

# THE LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES OF ASSOCIATION OF A COMPANY AFTER THE INTRODUCTION OF THE COMPANIES AND SECURITIES LEGISLATION (MISCELLANEOUS AMENDMENTS) ACT 1985

by

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The memorandum and articles of association comprise the company's constituent documents. Under the Companies Code 1981 the main provision dealing with the legal effect of the memorandum and articles of association is s.78(1). Prior to the introduction of the Companies and Securities Legislation (Miscellaneous Amendments) Act 1985<sup>1</sup> s.78(1) provided 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.

S. 78(1) now provides as follows:<sup>2</sup>

Subject to this Act, the memorandum and articles of a company have the effect of a contract under seal –

- (a) between the company and each member,
- (b) between the company and each officer,
- (c) between a member and each other member,

under which each of the above-mentioned persons agrees to observe and perform the provisions of the memorandum and articles as in force for the time being so far as those provisions are applicable to that person.

The broad effect of the original s.78(1) was that the memorandum and articles were intended to have contractual effect. The scope of this statutory contract has been the subject of considerable controversy both in Australia and in England.<sup>3</sup> The unclear wording of the Section and its predecessors has given rise to conflicting judicial interpretation. Thus, in the past it has not been entirely clear which parties were bound by the contract which the memorandum and articles constitute. Further, there has been some conflict in the cases relating to the ability of a member to enforce those articles of association which do not confer rights on him in his capacity as a member but confer rights in some outsider or private capacity. There has also been some confusion in the cases as to the extent to which the rule in *Foss v. Harbottle*<sup>4</sup> will defeat an individual or minority shareholders action when there has been an infraction of the statutory contract. It is not surprising then that it has

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1. Hereafter referred to as the 1985 Amending Legislation.

2. This provision took effect from 31 March 1986.

3. *Beattie v. E. and F. Beattie Ltd* [1938] Ch. 708 at 721 per Lord Greene M.R.

4. (1843) 2 Hare 461.

been said in relation to the English equivalent of the original s.78(1)<sup>5</sup> that 'it has been so overlaid with judicial interpretation that, on any count, it no longer means what it says and that a redrafting of it is long overdue'.<sup>6</sup> An early explanatory memorandum in relation to the introduction of the present s.78(1) specified that the purpose of the amendment was to clarify the law relating to the contractual status of the memorandum and articles.<sup>7</sup> It is intended by the writer to examine the consequences of the original Section 78(1) and then consider the effect of the new provision in order to ascertain whether the law has been clarified. It is further intended by the writer to briefly examine the relationship between s.78(1) and s.574 of the Companies Code.

### 1. Relationship between a Company or its Members and Non-Members

Under the former s.78(1) and its English counterpart, the courts have considered that the provisions of the articles and the memorandum do not constitute a contract binding the company or any member to a non-member because of the principle of privity of contract.<sup>8</sup> Hence a solicitor,<sup>9</sup> promoter,<sup>10</sup> or director<sup>11</sup> of a company to whom a right has been given by the articles has not been able to enforce such right upon the basis that there is a contractual relationship between himself and the company unless it could be shown that the relevant articles formed part of a contract independently of the articles and the memorandum.<sup>12</sup> It is thought that this principle is also applicable to debenture holders or their trustees who are entitled to appoint or remove a director under the Articles and that it should not be presumed that such a provision would be legally enforceable by such debenture holders or their trustees despite what might appear to be judicial pronouncements to the contrary in *Woodlands Ltd v. Logan & Ors.*<sup>13</sup>

The terms of the new provision alter this position to a limited extent. Section 78(1)(b) provides that the memorandum and articles of a company constitute a contract between the company and each 'officer'.<sup>14</sup> There is however, no provision such as that set out in Clause 40(5) of the National Companies Bill 1975 allowing outsiders, such as debenture holders or their trustees, to enforce an article to appoint or remove a director or other officer notwithstanding that such person is not a member or officer of the company. It is understood that such a provision was considered in the early stages of redrafting the former s.78(1).

### 2. Relationship between a Company and its Members

The former s.78(1) provided that the company and members were bound by the memorandum and the articles only to the extent that they had been signed and sealed by the members, not by the company. The English counterpart of this provision is to the same effect. As a result of this unclear wording English authorities until the end of the nineteenth

5. Section 20(1), Companies Act 1948.

6. L.C.B. Gower, *The Principles of Modern Company Law*, (1979) at 320.

7. Explanatory Paper Companies and Securities Legislation (Miscellaneous Amendments) Bill (No.2) 1984, Business Affairs Division, Commonwealth Attorney Generals Department June 1984, at 53.

8. *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch. 881 at 900 per Astbury J.; *Forbes v. N.S.W. Trotting Club Ltd* [1977] 2 N.S.W.L.R. 515 at 520 per Hutley J.A.

9. *Eley v. Positive Government Security Life Assurance Co. Ltd* (1876) 1 Ex.D. 88 (CA).

10. *Re English & Colonial Produce Co.* [1906] 2 Ch. 435.

11. *Browne v. La Trinidad* (1888) 37 Ch.D. 1; *Melhado v. Porto Alegre Railway Co.* (1874) L.R. 9 C.P. 503.

12. *Re New British Iron Co.* [1898] 1 Ch. 324.

13. [1948] N.Z.L.R. 230. In this type of case it was suggested by Cornish J. of the New Zealand Supreme Court that enforcement by legal proceedings against the company was unnecessary, as the outsiders were able to enforce their rights by merely exercising them.

14. As to the meaning of 'officer' see s.78(5) *post*.

century were in conflict as to the nature of the obligations created between a company and its members. Some authorities accepted the proposition that the memorandum and articles created a contract between the company and its members.<sup>15</sup> Others, including Court of Appeal decisions, negated this proposition.<sup>16</sup> In England, the modern law appears to have been eventually settled by the House of Lords in *Quin and Axtens Ltd v. Salmon*<sup>17</sup> to the effect that the provision is to be interpreted to mean that the constituent documents of the company operate with contractual force between the company and its members. After some initial doubts,<sup>18</sup> the Australian Courts adopted the same principle.<sup>19</sup> Section 78(1)(a) of the 1985 Amending Legislation confirms this proposition.

The functional nature of the statutory contract between the company and the members is evident when some case illustrations are considered. The company is entitled as against its members to enforce obligations contained in the constituent documents including such matters as liens on shares,<sup>20</sup> repayment of loans<sup>21</sup> and payment of calls,<sup>22</sup> and share transfer provisions.<sup>23</sup> A member is entitled as against the company to enforce his rights under the constituent documents including such matters as voting upon his shares,<sup>24</sup> attainment of a share certificate,<sup>25</sup> return of capital on a winding up,<sup>26</sup> redemption of shares at a fixed price,<sup>27</sup> and dividends due<sup>28</sup> and to enjoin the company from forfeiting his shares other than in accordance with the constituent documents.<sup>29</sup>

### 3. Relationship between Members of a Company

The extent to which the articles and the memorandum constitute a contract between the members inter-se has been a matter of long-standing debate.<sup>30</sup> Some English authorities have accepted the principle that the equivalent of the former s.78(1) is to be interpreted to mean that 'there is no contract in terms whatever between the individual members of the company.'<sup>31</sup> Other English authorities have accepted the proposition that the provision

15. See for example: *Johnson v. Lyttle's Iron Agency* (1877) 5 Ch.D. 687 at 693; *Welton v. Saffery* [1897] A.C. 299 at 315; *Hickman v. Kent or Romney Marsh Sheepbreeders' Association* *supra* n.8.

16. See for example *Eley v. Positive Government Security Life Assurance Co. Ltd* *supra* n.8 at 89; *Browne v. La Trinidad* *supra* n.9 at 12 and 15; *Baring-Gould v. Sharpington Combined Pick and Shovel Syndicate* [1899] 2 Ch. 80 at 89.

17. [1909] A.C. 442.

18. *The Land Mortgage Bank of Victoria Ltd v. Jane Reid* (1909) V.L.R. 284 at 289 per Cussen J.

19. *Heron v. Port Huon Fruitgrowers* (1922) 30 C.L.R. 315 at 339 per Isaacs J.; *Peters American Delicacy v. Heath* [1938-1939] 61 C.L.R. 457 at 480 per Latham C.J.; *Re Dividend Fund Incorporated (In Liquidation)*, (1974) V.R. 451 at 455 per Anderson J.; *Re Caratti Holding Co. Pty Ltd* (1975) 1 ACLR 87 at 99 per Burt J.; *Thor Industries Pty Ltd v. O'Donnell* (1977) ACLR 29,411 at 29,415 per Full Court of Victoria; *Coachcraft Ltd v. S.V.P. Fruit Co. Ltd* (1977-78) ACLC 29,924 at 29,933 per Menhennit J.; *Brentwood Village Ltd v. C.A.C.* (1983) 1 ACLC 1,006 at 1,008-1,009 per McLell and J.; *Magill v. Santana Pty Ltd* (1983) 1 ACLC 1,108 at 1,113 per Hutley and Glass JJ.A.

20. *Bradford Banking Co. Ltd v. Briggs, Son & Co. Ltd* (1886) 12 A.C. 29.

21. *Peninsula Co. Ltd v. Fleming* (1872) 27 L.T. 93.

22. *Buck v. Robson* (1870) L.R. Eq. 629.

23. *Thor Industries Pty Ltd v. O'Donnell* *supra* n.19; *Lyle & Scott Ltd v. Scotts Trustees* [1959] A.C. 763.

24. *Pender v. Lushington* (1877) 6 Ch.D. 70

25. *Burdett v. Standard Exploration Co.* (1899) 16 T.L.R. 112.

26. *Griffith v. Paget* (1877) 5 Ch.D. 894.

27. *Re Dividend Fund Incorporated (In Liquidation)* *supra* n.19.

28. *Wood v. Odessa Waterworks* (1889) 42 Ch.D. 636.

29. *Johnson v. Lyttle's Iron Agency* *supra* n.15.

30. *Re Caratti Holding Co. Pty Ltd* *supra* n.19.

31. *Welton v. Saffery* *supra* n.15 at 315 per Lord Herschell; see also *London Sack & Bag Co. Ltd v. Dixon & Lugton Ltd* (1943) 2 All E.R. 763 at 765 per Scott L.J.; *Re Greene*, [1949] Ch. 333 at 340 per Harman J.

does create a contract between the members *inter-se*.<sup>32</sup> The decision of Vaisey J. in *Rayfield v. Hands*,<sup>33</sup> wherein a member was allowed to enforce a pre-emption clause directly against another member without joinder of the company as a party to the proceedings, has been much touted as supporting the latter view.<sup>34</sup> However, the decision was qualified by the statement that such a principle 'may not be of so general an application as to extend to the articles of association of every company, for it is . . . material to remember that this private company is one of that class of companies which bears a close analogy to a partnership'.<sup>35</sup> Although it has been correctly pointed out that there is nothing in the English equivalent of the former s.78(1) which distinguishes between the contractual effect of articles in proprietary and in public companies,<sup>36</sup> the fact that Vaisey J. restricted his decision to circumstances in which the company in question was analogous to a partnership means that doubt must still remain as to how far the decision can be said to support the general principle espoused.

In the Australian context, the principle that the articles and the memorandum constitute a contract between the members *inter-se* has been accepted by implication by Latham C.J. of the High Court in *Peters' American Delicacy Ltd v. Heath*.<sup>37</sup> In more recent times, Burt J. of the West Australian Supreme Court considered the application of the principle in the case of *Re Caratti Holding Co. Pty Ltd* which again concerned, in part, the question of whether one member could enforce a pre-emption clause against another member. Burt J. made the following statement:

The extent to which the articles can bind one member contractually to another is a matter of long-standing debate, but the weight of authority seems clearly to establish that they do have that effect, particularly when the articles confer rights on members by way of pre-emption or otherwise to acquire the shares of another member. *Borland Trustee v. Steel Bros & Co. Ltd* [1901] 1 Ch. 279 and *Rayfield v. Hands* [1960] Ch. 1.<sup>38</sup>

Although upon appeal the Privy Council upheld the judgment at first instance on a different point it impliedly accepted the principle espoused.<sup>39</sup>

Despite these authorities it was still felt that the matter remained uncertain.<sup>40</sup> As a result, the terms of s.78(1)(c) now state clearly that there is a statutory contract between the members *inter-se*.

#### 4. Outsiders' Rights Incorporated in the Articles or Memorandum of Association

In relation to the English counterpart of the former s.78(1) there is authority which accepts that the provision gives the memorandum and articles contractual effect only in so far as they confer rights or obligations on the member 'in his capacity as member'<sup>41</sup> and that

32. *Pritchard's Case* (1873) 8 Ch. App. 956 at 960 per Mellish L.J.; *Eley v. Positive Government Security Life Assurance Co. Ltd* *supra* n.9. at 89 per Lord Cairns L.C.; *Browne v. La Trinidad* *supra* n.11 at 12 and 15 per Cotton and Lindley JJ.; *Salmon v. Quinn & Axtens Ltd* [1909] 1 Ch. 311 at 318 per Farwell L.J.

33. [1960] 1 Ch. 1.

34. For example see R. Pennington, *Penningtons Company Law* (1985) at 67; Gower, *The Principles of Modern Company Law*, *supra* n.6 at 316.

35. *Supra* n.33 at 9.

36. K.W. Wedderburn, 'Company Law – Effect of Articles as Contract – Remedy against Directors' (1958) *C.L.J.* 148 at 149; L.C.B. Gower, 'The Contractual Effect of Articles of Association', (1958) 21 *M.L.R.* 401 at 403.

37. *Supra* n.19 at 480; McTiernan J. concurred with his judgment.

38. *Supra* n.19 at 99.

39. *Caratti Holdings Co. Pty Ltd v. Zampatti* (1978) 52 A.L.J.R. 732 at 735.

40. Explanatory Paper, Companies and Securities Legislation (Miscellaneous Amendments) Bill (No. 2) 1984 *supra* n.7.

41. *Hickman v. Kent* *supra* n.8 at 900 per Astbury J.; *Beattie v. E. & F. Beattie Ltd* [1938] 1 Ch. 708.

this principle extends to cover the contract between members as well as that between members and the company.<sup>42</sup> It has been judicially stated that the time honoured expression 'in his capacity of member' means that a member may only enforce rights which are common to himself and all other members<sup>43</sup> and not rights which may concern him in his capacity as outsider or in some private capacity as for instance as solicitor, promoter or director.<sup>44</sup> Thus, in *Beattie v. E. & F. Beattie Ltd*<sup>45</sup> it was held that an article which provided that disputes between the company and its members must be referred to arbitration would not avail a person whose dispute was between the company and himself in his capacity as a director, even though he was also a member.

Initially, in the Australian context, there was uncertainty about the application of the principle in relation to the former s.78(1). Thus, in *Heron v. Port Huon Fruitgrowers' Co-operative Association Ltd* Knox C.J., Gavin Duffy and Starke JJ. made the following statement:

The law governing [this] contention has been the subject of very recent examination and statement by Astbury J. in *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association*, but his opinion shows that the matter is still surrounded with a good deal of difficulty.<sup>46</sup>

In more recent times, however, Burt J. in *Re Caratti Holding Co. Pty Ltd* made the following statement in support of the principle:

It was said that the articles cannot as against the company or as against another member confer upon a shareholder rights in some capacity other than that of a shareholder. That as a general proposition, is now well established, *Hickman's Case* [1915] 1 Ch. 881, now being regarded as the leading authority.<sup>47</sup>

In that case Burt J. held that the rights conferred upon the registered holder of a life governor's share to compulsorily acquire the shares of any other member at a sum equal to the capital paid up on the shares were conferred upon the holder in his capacity of shareholder or member. The sentiment expressed in *Re Caratti Holding Co. Pty Ltd* has been re-iterated in a number of other Australian cases.<sup>48</sup> In particular, there is a series of cases which has adopted the principle and which has suggested that the articles in a home unit company allocating rights of enjoyment of particular areas in association with the particular shares do relate to members in their capacity as such.<sup>49</sup>

The principle of the necessity for the articles and memorandum to confer rights or obligations on the member in his capacity as member has been criticized upon a number of grounds. The first ground of criticism is that this restrictive principle has sometimes led to a strained construction of the articles by the courts.<sup>50</sup> Thus, in *Rayfield v. Hands*<sup>51</sup> Vaisey J. construed an article imposing an obligation upon the directors of a company, who were also

42. *London Sack & Bag Co. v. Dixon & Lugton* supra n.31 at 765-766 per Scott J.; *Rayfield v. Hands* supra n.33.

43. *Beattie v. E. & F. Beattie Ltd* supra n.41 at 722 per Greene M.R.

44. *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* supra n.8 at 900 per Astbury J.

45. *Supra* n.41.

46. *Supra* n.19 at 323. Contrast the *obiter dicta* of Isaacs J. at 339-340.

47. *Supra* n.19 at 99.

48. *H.H. Halls Ltd v. Lepouris* (1964) 65 S.R. (N.S.W.) 181 at 189, per Macfarlan J.; *Forbes v. N.S.W. Trotting Ltd* supra n.8 at 520 per Hutley J.A.

49. *Fisher v. Easthaven* (1963) 80 W.N. (N.S.W.) 1,555; *Crumpton v. Morrine Hall Pty Ltd* (1965) N.S.W.R. 240 at 243 per Jacobs J.; *Magill v. Santina Pty Ltd* supra n.19 at 1111-1112, per Hutley J.A. and at 1113-14 per Glass J.A.; *Brentwood Village Ltd v. Corporate Affairs Commission* supra n.19 at 1008-9 per McLelland J.

50. S. Mayson & D. French, *A Practical Approach to Company Law*, (1982) at 33; Gower, supra n.6 at 317. Cf. H.A.J. Ford, *Principles of Company Law*, (1982) at 59.

51. *Supra* n.33.

members of the company by virtue of their share qualification, to purchase the shares of a retiring member at a fair value, as an obligation imposed upon them in their capacity as working members of the company. As a result, Vaisey J. enforced the obligation on the directors to take the plaintiff's shares at a fair value. It has been pointed out that as a general statement it is palpably incorrect to treat directors as if they were merely a sub-species of member.<sup>52</sup>

The second ground of criticism is that the principle is of questionable provenance because it was initiated by Astbury J. in *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association*<sup>53</sup> as an attempt at reconciling the conflict in the cases upon the question of the parties to the statutory contract by reference to the terms of the contract. It has been suggested that Astbury J. was attempting to extract from the cases a principle which is not explicitly or even implicitly contained in the judgments.<sup>54</sup> In the case itself, the plaintiff brought an action against the company relating to his expulsion from the company despite the fact that the articles provided for reference of disputes between members and the company to arbitration. Astbury J. held that the articles amounted to a contract between the company and the member and directed that the matters in dispute be referred to arbitration and the action stayed. Thus, *Hickman's Case* was concerned only with the issue of contract or no contract between company and member. No question was involved in the argument on the decision as to whether it went beyond the ambit of membership.<sup>55</sup> Nevertheless, Astbury J. was confronted with statements of principle in cases such as *Eley v. Positive Government Security Life Assurance Co. Ltd.*,<sup>56</sup> *Melhado v. Porto Alegre Railway Co.*<sup>57</sup> and *Browne v. La Trinidad*<sup>58</sup> to the effect that the English equivalent of the former s.78(1) did not create a contract between a company and its members. He rationalized these cases upon the basis of the principle under discussion with the effect that these cases are now respectively cited as authority for the proposition that a member cannot enforce an article which relates to him in his capacity as solicitor, promoter or director.<sup>59</sup> However, a close reading of these cases makes it clear that they were not influenced by the *Hickman* principle. Thus, in *Eley v. Positive Government Security Life Assurance Co Ltd*<sup>60</sup> it was held by the Court of Appeal that the plaintiff, who was appointed under the articles as the company's solicitor for a fixed period, could not rely upon the articles to perpetuate his retainer, even though the period had not expired and even though he became a shareholder, because there was no contract between the plaintiff and the company but only between the members. Similarly, in *Melhado v. Porto Alegre Railway Co.*<sup>61</sup> the plaintiffs, who were promoters of the defendant company, were held to have no action against the company for non-payment of preliminary expenses under the articles of association, which provided in directory terms for the payment of such expenses, as the Court of Appeal found there was no contract between the plaintiff and the defendant. Again, in *Browne v. La Trinidad*<sup>62</sup> the Court of Appeal applied *Eley's Case* to the situation where a director, who was also a

52. Wedderburn, *supra* n.36 at 149; Gower, *supra* n.36 at 402; D.W. Chantler, 'The Shareholders Corporate Contract in Western Australia', (1976) 12 *U.W.A.L.R.* 333 at 346.

53. *Supra* n.8.

54. R. Gregory, 'The Section 20 Contract' (1981) 44 *M.L.R.* 526 at 530-1.

55. *Ibid.* at 535-6.

56. *Supra* n.9.

57. *Supra* n.11.

58. *Supra* n.11.

59. Gregory, *supra* n.54 at 531.

60. *Supra* n.9 at 90.

61. *Supra* n.11 at 505-6.

62. *Supra* n.9 at 13-14 per Cotton L.J., and at 14-15 per Lindley L.J.

shareholder, sought to restrain his removal as a director by the company in general meeting despite the fact that the Court was prepared to assume that there was a stipulation incorporated into the articles of association that he would be appointed for a fixed term. Thus, it is apparent that the legal reasoning in this trilogy of cases is inconsistent with the *Hickman* principle.

A third ground of criticism is that, notwithstanding the *Hickman* principle, there has been a number of English and Australian decisions in which rights and obligations under the articles, which have not affected a member in his capacity as member, have been enforced. Thus, the Courts have allowed a shareholder-director, suing as a single shareholder or in a representative capacity<sup>63</sup> to enforce rights conferred by the articles upon him as a director to hold office, or to participate in management, or to exercise a veto over board decisions even though this has had the effect of allowing the enforcement of 'outsider rights'.<sup>64</sup> The confusion which these cases have caused is well illustrated by *Quin and Axtens Ltd v. Salmon*.<sup>65</sup> In that case the company's articles vested the general management of the company's business in the directors subject to the qualification that any resolution for the acquisition or letting of premises would be invalid if either of the two managing directors dissented therefrom. The directors passed resolutions for the letting of premises from which Salmon, one of the managing directors, dissented. Salmon, suing as a shareholder by way of representative action, sought an injunction to restrain the company acting on the resolutions. The House of Lords upheld the decision of the Court of Appeal granting an injunction and thereby indirectly allowed Salmon to enforce the right given to him as managing director in the articles to veto any resolution for the acquisition or letting of premises. The attempt by Lord Greene M.R. in *Beattie v. E. & F. Beattie Ltd*<sup>66</sup> to rationalize that case and *Salmon's* case by identifying the latter case as one in which 'the plaintiff's right as a member was being enforced' loses its cogency when a case like *Re Standard Salt and Alkali Ltd; Ex parte Lahiff*<sup>67</sup> is considered. In that case it was stated by Napier J. of the South Australian Supreme Court, applying the *Hickman* principle that an article which appointed a particular person, whether he was a member or not, as managing director for a specified period, could not be enforced against the company.

Despite the abovementioned criticisms, commentators have generally supported the *Hickman* principle.<sup>68</sup> There have however, been some divergent views as to the construction to be applied to this provision. Thus, it has been suggested that every member of a company has a right to have the company's business conducted in accordance with the contract in the articles even if that means indirectly the enforcement of outsider rights vested either in third parties or himself, so long as he sues in his capacity as member and not in his capacity as outsider.<sup>69</sup> Another view postulates that outsider rights will be enforced if two conditions are fulfilled. These are that the member sues in his capacity as

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63. A representative action is one brought on behalf of all the members of the company, except those members responsible for the alleged wrong, who, with the company, are made defendants to it.

64. *Pulbrook v. Richmond Consolidated Mining Co.* (1878) 9 Ch.D. 610; *Imperial Hydropathic Hotel v. Hampson* (1882) 23 Ch.D. 1; *Quin and Axtens Ltd v. Salmon* *supra* n.17; *Hayes v. Bristol Plant Hire* [1957] 1 All E.R. 688; *Re Richmond Gate Property Co. Ltd* [1965] 1 W.L.R. 335; *Ryan v. South Sydney Junior League Club Ltd* [1974] 3 ACLR 486.

65. *Supra* n.17.

66. *Supra* n.41 at 714.

67. [1934] S.A.S.R. 168 at 171.

68. Gower, *supra* n.6 at 317-318; Pennington *supra* n.34 at 64-65; R. Baxt, *Introduction to Company Law* (1986) at 44-5.

69. K.W. Wedderburn, 'Shareholder's Rights and the rule in *Foss v. Harbottle*' (1957) 15 *C.L.J.* 193 at 212-13; K.W. Wedderburn, *supra* n.36 at 150-51; Gregory, *supra* n.55 at 531.

member and that the enjoyment of the 'outsider-right' is incidental to the exercise by a particular organ of the company of a power vested by the companies legislation or by the company's memorandum or articles in that organ.<sup>70</sup>

The present s.78(1) of the Companies Code provides that each of the parties to the statutory contract 'agrees to observe and perform the provisions of the memorandum and articles . . . so far as those provisions are applicable to that person.' The editors of CCH Australian Company Law and Practice suggest that 'there is little reason for doubting that a similar interpretation will be put on Section 78 as amended.'<sup>71</sup> However, another author has commented that it is unclear whether the restriction on the statutory contract that it does not confer a benefit on a member in another capacity, for example as a company's solicitor, has been removed.<sup>72</sup> Ford points out in his text that although the matter is not clear, this form of drafting may suggest two things: firstly, that as with the previous s.78(1), obligations imposed upon the members would only be enforceable against them in their capacity as members; secondly, that a shareholder, as long as he sues as such, could compel the company not to depart from the statutory contract even if this results indirectly in the enforcement of 'outsider rights' vested in the plaintiff shareholder.<sup>73</sup> Thus, a provision such as that in *Eley v. Positive Government Security Life Assurance Co. Ltd*,<sup>74</sup> that a particular person should be the company's solicitor, would not affect the member in his capacity of member and could not be enforced as a contract by the company against him. In contradistinction to this, a member in this position would not necessarily be denied a remedy against the company. In accordance with cases like *Quinn & Axtens Ltd v. Salmon*<sup>75</sup> he could sue *qua* member to compel the company to observe the contract between it and the members that he should be employed as the solicitor of the company. Undoubtedly, this approach would protect a member from the hazardous situation of a company inserting unusual provisions in its articles which would be binding upon the member in another capacity. What is unusual or affects a member in another capacity would no doubt depend upon the *genus* of the company.<sup>76</sup>

Whilst the proposal outlined by Professor Ford has merit, it is suggested by the writer that in all probability this will not be the approach adopted by the Courts. From a consideration of the views espoused it is apparent that s.78(1) in this respect, is ambiguous or obscure and that, accordingly, s.5B(1) of the Companies and Securities (Interpretation and Miscellaneous Provisions) Code allows consideration to be given to certain extrinsic material in relation to the interpretation of the provision. Such material includes 'any explanatory memorandum relating to the Bill containing the provision'.<sup>77</sup> The explanatory memorandum, in so far as is relevant, states as follows:

It is intended that the memorandum and articles will constitute a contract between the company and its members and as between the members themselves in their

70. G.D. Goldberg, 'The Enforcement of Outsider-Rights under Section 20(1) of the Companies Act 1948 (1972) 35 *M.L.R.* 362; G.D. Goldberg, 'The Controversy on the Section 20 Contract Revisited (1985) *M.L.R.* 158.

71. *Australian Company Law and Practice*, (CCH Ltd) at 9905.

72. H.L.F. French, *Guide to Company Law*, (1987) at 47. Contrast the earlier view of the same author in 'Liberalisation of Standing to Sue for Non-Observance of Memorandum and Articles', (1985) 6 *Co. Lawyer* 283.

73. H.A.J. Ford, *Principles of Company Law*, (1986) at 483.

74. *Supra* n.9.

75. *Supra* n.17.

76. Ford, *supra* n.73 at 483.

77. Section 5B(2)(f) of the Companies and Securities (Interpretation and Miscellaneous Provisions) Code.



capacity as members, and also as between the company and its officers in their capacity as such, whether they are members or not.<sup>78</sup>

The reference to 'the members . . . in their capacity as members' is clearly reminiscent of the language used in *Hickman v. Kent or Romney Marsh Sheepbreeders' Association*<sup>79</sup> and *Beattie v. E. & F. Beattie Ltd.*<sup>80</sup> The conclusion then must be that the phraseology referred to is intended to preserve the Hickman principle as part of the framework of this area of company law.<sup>81</sup>

The terms of s.78(1) of the 1985 Amending Legislation do, however, alter the previous law to a limited extent. Section 78(1)(b) provides that the memorandum and articles constitute a contract between the company and each 'officer'. It is no longer true to say 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 . . . director, can be enforced against the company'.<sup>82</sup> It has been suggested that the effect of the provision is to overrule *Beattie v. E. & F. Beattie*.<sup>83</sup> This is doubtful when it is considered that the arbitration clause in the articles referred to disputes between members or between members and the company and not to disputes relating to the rights or obligations of a director. The explanatory memorandum emphasizes that the statutory contract is between the company and its 'officer's' in their capacity as such. Thus, where as in a case like *Beattie v. E. & F. Beattie Ltd.*,<sup>84</sup> the relevant article does not refer to rights or obligations of an officer but to those of a shareholder only and the officer attempts to enforce or rely upon that article in his capacity as officer, then it is thought that the Courts will continue to distinguish between the rights and obligations of a shareholder *qua* shareholder and the rights and obligations of an officer in his capacity as such. Where, however, the relevant article refers to an 'officers' rights or obligations and the 'officer' attempts to enforce or rely upon that article in such capacity, then there will no longer be any necessity for the Courts to make such a distinction. Further, it is thought that the Courts will distinguish between the rights and obligations of an 'officer' in his capacity as such and other capacities such as employee, supplier of goods, promoter.<sup>85</sup>

### 5. Relationship between a Company and its Officers

It has already been pointed out that under the former s.78(1) and its English counterpart the articles and the memorandum did not constitute a contract between the company and its officers.<sup>86</sup> Thus, directors have not been entitled to sue for the remuneration specified as payable to them under the articles<sup>87</sup> nor have they been obliged to take up the minimum share qualification required of directors under the articles<sup>88</sup> unless it could be shown that the articles evidenced the terms of a contract outside the articles.<sup>89</sup> On the other hand, the Courts have allowed a director, suing as shareholder, to enforce rights conferred by the

78. At 76 para 223.

79. *Supra* n.8 at 900.

80. *Supra* n.41 at 721.

81. P. Finn, (ed.), *Equity and Commercial Relationships*, (1987), Chapter 4 by L.S. Sealy, 'The Enforcement of Partnership Agreements, Articles of Association and Shareholder Agreements', at 105.

82. *Hickman v. Kent supra* n.8 at 900.

83. H. French, 'Liberalisation of Standing to Sue for Non-Observance of Memorandum and Articles', *supra* n.72 at 283.

84. *Supra* n.41.

85. Sealy, *supra* n.81 at 105.

86. *Re New British Iron Co. supra* n.12 at 326; *Re Wheal Buller Consols* [1888] 38 Ch.D. 42; *Re R. Bolton and Company* [1894] 3 Ch.D. 356 at 363.

87. *Re New British Iron Co.*, *ibid.* *Re International Cables Ltd* (1892) 66 L.T.R. 253 at 254.

88. In *Re Wheal Buller Consols supra* n.86 at 48; *Ex parte Cammell* [1894] 2 Ch. 392.

89. *Re New British Iron Co. supra* n.12.

articles upon him as a director to hold office or to participate in management or to exercise a veto over board decisions.<sup>90</sup> In addition to this incongruous position, there may be noted the criticism that 'it seems rather absurd to regard directors as outsiders since they stand in a fiduciary relationship to the company which in part is defined by the articles'.<sup>91</sup>

As already noted, s.78(1)(b) now provides that the memorandum and articles constitute a contract between the company and each 'officer'. The 'officer' need not be a member. However, the meaning of 'officer' for the purposes of the section is a very narrow one when compared with the definition in s.5(1) of the Companies Code. Section 78(5) provides that 'officer', means a director, the principal executive officer or a secretary of the company. In particular, it is to be noted that reference to 'employee of the corporation' is excluded. The philosophy then must be that principally the proper place for contract between the company and its officers is not in the memorandum and articles of association but in a service contract.

It has been suggested that as there is already a wide range of provisions in the Companies Code dealing with company officers their powers, duties and potential liabilities, s.78(1)(b) may be seen to be slightly superfluous.<sup>92</sup> However, it is thought that such provision would enable a director to enforce his right to remuneration specified under the articles and would oblige him to take up his minimum share qualification where the articles so require. Further, it is thought by the writer that the provision would now provide a sound legal explanation for the abovementioned cases in which the courts have allowed a director, suing as shareholder, to enforce rights conferred by the articles upon him as a director against the company. There should be no need in the future for the Courts to construe such articles as affecting an officer in his capacity as shareholder.

## **6. Enforcement of the Articles or Memorandum of Association and the Rule in *Foss v. Harbottle***

The extent to which a shareholder can enforce the statutory contract created under provisions like s.78(1) measures the extent to which the rule in *Foss v. Harbottle*<sup>93</sup> will not defeat an individual or minority shareholder's action. This rule has two aspects – the 'Proper Plaintiff' aspect and the 'Internal Management' aspect.<sup>94</sup> The 'Proper Plaintiff' aspect is to the effect that if a wrong is done to the company, the company acting normally through its board of directors<sup>95</sup> is the only proper plaintiff in an action to prevent or recover in respect of the wrong. This principle is a consequence of a company having a legal personality separate and distinct from its membership. The 'Internal Management' Aspect is based upon an elementary principle of law relating to companies that the Courts regard themselves as having no jurisdiction to interfere with the internal management of companies. Thus, where the alleged wrong is one which might be made binding on the company and all its members, by a simple majority of the members, no individual member of the company is entitled to maintain an action in respect of that matter. The relationship between the two aspects may be explained as follows.<sup>96</sup> If the alleged wrong is ratifiable by a simple majority of the members of the company, then no wrong has been done to the company and there is nothing in respect of which anyone sue. If, on the other hand, a

90. *Supra* n.64.

91. J.H. Farrar, 'Company Law', (1985) at 104.

92. Australian Company Law and Practice, (CCH Australia Ltd), *supra* n.72 at 9,804.

93. *Supra* n.4.

94. *Edwards v. Halliwell* [1950] 2 All E.R. 1064 at 1066; *Prudential Assurance Co. Ltd v. Newman Industries* [1982] 1 Ch. 204 at 210.

95. See Table A. Art 66.

96. *Edwards v. Halliwell supra* n.94; *Prudential Assurance Co. Ltd v. Newman Industries supra* n.94.

simple majority of the members opposes what has been done, then there is no valid reason why the company should not institute the suit. The rule in *Foss v. Harbottle* will not apply where a member has a personal right of action for wrongs done to himself in his capacity as member.<sup>97</sup> Further, in exceptional circumstances, a member may sue upon behalf of his company, by way of representative or derivative action, to remedy a wrong done to his company. Where a member has a personal right of action or a member may sue by way of derivative action the wrong complained of cannot be remedied by the company in general meeting passing an ordinary resolution.

Where there is an infraction of the company's articles there is a number of effects.<sup>98</sup> Firstly, there is a wrong done to the company by the perpetrator of the irregularity. Secondly, the company is put in breach of the statutory contract *vis-a vis* its shareholders where the irregularity occurs, for instance, in the passing of a resolution. Thirdly, a shareholder is put in breach of the statutory contract *vis-a vis* the other shareholders where, for instance, such shareholder fails to fulfill his obligations to the company.

The former s.78(1) created, and its English counterpart creates, a statutory contract in respect of 'all the provisions of the memorandum and the articles'. However, the Courts have taken the view that this does not mean that an individual shareholder has the right to have each of the provisions in the memorandum and articles enforced by declaration or injunction. Indeed, in *Salmon v. Quin & Axtens Ltd* Farwell L.J. took the view 'that it [might] well be that the Court would not enforce the covenants as between individual shareholders in most cases'.<sup>99</sup> The reason for this non-enforcement is that the Courts may consider any breach of the memorandum or articles to be one affecting a corporate right only and therefore ratifiable by the members in general meeting.<sup>100</sup> However, breaches of the constituent documents which infringe a shareholder's individual rights conferred upon him in his capacity as member are not ratifiable by the members in general meeting.<sup>101</sup> Whether a member has a personal right of action for any breach or attempted breach of the statutory contract is a question which has not been fully answered by the Courts and it may be said that the case law is still in a state of confusion.<sup>102</sup> However, it may be said with some degree of certainty that an individual member will have a personal right of action in the following circumstances:<sup>103</sup>

- (a) where the infraction of the statutory contract by the company prevents the company's organs being properly constituted such as when directors are irregularly elected,<sup>104</sup> directors hold office without the prescribed qualifications,<sup>105</sup> directors act without a quorum,<sup>106</sup> persons act as directors without lawful authority<sup>107</sup> and directors are excluded from board meetings;<sup>108</sup>

97. *Edwards v. Halliwell, ibid.*

98. R.J. Smith, 'Minority Shareholders and Corporate Irregularities', (1978) 41 *M.L.R.* 147 at 151.

99. *Supra* n.32 at 318.

100. See for example *MacDougall v. Gardiner* (1875) 1 Ch.D. 13.

101. *Edwards v. Halliwell supra* n.94 at 1067.

102. Smith, *supra* n.9 at 155; R.R. Druery, 'The Relative Nature of a Shareholder's Right to Enforce the Company Contract', (1986) 45 *C.L.J.* 219 at 238.

103. See generally Ford, (1986), *supra* n.73 at 485-7.

104. *Ryan v. South Sydney Junior Rugby League Club Ltd supra* n.64; *Papaiannoy v. The Greek Orthodox Community of Melbourne* (1979) C.L.C. 32,209.

105. *Catesby v. Burnett* [1916] 2 Ch. 325.

106. *Kraus v. J.G. Lloyd Pty Ltd* [1965] V.R. 232 at 235.

107. *Ibid.*

108. *Pulbrook v. Richmond Consolidated Mining Co. supra* n.64; *Hayes v. Bristol Plant Hire, supra* n.64.

- (b) where there is any irregularity in the passing of a special resolution which is required under the memorandum or articles;<sup>109</sup>
- (c) where the plaintiff seeks to restrain a threatened breach of any provision in the memorandum or articles.<sup>110</sup>

However, it is probably not correct to suggest that apart from these circumstances 'the Court will incline to treat a provision in the memorandum or articles as conferring a personal right on a member only if he has a special interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its constitution'.<sup>111</sup> The Courts have not restricted the personal action to those breaches of the statutory contract which affect the shareholder in a special way, such as the denial of a right conferred on a member by way of pre-emption or otherwise to acquire the shares of another member.<sup>112</sup> Rather, the Courts have allowed personal actions where it might be said that only a procedural irregularity, such as an irregular notice of meeting,<sup>113</sup> is involved. As pointed out elsewhere,<sup>114</sup> the confusion in the cases becomes acute when it is considered that a shareholder is entitled to bring a personal action where his voting right is wrongfully excluded<sup>115</sup> but not where his demand for a poll is wrongfully refused.<sup>116</sup>

It is suggested by the writer that the present s.78(1) does nothing to allay this confusion. The rule in *Foss v. Harbottle* is not expressly dealt with. It has been suggested that the deemed statutory contract between the company and the 'officers' of the company 'will make it easier for minority shareholders to seek enforcement of directors obligations and will overcome to a certain extent the decision in *Foss v. Harbottle* . . .'.<sup>117</sup> If a director breaches a provision in the articles, such as the prohibition against voting at board level with respect to a contract in which he has an interest,<sup>118</sup> then it will be the company that will have to institute an action against the director.<sup>119</sup> Again, where the breach in articles perpetrated by the director relates to the passing of a resolution at a general meeting of the company, such that the company is also put in breach of the statutory contract with its shareholders, then it will still be the company that will have to institute an action against the directors unless it can be shown that the individual shareholder has a personal right of action whereupon the company will be joined as a defendant in the action. It may be noted that earlier drafts of s.78(1) of the 1985 Amending Legislation also purported to create a statutory contract between each member and each officer but this was deleted from the final legislation upon the basis that it was an inappropriate method of safeguarding members' rights.<sup>120</sup> No doubt it was feared that such a provision could cause a multiplicity of actions by members against officers particularly in listed corporations.

By the same token, it may be that when an 'officer' seeks to enforce his rights under the

109. *Baillie v. Oriental Telephone & Electric Co.* [1915] 1 Ch. 503; *MacConnell v. E. Prill and Co. Ltd* [1916] 2 Ch. 57; *Edwards v. Halliwell supra* n.94. The right to bring a personal action is not restricted to those cases where the majority is insufficient. See Smith, *supra* n.98 at 156.

110. See for example *Wood v. Odessa Waterworks Co. supra* n.28; *Mosely v. Koffyfontein Mines Ltd* [1911] 1 Ch. 73.

111. Pennington, *supra* n.34 at 727.

112. *Borland Trustee v. Steel Bros. & Co. Ltd* [1901] 1 Ch. 279; *Rayfield v. Hands supra* n.33; *Grant v. John Grant & Sons Pty Ltd* (1950) 82 C.L.R. 1 at 29.

113. *Kaye v. Croydon Tramway* [1898] 1 Ch. 358.

114. Smith, *supra* n.99 at 151.

115. *Pender v. Lushington supra* n.24.

116. *MacDougall v. Gardiner supra* n.101.

117. R. Baxt, *Supplement to An Introduction to Company Law*, (1986) at 8.

118. Eg. Art. 71, Table A.

119. *Grant v. U.K. Switchback Railways* (1888) 40 Ch.D. 135.

120. Companies and Securities Legislation (Miscellaneous Amendments) Bill 1985 2nd Exposure Draft - Explanatory Memorandum. Australian Company Law and Practice, at 90-070.

statutory contract against the company, the Courts may refuse to countenance such suit where there is only involved a procedural irregularity which would be ratifiable by the company in general meeting.<sup>121</sup> If the Courts adopt such a stance this would be consistent with the rationale of the rule that they should not interfere in the internal management of a company.

### 7. Relationship between Section 78(1) and Section 574 of the Companies Code

Section 574 of the Companies Code gives the Court a discretion to grant prohibitory and mandatory injunctions to compel compliance with the Code. In particular, s.574(1) states that the Courts may, on the application of the Commission or any person whose interests have been, are, or would be affected, grant an injunction restraining a person who has engaged, is engaging, or is proposing to engage in any conduct that constituted, constitutes, or would constitute a contravention of the Code.<sup>122</sup> Under s.574(2) the Court may, on the application of either of the abovementioned persons, grant an injunction requiring another person to do an act or thing where such person has refused or failed, is refusing or failing, or is proposing to refuse or fail to do an act that he is required by the Code to do. In addition to granting prohibitory and mandatory injunctions, the Court may also order the person who is the subject of the injunction to pay damages to any other person either in addition to or in substitution for the grant of the injunction.

In order that proceedings under s.574 may be commenced, the applicant must have the requisite *locus standi*. It has been pointed out that since s.574(1)(a) grants the commission standing this will enable it to bring what in effect is a class action when there is a sizable number of persons affected by a contravention of the Code.<sup>123</sup> This is perhaps borne out by the recent litigation in the Supreme Court of Western Australia between the Commission and W.A. Pines Pty Ltd<sup>124</sup> wherein the Commission sought an injunction pursuant to s.574(1) restraining W.A. Pines Pty Ltd from offering shares in a company or proposed company without a prospectus, in breach of s.95 of the Companies Code.

Section 574(1)(b) also grants standing to 'any person whose interests are affected' by conduct that constitutes a contravention of the Code. It has been stated that the meaning of such an expression must be considered in the context of the statute in which it appears.<sup>125</sup> In *Broken Hill Proprietary Company Ltd v. Bell Resources Ltd*<sup>126</sup> Hampel J. took the view that the Companies Code is legislation which is clearly concerned in the broadest sense with the protection of the public in respect of commercial activities of corporations and the provision of information to the public relevant to those activities. With the assistance of s.5A of the Companies and Securities (Interpretation and Miscellaneous Provisions) Code,<sup>127</sup> Hampel J. considered that in interpreting s.574(1)(b) a broad interpretation

121. Sealy, *supra* n.82 at 105.

122. The Court may grant an interim prohibitory injunction pending the determination of an application under s.574(1).

123. *Law of Companies in Australia* (CCH Australia Ltd) (1986) at 310. The same argument would apply to s.574(2)(a).

124. *NCSC v. W.A. Pines Pty Ltd* (1987) 5 ACLC 138; *W.A. Pines Pty Ltd v. NCSC* (1987) 5 ACLC 487. On appeal to the Full Court of the Supreme Court the injunction granted at first instance was discharged because a majority of the Court held that the offer was not made to a section of the public.

125. *Re Gasbourne Pty Ltd* (1984) 2 ACLC 103 at 127, per Nicholson J.

126. (1984) 2 ACLC 157 at 162.

127. This provision states that the Courts, when interpreting a Code under the National Companies and Securities Scheme, must prefer a construction that would promote the purpose or object underlying the particular Code over a construction that would not promote that purpose or object whether the underlying purpose or object is expressly stated or not.

consistent with the objectives of the Code should be adopted and not the more restricted interpretation of the kind adopted under the previous Uniform Companies Legislation.<sup>128</sup> Hampel J. concluded that the interests referred to in s.574(1)(b) 'are interests of any person (which includes a corporation) which go beyond the mere interest of a member of the public.' It was stated that it is not necessary for an applicant to show that personal rights of a proprietary or similar nature are or may be affected or that any special injury arising from a contravention of the Code has occurred.<sup>129</sup> As a result, Hampel J. held in the circumstances of the case, where Bell Resources Ltd issued a tender offer to 7% of the shareholders of B.H.P. Ltd with a view to such shareholders exchanging their shares for shares in Bell Resources Ltd, that B.H.P. Ltd had *locus standi* under s.57(4)(1)(b). It was said that there was a sufficient nexus between B.H.P. Ltd and its shareholders to give the company standing as a person whose interests had been or would be affected by an alleged contravention of s.96(1) of the Companies Code.<sup>130</sup>

In the context of the rule in *Foss v. Harbottle* it has been suggested that s.574 may create an important statutory exception thereto in that an individual shareholder would be 'a person whose interests are affected' within s.574(1)(b).<sup>131</sup> Certainly, this would clearly be the case where under s.68(6)(f) an application for an injunction under s.574 may be asserted to restrain a company from entering into an agreement which is contrary to an express restriction or prohibition on the company's powers or not in pursuance of the company's objects and is therefore a contravention by the company of s.68(1) of the Code and by the officers of the company knowingly concerned under s.68(2). In cases where there is an alleged contravention of those provisions of the Code whereby a public company is prohibited from issuing shares, debentures or prescribed interests to the public unless a prospectus or similar statement is registered with the Commission,<sup>132</sup> there is authority which suggests that individual shareholders of the company issuing any such interest may have *locus standi* under s.574(1)(b).<sup>133</sup> Further, where a company offers shares to the members of another company in exchange for its own shares in contravention of s.96(1) of the Code, then it is probable that individual members of the offeree company would have *locus standi* under s.574(1)(b). This is implicit in the judgment of Hampel J. in *Broken Hill Proprietary Co. Ltd v. Bell Resources Ltd*.<sup>134</sup>

When consideration is given to the *locus standi* of an individual shareholder under s.574(1)(b) in relation to a breach of the statutory contract under s.78(1) of the Code the matter becomes less clear. It has been suggested that where an infringement of the articles involves a breach of duty a shareholder's interests 'may not be affected' unless it can be shown that the duty is owed to him or that he has an interest in its enforcement going beyond the interests of the shareholders generally.<sup>135</sup> In view of the liberal construction adopted by Hampel J. in *Broken Hill Proprietary Co. Ltd v. Bell Resources Ltd* to the effect that no special injury need be shown by an applicant under s.574(1)(b), it is suggested by the writer that no such restriction ought to be placed upon an applicant. It is suggested by the writer that the spectre of the rule in *Foss v. Harbottle* ought not to impinge upon the *locus*

128. See for example *Colotone Holdings Ltd v. Calsil Ltd* [1965] V.R. 129.

129. *Supra* n.126.

130. *Ibid.* It is thought that the analysis of Hampel J. would also apply to s.574(2)(b).

131. R. Baxt, *supra* n.68 at 209-210; *Equity and Commercial Relationships*, *supra* n. 81, 1987, Chapter 4, F.H. Callaway: *The Enforcement of Partnership Agreements, Articles of Association and Shareholder Agreements: Commentary*: 114 at 116-117; Cf. Ford, (1986) *supra* n.73 at 490.

132. Part IV Divs 1 and 4.

133. *Eastern Petroleum Australia Ltd v. Horeshoe Lights Gold Pty Ltd* (1985) 3 ACLC 594 at 599.

134. *Supra* n.126 at 160 and 162.

135. Callaway, *supra* n.131 at 118.

*standi* requirement. If it is probable that the breach is one that would be ratifiable by a majority of the company in general meeting then this should be a matter which is relevant to the Court's overall discretion in granting an injunction. Further, the Court would not be prevented from adjourning the proceedings and remitting the matter to the company in general meeting in order to ascertain its wishes once a breach has been proved. In any event, it may be that in the case of many companies the question is an academic one when the scope of s.574 is considered.

The scope of the section is not as yet entirely clear. However, s.574(1) applies where there is a contravention of the Code whether a person commits an offence under the Code or not. Thus, in *Broken Hill Pty Co. Ltd v. Bell Resources Ltd*<sup>136</sup> it was found that, since Bell Resources Ltd had not complied with s.96(1) of the Code because it issued an application for shares to the public without attaching a registered prospectus, there was a contravention of the Code within the meaning of s.574(1). Section 574(2) applies where a person fails to do an act or thing that he is required by the Code to do.

It has already been noted that under s.68(6)(f), a contravention of s.68(1) or s.68(2) may be relied upon in an application for an injunction under s.574 to restrain the company from entering into an agreement. When these provisions are compared with the terms of s.78(1) it is very difficult to argue that a breach of the articles 'constitutes a contravention of the Code' or that when a party to the statutory contract refuses or fails to comply with the articles that 'he refuses or fails to do an act or thing that he is required by the Code to do.'<sup>137</sup> The terminology of s.78(1) does not lend itself to such arguments. Each of the parties to the statutory contract simply 'agrees to observe and perform the provisions of the memorandum and articles – so far as those provisions are applicable to that person'. There is no indication that a breach of the articles 'constitutes a contravention of the Code' for the purposes of s.574(1). Further, s.78(1) does not directly require a party to the statutory contract to do an act for the purposes of s.574(2).<sup>138</sup> Perhaps s.574 may be relied upon where the duties and obligations imposed upon a company and its relevant 'officers' under the Companies Code are duplicated in the articles of association.<sup>139</sup>

### Conclusion

The new s.78(1) has clarified the position in relation to the identity of the parties to the statutory contract created by the section. It is arguable that the language of the new provision may be construed such that a member may enforce the statutory contract even though this may have the effect of indirectly enforcing 'outsider rights'. However, upon a consideration of the explanatory memorandum relating to the provision, it is thought that the better view is that the *Hickman* principle will continue to be applied by the Courts and 'outsider rights' will not be enforceable. With the introduction of s.78(1)(b) an 'officer', as defined in s.78(5), will no longer be considered an outsider. This provision would now provide a sound legal explanation for those cases in which the Courts have allowed a director, suing as shareholder, to commence a personal action to ensure that the company's organs are properly constituted. Nevertheless, having regard to the explanatory memorandum, it is thought that directors also will only be entitled to enforce those rights which affect them in their capacity as directors and not in some other capacity.

The new provision does not attempt to reduce the confusion in the case law relating to

136. *Supra* n.126.

137. Callaway, *supra* n.131 at 117.

138. *Ibid.*

139. *Ibid.*

the effect of the rule in *Foss v. Harbottle* upon the enforcement of the statutory contract by an individual member. Although s.574 of the Companies Code may prove in the future to be an important exception to the rule in *Foss v. Harbottle*, it is doubtful that it will be of much assistance in the enforcement of the statutory contract. Even if a wide interpretation be given to the *locus standi* requirement, such that an individual shareholder would be a 'person whose interests are affected' in the case of a breach of his company's articles, it is thought that the language of s.78(1) does not lend itself to the enforcement of the statutory contract through the mechanism of s.574.

Notwithstanding the deficiencies created by the rule in *Foss v. Harbottle*, the statutory contract will remain an important remedy to an individual member particularly in those cases where it is accepted by the Courts that the irregularity under the statutory contract is one in which the member may institute a personal action. Further, the statutory contract will continue to be relevant to a company where it seeks to institute proceedings against a member in order to enforce a pecuniary liability.<sup>140</sup>

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140. *Ford*, (1986) *supra* n.73 at 48.