SCOPE, AMBIT AND CONTRACTUAL OBLIGATIONS OF A COMPANY'S CONSTITUTION

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INTRODUCTION

The incorporation of a company under the Companies Act 2016 creates a separate legal entity on the company, distinct from its members or directors of company. The governing rules between members and the company are spelt out in the constitution of a company under the CA 2016 regime and in the Articles of Association of a company under the Companies Act 1965 which has since been repealed.

THE CONSTITUTION

The Companies Act 2016 (CA 2016) came into force on 31 January 2017. Under the CA 2016, the Memorandum and Articles of Association of a company incorporated under the Companies Act 1965 (CA 1965) will form its constitution as clearly provided by Section 34(c) of CA 2016:

Section 34 provides:

'34. Form of constitution

The constitution of a company:

(c) in the case of a company registered under the corresponding previous written law, is the memorandum and articles of association as originally registered or as altered in accordance with the corresponding previous written law,

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and includes any alteration or amendment made under sections 36 or 37, if any, as the case may be.'

Whilst the Memorandum of Association states the objectives and structure of the company, setting up the parameters of its business activities, the Articles of Association on the other hand regulates the conduct of the members' affairs, whether it be amongst themselves or with the company.

Section 33 of CA 2016 lays down the legal effects of the constitution by providing that the constitution, once adopted, would be binding upon the company and its members.

Section 33 provides:

'33. Effect of constitution

1. The constitution shall, when adopted, bind the company and the members to the same extent as if the constitution had been signed and sealed by each member and contained covenants on the part of each member to observe all the provisions of the constitution.
2. All moneys payable by any member to the company under the constitution shall be a debt due from such member to the company.'

Contractual Relationship Conferred upon by the Constitution

The notional signing and sealing of the constitution create a contractual relationship between the company and the members. However, it does not extend to, nor govern, professionals dealing with the company such as auditors, lawyers or consultants.

In *Eley* v *Positive Government Security Life Assurance Co Ltd.*,[1] the plaintiff, being a solicitor who drafted the articles of association of the defendant company had purportedly incorporated the mandatory engagement of his services in the said articles of association.

Article 118 of the articles of association in question provided:

'Mr William Eley, of No 27, New Broad Street, in the city of London, shall be the solicitor to the company, and shall transact all the legal business of the company, including

1 (1876) 1 Ex D 88.

> Parliamentary business, for the usual and accustomed fees and charges, and shall not be removed from his office except for misconduct.'

The company acted on the article for some years but subsequently chose to cease their engagement of the plaintiff's services. The plaintiff sued the company for breach of the article, and for its enforcement as a contract. The court of first instance held that the articles of association did not create any contract between the plaintiff and the company, following which the plaintiff then appealed to the Court of Appeal.

The Court of Appeal affirmed the decision and equally held that the substratum of the Articles of Association only binds the members. It has no application to non-members. The said articles of association did not create any contract between the solicitor and the company. Article 118 was invalid to begin with as there can be no contractual rights conferred to persons other than the shareholders.

Lord Cairns LC, with whom Lord Coleridge CJ and Mellish LJ concurred, held at p 90:

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

The Court of Appeal's decision in *Eley* emphasised the trite proposition of law that the constitution confers rights only on members. It is trite principle that no article can form a contract between the company and a third party, such as a solicitor, director, auditor etc.

MEMBERS' RIGHTS

In *Hickman* v *Kent or Romney Marsh Sheep-Breeders' Association*,[2] a provision in the articles provided that disputes between the association and any of its members should be referred to arbitration. The plaintiff, Hickman, initiated an action complaining of various irregularities in the affairs of the association, including the refusal to register his sheep in its published flock book and he sought an injunction to restrain the company from expelling him. In response, the defendant company countered with proceedings to stay the plaintiff's action and to refer the dispute to arbitration in accordance with its articles of association. The court held that the articles as a contract compelled Hickman to take the matter to arbitration.

The Chancery Division further emphasised that the contractual rights within the articles of association is jealously guarded for members exclusively and such rights do not extend to non-members, even if such non- members become members subsequently.

Astbury J held at p 897 and 900, 897 and 900 respectively:

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

A Member's Right to Enforcement of the Articles

A member that wishes to enforce a right in the Articles of Association must demonstrate that the enforcement of a right which is common to

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2 [1915] 1 Ch 881.

himself and all other members. It would not be applied in a dispute between the company and the appellant in the capacity as a director.

In *Beattie* v *E & F Beattie Ltd.*,[3] the English Court of Appeal held that the articles of association bind members of a company in their capacity as members. In this case, the individual being a member and also the director attempted to enforce the arbitration clause contained in the articles of association, when he was sued by the company for the return of certain sums of money which was alleged had been improperly paid to him. The Court of Appeal ruled that since he was being sued in his capacity as a director and not that of a member, he could not rely on the argument that the Articles of Association had conferred the right to him.

CONTRACTUAL RIGHTS OF MEMBERS

The Articles of Association constitute a contract between the members and the company which is also enforceable as a contract among the members inter se.

In *Rayfield* v *Hands,*[4] the plaintiff being a member of Field Davis Ltd, sought to enforce Article 11 of the company's articles of association to compel the directors of the company to acquire his shares by claiming that Article 11 created a contractual relationship between the members of the company as vendor and the directors as purchasers.

Article 11 provided that:

> 'Every member who intends to transfer shares shall inform the directors who will take the said shares equally between them at fair value…'

The High Court held that the directors are bound by Article 11 as it governs the contractual rights between members. The article governs not the relationship of the members and the directors but the contractual relationship between members and such directors as members.

Vaise,y J. held at p 6:

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3 [1938] Ch 708.
4 [1960] Ch 1.

> "Now the question arises at the outset whether the terms of Article 11 relates to the rights and of members inter se, or whether the relationship is between a member as such and directors as such. I may dispose of this point very briefly by saying that, in my judgement, the relationship here is between the plaintiff as member and the defendants not as directors but as members."

In *Malayan Banking Ltd* v *Raffles Hotel Ltd*.,[5] the Federal Court of Singapore held that the Articles of Association does not in any circumstances constitute a contract between the company and non-members. The Court refused to allow *Malayan Banking Ltd* to enforce the provisions in the articles of association.

In this case, Raffles Hotel Ltd assigned the reversion of the lease on 'Raffles Hotel Singapore' to Malayan Banking Ltd. Raffles Hotel Ltd had a provision in its articles of association that the lessor may appoint a director of the company. Relying on this provision, Malayan Banking Ltd being a lessor of a property acted on its own directors' resolution unilaterally to be appointed as a director of Raffles Hotel Ltd, relying on Article 77 of the plaintiff's articles of association which empowers the lessor to appoint a director of the plaintiff's company.

The High Court held that Article 77 of the Articles of Association did not confer any contractual rights on Malayan Banking Ltd to appoint itself as a director of Raffles Hotel Ltd. As Malayan Banking Ltd was not a shareholder of Raffles Hotel Ltd, the lessor is an outsider with no legal standing to enforce the article as it strictly only applies to the relationship between the members and the company. This was upheld by the Federal Court.

JWD Ambrose, J. in his leading remarks in the Federal Court's decision opined at p 165:

> "it is, however, suggested that Article 77 constitutes an offer capable of acceptance and that nothing beyond mere nomination of a director is required by the article. I am unable to accede to this suggestion. It is further suggested that as the defendant company is in the position of a defendant and not of a plaintiff it can rely on Article 77 without depending on a contractual right. I am unable to accept this suggestion for the

5 [1965 – 1967] SLR(R) 161.

> reason that the defendant company cannot, even as a defendant, take advantage of the power purporting to be given by Article 77 without having recourse to some contract between the defendant company and the plaintiff company conferring on the former a right to appoint a director of the latter."

The Federal Court concluded that the reliance on Article 77 for the appointment of Malayan Banking Ltd as a director of the company was invalid and flawed with no legal effect.

The Federal Court laid down the prerequisites that for any outsider to rely on the articles of association, firstly, there must be a contractual right which must first be conferred to the outsider by reference to the said article in the articles of association, which would then allow the outsider to enforce such a contractual right.

Ambrose J reiterated the proposition of law firmly at p 166:

> "For the above reasons I come to the conclusion that Article 77 of the plaintiff's articles of association is not binding on the plaintiff company as between the plaintiff company and an outsider; that without having recourse to a contractual right the defendant company, being an outsider, cannot take advantage of a power purporting to be given by Article 77; and that the defendant company's appointment of itself as a director of the plaintiff company in exercise of the power purporting to be given to it by Article 77 is invalid, that is, has no legal effect. In the result, I would dismiss this appeal with costs."

THE MALAYSIAN APPLICATION

In *Perdana Petroleum Berhad* v *Tengku Dato' Ibrahim Petra & 3 Ors*[6], the four individuals were previous directors of the plaintiff company who attempted to seek recourse from the company for legal cost incurred in defending lawsuits commenced against the directors by the company on various allegations of breach of directors' duties. The

6 [2022] 1 AMR 136.

plaintiffs relied on Article 170 of the of the company's Articles of Association, which provided as such:

> '170. Indemnity Every director, managing director, agent, auditor, secretary, and other officer for the time being of the company shall be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgement is given in his favour or in which he is acquitted or in connection with any application under the Act in which relief is granted to him by the court in respect of any negligence, default breach of duty or breach of trust.'

The Court of Appeal held that the articles of association related to the rights of members inter se which constitutes a contract between the members and the company and among the members inter se. The articles of association are not terms in a contract between a company and a third party whether it be the directors or otherwise.

Darryl Goon JCA opined at p 159:

> "In our view, without more, the articles of association do not become terms in a contract between a company and third party (i.e. person or persons other than its members qua members), whether it be officers of the company or otherwise."

Likewise, the High Court in *John & Ors* v *PriceWaterhouse (a firm) & Anor*[7] reiterated the well-established strict principle of law that the articles of association only bind the company and its members inter se and not third parties including the auditors.

Ferris J opined at p 960:

> "The articles of association of a company constitute a contract between the members of the company *inter se* and between each of them and the company but they do not, without more, constitute a contract between the company and its directors or auditors."

In *Globalink Telecommunications Ltd* v *Wilmbury Ltd & Ors.*,[8] the third defendant Mr Hall, a director of a company, sought an indemnity against the company in respect of his liability for his own

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7 [2002] 1 WLR 953.

8 **[**2003] 1 BCLC 145.

costs which were incurred in an action against him that was struck out upon his application. The indemnity sought was based on Article 18 of the company's articles of association which provided that:

> a, "director ... shall be indemnified out of the assets of the company against all losses or liabilities which he may sustain or incur in or about execution of the duties of his office or otherwise in relation thereto, including any liability incurred by him defending any proceedings ... in which judgment is given in his favour ...".

Stanley Burton J then stated as follows at p 154:

"The articles of association of a company are as a result of statute a contract between the members of a company and the company in relation to their membership. The articles are not automatically binding as between a company and its officers as such. In so far as the articles are applicable to the relationship between a company and its officers, the articles may be expressly or impliedly incorporated in the contract between the company and a director. They will be so incorporated if the director accepts appointment "on the footing of the Articles," and relatively little may be required to incorporate the articles by implication."

Similarly, in *Perdana Petroleum Berhad*, the Court of Appeal noted that the said Article 170 was not incorporated into the contract of appointment of the directors. The directors have failed to present any binding contract incorporating the article on which basis they rely upon to claim indemnity from the company.

Daryl Goon JCA insightfully remarked at pp 165-166 as follows:

> "The question that arises in the current case is therefore, was article 170 incorporated, either expressly or impliedly, as a term in the respondents' appointment as directors of the appellant?

The Respondents and Article 170

It is significant in this case that nothing pertaining to the circumstances of the respondents' appointment as directors of the appellant was alluded to or given in evidence.

There was no mention made in the evidence of the respondents of their appointment as directors, no evidence as to whether there was any written or oral contract of appointment or employment, no evidence whether their appointments were in writing or evidenced in writing. There was also no evidence led on record as to whether the respondents were all shareholders of the appellant.

In short there was no reliance on any contractual basis, or how article 170 might have been incorporated as a term of any such contract in the respondents' attempt to enforce article 170, save for the fact of its existence, and that they were former directors of the appellant.

The affidavits filed in respect of the respondents' application were focused only on the indemnities claimed and the suits in respect of which the indemnities were sought."

The Court of Appeal concluded that these directors could not enforce the provision in the Articles of Association as there was no contractual basis for such enforcement without a binding contract between the directors and the company incorporating the article.

In *Perdana Petroleum Berhad*, the Court of Appeal held that the legal status of the Articles of Association of a company be it under the purview of CA 2016 or CA 1965, remains the same – the articles of association is a contract between members inter se, and that between the members and the company.

THE ROLE OF THE COMPANY SECRETARY

The presumption and misconception that the directors as officers of the company could rely on the articles in the Articles of Association to enforce its provisions has now been clarified in the Court of Appeal's decision of *Perdana Petroleum Berhad*. Directors in Malaysia have more reason to look for other means to ensure that they are sufficiently protected from pitfalls and liabilities since merely having indemnity provisions in a company's constitution does not suffice.

As the company secretary is the officer ensuring that the company is compliant with statutory and regulatory requirements, the company secretary has to be well aware of the effects of a company's constitution on the relationships it governs. The articles in the Articles of Association concerning the directors' rights and benefits have to be

incorporated into the contract of employment or the appointment letter of the director as the mere appointment of a director does not allow him to enforce the articles against the company he owes such duties to. This is especially so when the courts have deemed it little to no effort to incorporate the articles into a contract of employment as enunciated in the Court of Appeal in *Perdana Petroleum Berhad* at p 159:

> "In our view, without more, the articles of association do not become terms in a contract between a company and a third party (i.e. person or persons other than its members qua members), whether it be officers of the company or otherwise. However, the articles may be incorporated into such contracts, expressly or impliedly. It is also the case that courts take the view that comparatively little is required for the incorporation of a term in the article that provides indemnity to an auditor or director who is appointed. However, it remains necessary that there be an incorporation of the particular article in question."

The company secretary is a key advisor of the company and the role's importance and significance in navigating compliance in a challenging business environment has been acknowledged by the Ministry of Finance, thus allowing specified tax deduction of company secretary fees of RM5,000 which has taken effect in 2015 [PU(A) 336/2014] but later diluted to the new aggregate tax deduction of company secretary and tax fees to RM15,000 in 2020 [PU(A) 162/2020].

CONCLUSION

Whilst it may be understandable for directors, or any other officer of a company, to presume that the provisions of the constitution of a company and its ensuing protection and indemnities, would extend to them, the Malaysian position at law echoes those of other jurisdictions have asserted otherwise. Directors and such other officers of the company would be well advised to incorporate indemnification terms into their contracts of employment with the company or to set out such terms clearly in a separate contract in order to avoid ambiguity when conflict arises.