the articles of association of every company, for it is, I think, material to remember that this private company is one of that class of companies which bears a close analogy to a partnership; see the well-known passages in *Re Yenidje Tobacco Co*.[81]

Nobody, I suppose, would doubt that a partnership deed might validly and properly provide for the

acquisition of the share of one partner by another partner on terms identical with those of article 11 in the present case. I do not intend to decide more in the present case than is necessary to support my conclusion, though it may be that the principles upon which my conclusion is founded are of more general application than might be supposed from some of the authorities on the point.

I will make an appropriate declaration of the plaintiff's rights, or will order the defendants to give effect to them, and if necessary there must be an inquiry to ascertain the fair value of the shares …

➢ Notes

1. The judge in this case circumvented the difficulty raised by *Hickman*'s case **[4.37]** and *Beattie v E & F Beattie Ltd* (Note 3 following *Hickman v Kent or Romney Marsh Sheep-Breeders' Association* **[4.37]**, p 256) by the blunt assertion that the article affected the directors 'not as directors but as members'. In the case before him, the directors did happen to be members, and were, in fact, required by the company's articles to hold shares. But in many companies this is not so. The judgment as a whole rather too readily assumes that directors are bound to be members—something that was more likely to be true a century ago when the *Leicester Racecourse*case was decided than it is today.

2. In *Newtherapeutics Ltd v Katz* [1991] Ch 226, Knox J held that the appointment of a person to the office of director did not of itself establish a contractual relationship between him and the company. He might, and commonly would, also enter into a contract (eg of employment) with the company; but merely as office-holder such rights and duties as he had were not based on any contract, express or implied. Vaisey J's reference to *Carlill v Carbolic Smoke Ball Co* and *Clarke v Earl of Dunraven* would not appear to be compatible with this ruling.

➢ Question

CA 2006 s 33 substantially re-enacts its predecessor, CA 1985 s 14. This is despite the fact that both the Law Commissions (*Shareholder Remedies*, Law Com No 246, 1997) and the CLR considered possible amendments to CA 1985 s 14, particularly with a view to defining by statute which rights are 'membership' rights (as distinct from rights which are better seen as vested in the company itself), and are accordingly rights which members can enforce in their personal capacity. Both bodies initially toyed with, but eventually rejected, the idea of setting out in the legislation a non-exhaustive list of such 'personal' rights (eg to attend and vote at meetings and to receive dividends). The CLR also considered whether it would be preferable to declare *all* obligations imposed by the constitution to be enforceable by individual members (subject to an exception where the complaint is trivial or where to pursue it would be pointless), unless the contrary is provided in the constitution. What are the advantages and disadvantages of each approach?

(p. 260) Further Reading

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SEALY, LS, '"Bona Fides" and "Proper Purposes" in Corporate Decisions' [1989] *Monash University Law Review* 16.
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