'personally' liable depended on proof that the defendants were their 'directing mind and will' (the phrase used by Viscount Haldane LC in *Lennards Carrying Co Ltd v Asiatic Petroleum Co* **(p. 176)** *Ltd* [1915] AC 705, 713–714). But in my judgment it does not so depend because it was sufficient for the OFT to show that the companies intentionally or negligently infringed the provisions of the 1998 Act; the companies have accepted that they did so infringe the 1998 Act and the question whether the defendants were the 'directing mind and will' of the companies does not come into the matter.

26 Mr Anderson further submits that the word 'personal' in the requirement for the claimant to be 'personally' at fault is used in a different sense from that in which it is used when one says that a corporation which cannot be vicariously liable is 'personally' liable. But it is difficult to see why that should be so. If indeed it were the law that the *ex turpi* maxim could only be used against a company if the act was specifically authorised by the whole board of directors (or the shareholders in general meeting) there would be little scope for the maxim to be used at all in a corporate context. That would not be a desirable legal development. To the extent that it might be suggested that the maxim could be used in addition against a company when it was an employee who was 'the directing mind or will' who intentionally or negligently committed the act of infringement, that would involve a potentially difficult and fact-sensitive inquiry which would be inappropriate for a maxim that is intended to be both comprehensible and readily applicable. It is more in accordance with principle to say that if the liability of the company is personal (rather than merely vicarious), then there is no impediment to the application of the maxim save (perhaps) in cases of strict liability where there has been no intention or negligence on the part of any person which is not something that needs decision now.

27 The judge appears to have accepted this part of Mr Anderson's argument because he says, in paras 74 and 75, that the claimant companies were liable to pay penalties not by virtue of any special rule of attribution in the *Meridian* sense but by virtue of the general law of agency. But to talk of liability for the acts of one's agents is to talk of vicarious liability, and the company's liability is not vicarious for the simple reason that the 1998 Act does not impose any liability of any kind on the directors or employees of an undertaking for which the companies can be vicariously responsible. The liability is a 'personal' one and that is enough to make the acts of the company 'personal' for the purpose of the application of the maxim.

Litigation: procedural issues

Conduct of litigation

Blackstone ('Limits to the idea of a company as a "person"?', p 77) quoted Sir Edward Coke as authority for the view that a company must always appear in court by attorney, 'for it cannot appear in person, being invisible, and existing only in intendment and consideration of the law'. The courts have for many centuries strenuously insisted on this rule, both in civil and in criminal cases, and it has only been by statute that inroads have been made into it —and then mainly in relation to lower courts such as the magistrates' courts. So we have the paradox that the law is happy to identify a company with the individual who is its 'directing mind and will' for the purpose of making it criminally liable, while at the same time it will refuse to allow the company to appear before it in the person of the same individual. This remains the basic rule: in*RH Tomlinssons (Trowbridge) Ltd v Secretary of State for the Environment* [1999] 2 BCLC 760, CA, it was solemnly affirmed by the Court of Appeal. However, the Civil Procedure Rules, which came into effect on 26 April 1999, allow a company (with the leave of the court) to appear by an *employee* and, by implication, to appear 'in person' in other ways, so that the rule has now been superseded for civil cases in the county courts and the High Court.

(p. 177) Service of documents

CA 2006 s 1139: Service of documents on company

A document may be served on a company registered under this Act by leaving it at, or sending it by post to, the company's registered office.

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WEDDERBURN, KW, '*Ultra Vires* in Modern Company Law' (1983) 46 MLR 204.
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Find This Resource

Notes:

[1] Note, however, that if the agency is undisclosed (so the third party does not appreciate that the intended counter-party is the company), then the company cannot ratify the unauthorised transaction: *Keighley Maxsted & Co v Durant* [1901] AC 240, HL. By contrast, an authorised agent can effect binding contracts between the principal and the third party whether or not the agency is disclosed.

[2] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, HL; *Guinness plc v Saunders* [1990] 2 AC 663, HL; *Clark v Cutland* [2003] EWCA Civ 810, CA.

[3] See s 41(4)(d). Since, by definition, the contract is in breach of the company's constitution, it might be thought that the affirmation procedure can only proceed if the*company* has the *capacity* to affirm (s 39 is immaterial in this context). Sometimes the constitutional provision that has been breached will not touch *company* capacity (eg provisions determining which directors are to make certain decisions), but others will (eg provisions determining the type of business to be pursued by the company). In the latter case, presumably the articles will have to be altered first. In the other cases, the company has the capacity to affirm, and provided the appropriate organ makes the decision, it will be effective by *ordinary* resolution, even though a decision to amend the relevant constitutional provision generally, for the future, would have required a special resolution. Also see the cases at 'Ratification of acts of directors: CA 2006 s 239', pp 437ff, on ratification of past breaches committed by the directors.

[4] More accurately, this rule allowed outsiders to presume (in the absence of facts putting the outsider on inquiry) that there had been compliance with all matters of internal (non-public) management and procedure required by the articles (or other internal rules) for the proper exercise of any power.

[5] Ie the memorandum and articles.

[6] Article 3 refers to the registration of documents in a central register to be maintained by each member state, and the publication of particulars thereof in the national*Gazette*. This is provided for in the case of the UK by CA 2006 Pt 35, see 'General disclosure obligations', pp 715ff.

[7] Note that EU Directive (77/91/EEC) Art 2(b) requires *public* companies to state their objects in their constitution. Whether s 31(1) (which provides that a company's objects are 'unrestricted') in the absence of a 'statement' meets this requirement is not clear.

[8] Section 31(2) provides that where a company changes its articles to add, remove or alter a statement of the company's objects, it must give notice to the registrar. The registrar is to register that notice, and the alteration does not take effect until it has been so registered. Section 31(3) ensures that such an amendment to the company's articles will not affect any rights or obligations of the company or render defective any legal proceedings by or against it.

[9] The doctrine had been applied rather earlier to 'statutory' companies incorporated by special Act of Parliament, where it had an important role to play, for these companies commonly had powers to acquire land compulsorily for the purposes of constructing the railways, canals, etc for which they were formed, and it was vital that the courts could keep the exercise of such powers under strict control. It did not apply to the 'deed of settlement' companies

which were the forerunners of the modern company, since such companies, being in essence partnerships, were always free to change their constitution by agreement among the members. The *Ashbury Rly Carriage* case had the double effect of confirming that the doctrine applied to companies incorporated by registration under the Companies Acts, and also that an *ultra vires* act of a company could not be validated even by a unanimous ratification.

The doctrine of *ultra vires* has never been applied to companies incorporated by Royal Charter (except in regard to powers conferred upon them by statute: *Hazell v Hammersmith and Fulham London Borough Council* [1992] 2 AC 1, HL). A chartered corporation which ventured into activities not authorised by its charter ran the (largely theoretical) risk that the charter might be forfeited on the initiative of the Crown, but the transactions which it entered into were not invalidated. However, it is possible that the judges, when laying down the *ultra vires* doctrine, did recall the scandals associated with the 'trafficking' in obsolete charters which went back to the days before the Bubble Act of 1720, and wanted to ensure that similar abuses did not arise with registered and statutory companies.

[10] Knowing that, even at common law, in addition to the powers specifically conferred by the memorandum, a company would have the power to do whatever could fairly be regarded as incidental to its express objects: *AG v Great Eastern Rly Co* (1880) 5 App Cas 473, HL.

[11] The *ratio decidendi* of this case is confined to the *ultra vires* rule. As appears from the speech of Lord Parker of Waddington, the court must sometimes also construe the objects clause of the memorandum when proceedings are brought to have the company wound up under Insolvency Act 1986 (IA 1986) s 122(1)(g) (the 'just and equitable' ground) (see 'Compulsory winding up on the "just and equitable" ground', pp 795ff). The relevant question then is whether the 'main object' or 'substratum' of the company has failed. For this purpose a clause such as that considered in *Cotman v Brougham* is ineffective, and will not prevent the court from determining the 'main object' of the company as a matter of substance.

[12] Also see *HA Stephenson & Son Ltd v Gillanders Arbuthnot & Co* (1931) 45 CLR 476 (High Court of Australia).

[13] [1904] 2 Ch 608, CA.

[14] Although, of course, the normal contract rules apply if the third party has induced the company, via its agent, to enter into the contract because of the third party's fraud, misrepresentation, etc.

[15] The predecessor provision in CA 1985 s 35A referred to the 'board of directors', which gave it limited application in practice. Presumably this change is intended to widen the application of the provision, although views on this differ, and the Hansard debates on the Bill do not illuminate.

[16] [1981] AC 513 at 528 and 529, HL.

[17] These remarks must now be read in the light of CA 2006 s 40.

[18] This fourth requirement will not now be relevant, in the light of the reforms now embodied in CA 2006 s 40, except in the case where the 'contractor' cannot bring himself within the section, eg because he was not dealing in good faith.

[19] *Rama Corpn Ltd v Proved Tin and General Investments Ltd* [1952] 2 QB 147, [1952] 1 All ER 554, concerning a contract negotiated by a single non-executive director.

[20] Note that the scope of the director's actual authority can raise difficult questions of construction. See, eg, *Reckitt v Barnett, Pembroke & Slater Ltd* [1929] AC 176, HL, where a power to draw cheques 'without restriction' was construed as limited to drawing cheques related to the conduct of the principal's affairs.

[21] (1887) 18 QBD 815, CA.

[22] [1902] AC 117.

[23] Colvilles was a steel company which was later taken over by BSC.

[24] The agent may be 'held out' by the company's documents, or by the board or other duly constituted authority, or there may be circumstances which estop the board or other organ of the company from denying that he is a managing director.

[25] It has been held that, in order to succeed under this head, the third party must have actual knowledge of the article conferring the power to delegate: see *Houghton & Co v Northard Lowe & Wills Ltd* [1927] 1 KB 246, CA.

[26] In this case, knowledge of the existence of a power to delegate is unnecessary.

[27] This decision was reversed by the House of Lords (*British Equitable Assurance Co Ltd v Baily* **[3.19]**) on the basis of a different construction of the policy. But the validity of the passage cited was not disputed by the House of Lords; and, indeed, Lord Macnaghten expressly approved it.

[28] This section directed the compulsory re-registration of certain companies under the 1862 Act.

[29] Also see *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* **[6.06]**. A similar distinction was made in *Equitable Life Assurance Soc v Hyman* **[4.03]**: should the contract containing the 'guarantee' be read as subject to the discretionary power conferred by the article in question, or would an exercise of the discretion that was inconsistent with the guarantee be a breach of contract?

[30] Note this early example of an attempt to limit the liability of members by contract before this was made possible by statute.

[31] It is a separate question whether these third parties might sue the promoters in damages for breach of warranty of authority: see Note 2.

[32] [1982] QB 938 at 945.

[33] (1857) 8 E & B 647.

[34] [1954] 1 QB 45 at 47.

[35] [1966] ALR 744.

[36] (1950) 84 CLR 377.

[37] Lord Millett in *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, [2003] 2 AC 366 at [107].

[38] Lord Nicholls in *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, [2003] 2 AC 366 at [21].

[39] Lord Steyn in *Bernard v AG of Jamaica* [2004] UKPC 47 at [18].

[40] Eg, a company may be vicariously liable for an employee's defamatory libel, even though the company itself could not have acted with the necessary malice: *Citizens' Life Assurance Co Ltd v Brown* [1904] AC 423.

[41] *Lister v Romford Ice & Cold Storage Co Ltd* [1957] AC 555, HL.

[42] And perhaps could have sued its own employees in negligence, for the loss caused.

[43] < www.justice.gov.uk/legislation/bribery >.

[44] S Gentle, 'The Bribery Act 2010: Part 2: The Corporate Offence' (2011) Crim LR 101.

[45] D Aaronberg and N Higgins, 'All Hail the Bribery Act—The Toothless Wonder!' (2011) Arch Rev 5.

[46] C Wells, 'Who's Afraid of the Bribery Act 2010' [2012] JBL 420.

[47] The case arose out of the Southall train disaster, when two trains collided at high speed and seven people were killed, but the charges of manslaughter resulted in acquittals on the direction of the judge, for want of evidence to bring home either an *actus reus* or a *mens rea* to a 'directing mind and will'. The Court of Appeal confirmed that this was the correct approach in law.

[48] This sentence was criticised as being too widely stated by Lord Reid in *Tesco Supermarkets Ltd v Nattrass* **[3.28]**.

[49] The House of Lords in this case adopted the 'directing mind and will' approach, and, consequently, concluded that subordinates would never count as the 'directing mind'. The conclusion would not now be so clear-cut. See *Meridian Global Funds Management Asia Ltd v Securities Commission* **[3.29]**. In this case, Lord Hoffmann stated that it would be a mistake to seize upon the phrase 'directing mind and will' and use that as the sole criterion for determining whose thoughts and/or actions will be attributed to a company. The question should be 'whose act was … intended to count as the act of the company?'

[50] For further reading, see C Wells, *Corporations and Criminal Responsibility* (2nd edn, 2001); GR Sullivan, 'The Attribution of Culpability to Limited Companies' [1996] CLJ 515; CMV Clarkson, 'Kicking Corporate Bodies and Damning their Souls?' (1996) 59 MLR 557.

[51] https://consult.justice.gov.uk/digital-communications/deferred-prosecution-agreements.

[52] See GJ Virgo, 'Stealing from the Small Family Business' [1991] CLJ 464; DW Elliot, 'Directors' Thefts and Dishonesty' [1991] Crim LR 732.

[53] [1995] 1 AC 456, [1995] 1 All ER 135, HL.

[54] [1944] 2 All ER 515, DC.

[55] This principle has been applied by the Court of Appeal in *Jafari-Fini v Skillglass Ltd* [2007] EWCA Civ 261 and in the Privy Council by Lord Hoffmann in *Lebon v Aqua Salt Co Ltd* [2009] UKPC 2, PC.

[56] P Watts, '*Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm)*: Audit Contracts and Turpitude?' (2010) 126 LQR 14.

4. Shareholders as an Organ of the Company

Chapter: (p. 178) 4. Shareholders as an Organ of the Company
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General issues

In Chapter 2 we saw how the law recognises a company as a person in its own right, capable of having rights, owning property, making contracts, accepting or incurring obligations, committing wrongs and conducting litigation. Chapter 3 then addressed the practical matter of the way in which this artificial legal person functions: how its corporate will is manifested, its decisions taken and its acts performed. Plainly, a company cannot do anything except through human beings who are its members and officers and, vicariously, through its employees and agents.

In neither of these earlier chapters was much attention given to the role of the shareholders, or, more generally, the members of the company.[1] Yet both the Companies Act 2006 (CA 2006) and individual companies' constitutions assume a limited, but nonetheless significant, role for the company's members (as defined in CA 2006 s 112).[2] The Act gives members certain rights and reserves to them certain important decisions, to the exclusion of the company's directors. This is usually done when there is a substantial risk associated with leaving power in the hands of the directors. So members, not directors, must approve certain types of contracts between the company and its directors.[3] In addition, members have the right to decide upon changes to the constitution of their company[4] and to the rights attached to their shares.[5] Some of these statutory rules are mandatory; others can be strengthened or relaxed by the company's own articles. In addition, the members have the right to remove directors,[6] and, when wrongs have been committed against the company but the directors (perhaps through self-interest) are not inclined to pursue the claims, the members can sometimes pursue these claims and obtain a remedy for the company.[7]

Beyond this, the members' additional rights of control are derived from the company's constitution itself. This is the agreement that divides a company's power between the directors and the members. As noted earlier (see 'Constitutional documents: articles of association and the company's objects', p 25), the principal constitutional document (and the one on which this chapter focuses) is the company's *articles*: see CA 2006 ss 17 and 18. This sets the constitutional framework for the company. Companies are free to draft their own articles, but CA 2006 provides default sets of Model Articles for different types of companies (as did Companies Act 1985 (CA 1985) in Tables A–F). These Model Articles will automatically apply to companies that do not register their own articles, and will in any event apply to the extent that any registered articles do not exclude or modify the relevant Model Articles (CA 2006 s 20).

(p. 179) Taking the Model Articles for private companies limited by shares[8] as typical for small companies, we see they contain details about meetings of members, appointment and termination of directors and their duties and proceedings, delegation of power, issues of shares and payment of dividends, and the use of the company's seal. The overriding assumption in these Model Articles is that the directors, not the members, will manage the business of the company (subject of course to any exceptions in CA 2006, and also see *Barron v Potter* **[4.08]**).

Despite this rather unequal power split, the members and the directors constitute the two 'organs' of the company. The term signifies their constitutional authority to act *as*the company rather than merely to represent the company as its agent under an authority derived from some superior corporate source. Put another way, this is simply an attribution rule of the sort described by Lord Hoffmann in *Meridian* **[3.29]**.

These two organs share between them the most important corporate functions, and (except in the case of the single member company, the wholly owned subsidiary or the company with only one director) each organ normally, historically, acted by decisions (resolutions) taken at meetings. The organ constituted by the members

is called '*the general meeting*' and by the directors '*the board of directors*' or 'the board'. This terminology recognised that a *meeting* was the focus of corporate decision-making by these organs.

Historically, too, members' meetings were typically well attended, with vigorous debate and meaningful voting. Nowadays, the 'meetings' of very small companies are perfunctory affairs, if held at all. And attendance at the meetings of large companies is commonly unrepresentative,[9] and the 'business' a routine rubber-stamping of the directors' proposals. CA 2006 and the Model Articles recognise this, and make explicit concessions which expand the normal concept of a meeting or provide for alternative decision-making strategies (see 'Formal decision-making by members', p 192). But old concepts die hard: both the courts and the legislative reformers have striven to preserve some vestiges of the democratic ideal in their attitude to corporate governance, even when it seems to be plain on all sides that the struggle is a relatively hopeless one.

This chapter considers the members' rights and duties under CA 2006 and the company's constitution. It considers the problems in dividing power between the company's members and directors and the consequences of that division, the rules of interpretation which apply to constitutional documents, the practical exercise of the decision-making powers given to members and the legal constraints on that exercise. Finally, it considers the enforcement of the constitution by the members, and their potential use of shareholders' agreements to achieve what they cannot achieve via the articles.

Dividing corporate power between members and directors

The previous introduction, however brief, shows clearly that the constitutions of modern companies, with the backing of the law, have put the power to run the company's business in the hands of the directors, and have left the members a very minor role. Typically this extends to amendment of the constitution, declaration of a dividend, election or re-election of **(p. 180)** directors and appointment of auditors—and even in these matters there may be little for them to do except rubber-stamp the recommendations of the directors.

In other words, the role of the member has become more and more that of a passive investor (no doubt partly from choice, but also from apathy and a sense of impotence), while power has progressively come to be concentrated in the hands of the directors, especially the executive directors. The larger and more widely dispersed the membership or shareholding of the company, the more marked this difference between 'ownership' and 'control' usually is. (This trend has in part been reversed by the growth of the institutional members such as the pension funds, unit trusts and insurance companies and, more recently, buy-out funds,[10] although that too has created its own set of problems.)

This commonly described split between 'ownership' and 'control' has generated an enormous literature on the resulting agency problems: how can the members (the owners) ensure that the executives (the controllers) manage the company as they would want? On the other hand, moving too far in the other direction would entail the loss of other benefits. Concentrating management in the hands of the board is not only efficient, it also allows for the employment of dedicated experts to manage the business.

Reformers, motivated both by idealistic notions of 'shareholder democracy' as an end in itself, and also by a sense that directors do have too much power over 'other people's money', which is at times abused ('the unacceptable face of capitalism'), have lobbied for new legislation that consciously seeks to put a larger share of real control into the hands of the members. Since the time of the 1948 Act, and with increasing vigour since then, member approval has been required for certain decisions (see 'General issues', p 178, for illustrations). The procedures for these member-authorisations are sometimes quite rigidly prescribed, and the consequences of failing to observe the formalities very severe. The costs of compliance, both in money and in time, can prove a heavy price to pay for the theoretical gain. By contrast, in many North American jurisdictions reformers have accepted the case for a reduction in member-consents in the interests of business efficiency.

In some European companies codes, by contrast, and most notably in that of Germany, the problems associated with the concentration of power in the hands of the board of directors have been tackled in another way. In these systems, there is provision for a '*two-tier*' management structure, consisting of a managerial (or executive) board and a supervisory board, the former having charge of matters of day-to-day management and the latter being

responsible for the control of the executive board and, in particular, having the power of appointment and removal of its personnel. These supervisory boards in Germany also play an important role in ensuring worker participation in management, or '*co-determination*'. In most German public companies, one-third of the members of the supervisory board must be elected by the company's employees, while the other two-thirds are elected by the members.

The Draft Fifth EU Company Law Directive, in its original form (9 October 1972), contained proposals for the adoption of this model for public companies by all the member states of the EU. If implemented in the UK, such a change would have introduced a further 'organ' into the hierarchy of corporate management, and would have called for a basic reconsideration of the principles laid down in the cases on which we currently rely. However, the move was resisted by various governments, and a compromise in relation to SEs (*Societas Europaea*) allowing the British to retain their own system, was eventually reached.[11]

(p. 181) In the UK, concern for employees' interests has been limited to some very modest provisions in the Companies Acts, such as CA 2006 s 172 (directors to have regard to interests of employees in their duty to promote the success of the company), and CA 2006 s 247 and Insolvency Act 1986 (IA 1986) s 187 (power to make over assets to employees on a cessation of business or in a liquidation). The directors' annual report must give certain information about its employment policies and employee involvement, and there are inducements in the tax legislation to establish employee share-ownership schemes, which have now become relatively common.

All of this only serves to show that, in the *constitutional* split of power, the directors reign supreme. This chapter looks at what few, but sometimes crucial, collective and personal rights the members do have under the constitution, and how they must exercise those rights. There is little by way of provision for general control over the directors here. That is left to mechanisms discussed in Chapters 5 and 6.

Orthodox constitutional division of powers

The division of powers between the members in general meeting and the board of directors is discretionary, and determined by the company's articles (subject, of course, to any mandatory provisions of CA 2006). The relevant Model Articles for private companies from the 1985 and 2006 Acts are set out in the following extract.[12] These are illustrative of the general approach within such companies (and, as noted earlier, apply by default if alternative articles have not been registered: CA 2006 s 20).

CA 2006 Model Articles for Private Companies Limited by Shares

3. Directors' general authority

> Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.

4. Shareholders' reserve power

> **(1)** The shareholders may, by special resolution, direct the directors to take, or refrain from taking, specified action.
> **(2)** No such special resolution invalidates anything which the directors have done before the passing of the resolution.

Companies (Tables A to F) (Amendment) Regulations (SI 2008/739)

Table A

70 Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company. No alteration of the memorandum or articles and no such direction shall invalidate any prior act of the

directors which would have been valid if that alteration had not been made or that direction had not been given. The powers given by this regulation **(p. 182)** shall not be limited by any special power given to the directors by the articles and a meeting of directors at which a quorum is present may exercise all powers exercisable by the directors.[13]

Articles and the rules governing their interpretation

If the articles, as the company's primary constitutional document, define the division of powers between the members and the directors, then it is important to know how their terms are interpreted. Orthodox rules of contractual interpretation generally apply, since the articles constitute a contract between the company and its members,[14] but the following cases illustrate particular problems and limitations. It emerges that the articles constitute a rather unusual type of contract. (This is even more apparent when the personal rights arising under this contract are considered: see 'Members' personal rights', pp 250ff.)

The court has no jurisdiction to rectify the articles of association.

[4.01] Scott v Frank F Scott (London) Ltd [1940] Ch 794 (Court of Appeal)

The facts appear from the judgment.

> The judgment of the Court of Appeal (SCOTT, CLAUSON and LUXMOORE LJJ) was delivered by LUXMOORE LJ: The … question which falls to be considered is whether the defendants are entitled to have the articles of association rectified in the manner claimed by them. Bennett J [at first instance] said he was prepared to hold that the articles of association as registered were not in accordance with the intention of the three brothers who were the only signatories of the memorandum and articles of association, and down to the date of Frank Stanley Scott's death the only shareholders therein. Bennett J, however, held that the court has no jurisdiction to rectify articles of association of a company, although they do not accord with what is proven to have been the concurrent intention of all the signatories therein at the moment of signature. We are in complete agreement with this decision. It seems to us that there is no room in the case of a company incorporated under the appropriate statute or statutes for the application to either the memorandum[15] or articles of association of the principles upon which a court of equity permits rectification of documents whether inter partes or not …

The articles cannot be supplemented by additional terms implied from extrinsic circumstances.

[4.02] Bratton Seymour Service Co Ltd v Oxborough [1992] BCLC 693 (Court of Appeal)

The company was set up to manage the commercial aspects of a development consisting of a number of flats, the shares being held by the flat owners. The question for the court **(p. 183)** was whether it was possible to imply into the company's articles a term that the members should make contributions for the upkeep of the garden, swimming pool and other communal amenity areas of the development. The Court of Appeal held that no such term could be implied.

> STEYN LJ: … Section 14(1) of the Companies Act 1985 [now see CA 2006 s 33] provides that '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'. By virtue of s 14 the articles of association become, upon registration, a contract between a company and members. It is, however, a statutory contract of a special nature with its own distinctive features. It derives its binding force not from a bargain struck between parties but from the terms of the statute. It is binding only insofar as it affects the rights and obligations between the company and the members acting in their capacity as members. If it contains provisions conferring rights and obligations on outsiders, then those provisions do not bite as part of the contract between the company and the members, even if the outsider is coincidentally a member. Similarly,

if the provisions are not truly referable to the rights and obligations of members as such it does not operate as a contract. Moreover, the contract can be altered by a special resolution without the consent of all the contracting parties. It is also, unlike an ordinary contract, not defeasible on the grounds of misrepresentation, common law mistake, mistake in equity, undue influence or duress. Moreover … it cannot be rectified on the grounds of mistake.

Turning now to the present case, the question is whether the implied term of requiring members to contribute to maintenance of the amenities can be implied not on the basis of any language to be found in the articles, but on the basis of extrinsic circumstances. The question is, is it notionally ever possible to imply a term in such circumstances? I will readily accept that the law should not adopt a black-letter approach. It is possible to imply a term purely from the language of the document itself: a purely constructional implication is not precluded. But it is quite another matter to seek to imply a term into articles of association from extrinsic circumstances.

Here, the company puts forward an implication to be derived not from the language of the articles of association but purely from extrinsic circumstances. That, in my judgment, is a type of implication which, as a matter of law, can never succeed in the case of articles of association. After all, if it were permitted, it would involve the position that the different implications would notionally be possible between the company and different subscribers. Just as the company or an individual member cannot seek to defeat the statutory contract by reason of special circumstances such as misrepresentation, mistake, undue influence and duress and is furthermore not permitted to seek a rectification, neither the company nor any member can seek to add to or to subtract from the terms of the articles by way of implying a term derived from extrinsic surrounding circumstances. If it were permitted in this case, it would be equally permissible over the spectrum of company law cases. The consequence would be prejudicial to third parties, namely potential shareholders who are entitled to look to and rely on the articles of association as registered. Despite Mr Asprey's lucid and incisive argument, I take the view that on this ground alone the implication cannot succeed.

DILLON LJ and SIR CHRISTOPHER SLADE delivered concurring judgments.

➢ Notes

1. When determining the meaning of an amendment of the articles of association, the courts will not consider the effect which the alteration was intended to have, or circumstances in which the alteration was made, but the court will however add words to avoid absurdity, or imply a term which is strictly necessary proceeding from the express words of the articles viewed objectively in their commercial setting. The next case is an illustration.

2. In *Coroin Ltd, Re* [2011] EWHC 3466 (Ch), the court was prepared to admit some extrinsic background for the purpose of construing the articles in question. David Richards J **(p. 184)** held that it would be 'somewhat artificial to construe the articles in isolation from the shareholders' agreement (see 'Shareholders' agreement', pp 244ff) and from the background admissible to the construction of that agreement. Nor would it conflict with the reasons for the usual exclusionary rule to take account of the shareholders agreement and its background' [69]. Key to this approach were the facts that the articles were adopted pursuant to the shareholders' agreement; both documents were negotiated by and were intended to govern relations between the initial investors as members of the company; and the agreement was clearly intended to bind all present *and future* shareholders of the company (although the judge held it unnecessary to reach a final conclusion on this last point for the purpose of determining the issues in dispute).

'Implied terms' in the articles.

[4.03] Equitable Life Assurance Society v Hyman [2002] 1 AC 408 (House of Lords)