STATUTORY CONTRACT IN SINGAPORE: IS THERE A QUA MEMBER REQUIREMENT?

Teo Choon Mong Frank v Wilh Schulz Gmbh & Anor[1]

Introduction

Suppose an article of association of a company provides that a member is entitled to nominate a director. The other members or the company refuses to allow him to exercise that right. Can he enforce the provision in the article entitling him to nominate a director? In this article the writer seeks to answer this question. In doing so, one needs to examine the scope of section 39 of the Singapore Companies Act[2] (hereinafter referred to as "the Act") which is in pari materia with section 20 of the English Companies Act 1948. Section 39 of the Act makes the memorandum and articles of association of the company binding between the company and the members, and between members and members.

In the case of *Teo Choon Mong* v *Wilh Schulz Gmbh & Anor*[3] the Singapore Court of Appeal considered the terms of the shareholder agreement and articles of association, both of which were, in the court's view, of vital importance in the case. The court had a great opportunity to consider the issue of whether there is a qua member requirement before one can enforce a statutory contract under section 39 of the Act. To put in another way: Does the section give the memorandum and articles of association contractual effect only in so far as they confer rights or obligations on the member in his capacity of member?

Facts

The appellant entered into a joint venture with the respondents to set up a manufacturing plant in Malaysia through the vehicle of a company, Forgetech Sdn Bhd (Forgetech). By a shareholder agreement dated 24 January 1994, the parties agreed, inter alia, that they were each entitled to nominate a director to the board of Forgetech and this included the right to remove that director and nominate another in his stead. Accordingly, Wolfgang Schulz representing the first respondent, Volker Johnen representing the second respondent and the appellant were appointed as directors of Forgetech. The appellant was also appointed managing director of Forgetech for a period of five years commencing 1 January 1996.

1 [1998] 2 SLR 529
2 (Cap 50) 1994 Ed.
3 See n 1 above

The relationship between the appellant and the respondents turned sour and on 20 January 1997 the respondents sought to take over control of the plant and terminate the appellant's position as managing director. The appellant commenced an action against the respondents in the High Court of Sabah and Sarawak at Kuching and obtained ex parte an interim injunction restraining the respondents from doing so. This injunction was suspended and during this period of suspension the respondents proceeded to call an extraordinary meeting to remove the appellant from his office as a director of Forgetech. The appellant thereupon commenced an action in the High Court in Singapore and applied for an injunction to restrain the respondents' proposed action until trial. The High Court dismissed the application and the appellant appealed to the Court of Appeal.

The Decision

LP Thean JA, in allowing the appeal held that it was clear from the shareholder agreement and the relevant articles of association that each party to the joint venture was entitled to nominate one director and to remove him and nominate another in his stead. It followed that the right to remove the appellant as director vested in him alone. It would have gone against the express wording of the articles of association and the shareholder agreement to allow the respondents to remove the appellant as a director of Forgetech. By removing the appellant as director when they were not entitled to do so, the respondents have repudiated the relationship established by the shareholder agreement and the articles of association. The respondents should have been restrained from removing the appellant as a director of Forgetech.

Comments

It is interesting to note that the court held that based on the articles of association that incorporated the terms of the shareholder agreement the member was entitled to nominate a director. Does this mean that for a member to enforce a statutory contract under section 39 of the Act there is no qua member requirement? Before we proceed further with our discussion, the writer would like to point out that the discussion on the issue of whether there is a qua member requirement under Section 39 of the Act is equally relevant and applicable to the scenario of a statutory contract between a member and the company on the one hand and that of a situation of a statutory contract between members themselves.[4]

4 see *London Sack & Bag Co* v *Dixon & Lugton* [1943] 2 All E.R.763

Section 39 of the Act provides that:

> "... 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."

It is unfortunate that the court did not deal with this controversial issue. Some help may be sought from England as Section 39 of the Act is in pari materia with Section 20 of the English Companies Act 1948. In the United Kingdom there is much debate on this issue and much has been written on it. Professor Gower's[5] earlier proposition was that:

> "the memorandum and articles have no direct contractual effect in so far as they purport to confer rights or obligations on a member otherwise than in his capacity of a member."

Cases cited to support this proposition include *Rayfield* v *Hands*[6], *Hickman* v *Kent*[7] and *Beattie* v *E and F Beattie Ltd*[8]

However in a later edition of his book[9] a different view was taken when it was stated:

> "Furthermore, there is obvious sense in restricting the ambit of the section to matters concerning the affairs of the company. But there is no obvious justification in the statutory wording for still further restricting it to matters concerning a member in his capacity of member ... What does matter is that it apparently prevents a member who is also a director or other officer of the company from enforcing any rights purporting to be conferred by the articles on directors or officers."

In *Rayfield* v *Hands*[10] the company's articles provided that a member who wished to transfer shares had to inform the directors who were to take the shares equally between themselves at a fair value. Rayfield wanted to transfer his shares. He brought an action to compel the defendant directors (who were also members) to purchase the shares in accordance with the articles. Vaissey J held that there was a contract between Rayfield and the defendant directors (in their capacity as members) constituted by the article, and ordered that the defendant directors purchase Rayfield's shares in accordance with the articles.

5 in L.C.B. Gower's *Principles of Modern Company Law*, 2nd Ed,1957 at p 252
6 [1960] Ch 1
7 [1915] 1 Ch 881
8 [1938] ICh 708
9 see 5th Ed, 1992 at p 284
10 see n 6 above

In *Hickman* v *Kent*[11] the articles provided for reference of disputes between members and the company to arbitration. The plaintiff brought an action against the company in connection with his expulsion from the company. Astbury J held that the company was entitled to have the action stayed because the articles amounted to a contract between the company and the member and referred such matters to arbitration.

In *Beattie* v *Beattie*[12] *there* was a dispute between a director and his company. The director sought to have the dispute referred to arbitration under one of the articles. The Court of Appeal, following *Hickman* v *Kent*[13] regarded this as a dispute qua director not member and refused to refer the dispute to arbitration. Professor Wedderburn has suggested that in this case, since the director was also a member it fell within the articles and his right as a member to have the company's business conducted in accordance with the articles. Professor Wedderburn's assertion was that:

> "A member can compel the company not to depart from the contract with him under the articles even if that means indirectly the enforcement of 'outsider' rights vested in either third parties or himself, so long as but only so long as he sues qua member and not qua outsider."[14]

Professor Wedderburn used the case of Quin *& Axtens Ltd* v *Salmon*[15] to support his proposition. He pointed out that in that case the court allowed a managing director, suing as a member, to obtain an injunction restraining the company from completing transactions entered into in breach of the company's articles. The articles provided that the consent of the two managing directors was required in relation to such transactions. This in effect showed that a member had a personal right to require the company to act in accordance with its articles, which right could be enforced by the member even though the result was indirectly to protect a right which was afforded to him in some other capacity. If this is correct, the supposed principle that there is a statutory contract between the company and its members only in respect of matters affecting members qua members is effectively outflanked.

11 see n 7 above
12 see n 8 above
13 see n 7 above
14 [1957] CLJ 194, 212
15 [1909] 1 Ch 311

Mr. Goldberg took a middle view, that is, a formula that was not so narrow as Professor Gower's original proposition or as wide as Professor Wedderburn's. His view is as follows:

> "A member of a company has under section 20(1) of the English Companies Act 1948 (now section 14 of the 1985 English Companies Act) a contractual right to have any of the affairs of the company conducted by the particular organ of the company specified in the Act or the company's memorandum or articles, even though the enforcement of that right (and the correlative obligation) may incidentally enforce also a right or a power bestowed by the memorandum or articles on a person in a capacity otherwise than as a member of the company, be that person in fact a member or not; but a member has no right under the subsection to have enforced a right or power bestowed by the memorandum or articles on a person otherwise than in his capacity as a member, whether or not that person is in fact a member, unless the enforcement of that latter right or power is incidental to the enforcement of the members' contractual right under the said subsection to have any of the company's affairs conducted by the particular organ of the company specified in the Act or in the memorandum or articles."[16]

He argued that his view would produce a conclusion desirable on policy grounds and would not conflict with the decision in *Beattie* v *Beattie*.[17]

A refinement of this was put forward by Professor G N Prentice.[18] He argued that:

(1) It is misleading solely to ask whether a member sues qua member or qua outsider;

(2) It is not enough to shift the emphasis on to the organ of the company concerned;

(3) It is necessary to go one stage further and ask whether the provision in question affects the power of the company to function in the circumstances in question and it is only where there is some interference with the power of the company to function that a member will have a remedy.

It can be said that Professor Prentice's view is similar to Mr. Goldberg's view.

16 (1972) 35 MLR 362
17 see n 8 above
18 (1980) 1 Co Law 179

Mr. Roger Gregory strongly supports Professor Wedderburn's literal view when he says:

> "There is simply too much authority against the possibility that "outsider"-right articles are incapable of enforcement. Even if we may, on occasion, be compelled to accept that Parliament does not mean what it says, how can we, in the face of clear wording, adopt a novel canon of statutory interpretation that the statute does not mean what it says?"[19]

It is submitted that in England there are basically two opposing views; one view where restrictions are to be read into the section and the other which is the literal view. It can be seen that there are many cases in England that have decided differently on the issue. Each writer can thus always find sufficient authority to support his view, sometimes by reading more into some of the judgments than the judges themselves said. Unless one is able to review and reconcile all the relevant authorities, an insurmountable task, the debate can carry on indefinitely.

What is the position in Singapore? There are no cases in Singapore directly on this point. Should we get ourselves embroiled in this debate? The answer is no. Fortunately the irreconcilable or inconsistent English decisions or debate does not bind us. And as Professor L.S. Sealy said that the English equivalent of Section 39 of the Act "was enacted to cover a gap which was thought to have been created when the memorandum and articles replaced the deed of settlement in 1856; neither it nor all the subsequent theorising has any relevance to the present-day world. Our legislators should go back to the drawing-board."[20]

It is submitted that the Singapore courts are free to decide according to common sense and the clear words of the section whether there is a qua member requirement under section 39 of the Act. It is submitted that we should adopt the literal interpretation of the clear words of the section which is the view taken by Professor Wedderburn. Section 39 of the Act expressly says "all the provisions ... of the articles." By placing restrictions or limitations on the scope of section 39 of the Act and saying that "outsider "-rights in the articles are beyond the scope of section 39 of the Act one is saying that "all" in section 39 of the Act does not mean "all" or to put in another way it might mean "not all". By adopting such

19 (1981) 44 MLR 526 at p540

20 in his book entitled, "Cases and Materials in Company Law," (3rd Ed, Butterworths, 1985) at p 132

an approach one is going against a basic rule of statutory interpretation that where words are clear and unambiguous, one must give effect to it. Further Section 39 of the Act itself makes no distinction between rights conferred upon a member qua member and rights conferred in some other capacity. Hence Section 39 of the Act should be read literally; it applies to all the provisions of the articles, whether they may relate to qua members or not.

It is unfortunate that this controversial issue was not discussed in the case. One could take a narrow view of the facts of the case and say that the qua member requirement was satisfied as all the shareholders of the company were each entitled to appoint a director to the board. On the other hand one could take a broader view and say that the case stands for the proposition that there is no qua member requirement in section 39 of the Act.

It is interesting to note that the House of Lords in the case of *O'Neill & Another* v *Phillips & Others* (delivered on 20 May 1999) dealt with the meaning of the phrase "interests of its members" as provided in section 459(1) of the English Companies Act 1985. It is to be noted that though the qua member requirement has been often equated with the phrase "interests of its members", the latter phrase is wider than the qua member requirement. Section 459(1) is similar but not in pari materia to section 216 of the Act. Section 459(1) allows a member to petition for a winding up order "on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the **interests of its members**...". Lord Hoffman stated that Nourse LJ in the Court of Appeal took a broad view of the phrase 'interests of a member'. They were not necessarily limited to his strict legal rights. So, for example, a member who had subscribed for shares on the understanding that he would take part in the management of the company might have an interest as member in his continuing participation, though this was not a right attached to his shares under the articles of the company. Lord Hoffmann said obiter that the requirement that prejudice must be suffered as a member should not be too narrowly or technically construed.

It can be seen from the Court of Appeal and House of Lords in the case of *O'Neill & Another* v *Phillips & Others* that even where there is a requirement of "interests of its members", one is to take a broad view of it. Hence it is submitted that where the express words "qua member" are not there one should not read in such words.

Conclusion

It can be seen that there are basically two views of interpreting Section 39 of the Act; one where restrictions are to be placed into the section and the other is the literal view. A literal interpretation of Section 39 of the Act is to be preferred. To enforce a statutory contract under Section

39 of the Act one would need only to be a member and need not show that the right involved membership rights or the organ of the company. Hence the answer to the question put at the beginning of this article is in the affirmative. Under Section 39 of the Act, the member can enforce the provision in the article of association entitling him to nominate a director.

LEOW CHYE SIAN*

* LL.M (Cambridge), LL.B (Hons) Sing. Assoc Prof, Nanyang Business School, Nanyang Technological University, Singapore.