
LESSON 4

CONTENTS

- 1 Read the Study Text below
- 2 Attempt Reinforcing Questions at the end of the Study Text.
- 3 Check your answers with those given in Lesson 9

STUDY TEXT

COMPANY MANAGEMENT

4.1 Introduction

A company, being an artificial person, cannot manage its own affairs. It is therefore not surprising to find that the articles of every registered company have provisions regarding the delegation of powers pertaining to the company's management. For example, Table A, Article 80 provides that "the business of the company shall be managed by the directors".

4.2 Numbers of Directors

S.177 provides that every company (other than a private company) shall have at least two directors, and every private company shall have at least one director. Under Table A, Article 75 the actual number of the directors would initially be decided upon by the subscribers of the memorandum, or a majority of them, and until so determined the signatories to the memorandum of association shall be the first directors. Table A, Article 94 empowers the company from time to time by ordinary resolution to increase or reduce the number of its directors.

4.3 Appointment of Directors

In the absence of other provisions in a company's articles, the directors of the company would be appointed in accordance with the following provisions of Table A.

4.3.1 First Directors

The names of the first directors shall be decided in writing by the subscribers of the memorandum of association or a majority of them. If there is a deadlock, all the signatories to the memorandum of association shall be the company's first directors.

4.3.2 Subsequent Directors

The subsequent directors are appointed by the members in general meeting beginning from the first annual general meeting at which all the first directors retire from office and the members are given the first opportunity to elect directors of their own choice. The retiring directors are however eligible for election under Article 89. At the second annual general meeting one-third of the directors are to retire from office, the ones to retire being the ones who have been longest in office since their last election. As between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot. One-third of the board shall thereafter retire annually.

4.3.3 Casual Appointments

Article 95 permits the board of directors to fill a vacancy in the board or to get an additional director to join the board for practical reasons provided that the appointment does not cause the number of directors to exceed the limit imposed by the articles. The person appointed director in this way shall hold office until the next annual general meeting. He will then be eligible for re-election, but his appointment will not be taken into account when deciding on the directors who shall retire from office.

4.4 Restrictions on Appointment

The following are the restrictions which the Act imposes on appointment of directors:

1. S.182(1): Appointment by the Articles

S.182(1) provides that a person shall not be capable of being appointed director of a company by the articles unless, before the registration of the articles, he has by himself or by his agent authorized in writing –

- i. signed and delivered to the registrar for registration a consent in writing to act as such director; and
- ii. either –
 - a) signed the memorandum for a number of shares not less than his qualification, if any; or
 - b) taken and paid or agreed to pay for his qualification shares, if any; or
 - c) signed or made and delivered to the registrar for registration an undertaking to take and pay for his qualification shares, if any, or the statutory declaration that a number of shares not less than his qualification, if any, are registered in his name.

2. S.183: Qualification Shares

S.183(1) provides that it shall be the duty of every director who is by the articles of the company required to hold a specified qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or within the shorter time (if any) fixed by the articles.

Subsection (3) further provides that if the director fails to obtain his share qualification, or ceases to hold the required number of shares, he shall vacate his office. If he does not actually do so but continues to act as director he becomes a de facto director : Rv Ivan Arthur Camps (67).

3. S.186 : Age Limit

S.186 provides that no person shall be capable of being appointed a director of a public company or a private company which is a subsidiary of a public company if at the time of his appointment –

- (a) he has not attained the age of twenty-one; or
- (b) he has attained the age of seventy.

This provision does not apply if:

- (a) The company's articles provide otherwise; or
- (b) "Special notice" of the resolution to appoint the director was given to the company.

The company must also have given notice of it (i.e. the special notice) to its members and stated the age of the proposed director.

S.142 defines "special notice" as a notice given to the company not less than twenty eight days, before the meeting at which the relevant resolution is to be moved.

4. S.188 : Undischarged Bankrupts

S.188 provides that if an undischarged bankrupt acts as director of any company without leave of the court he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding Shs.10,000/=, or both.

5. S.189 : Fraudulent Persons

S.189(1) empowers the court to make an order restraining a person from being appointed, or acting, as a company's director for a period not exceeding five years if –

- i. The person is convicted of any offence in connection with the promotion, formation or management of a company; or
- ii. In the course of a winding up, it appears that the person has been guilty of fraudulent trading (under s.323) or has otherwise been guilty, while an officer of the company, of any fraud or breach of duty to the company.

6. S.184 : Individual Voting

S.184(1) provides that appointment of directors is to be voted on individually unless a motion for the appointment of two or more persons as directors by a single resolution was agreed upon by the meeting without any vote being given against it.

A resolution moved in contravention of this provision is void {s.184(2)}.

4.5 Defects in Appointment

S.181 provides that a director's acts shall be valid despite any defect that may afterwards be discovered in his appointment or qualification. This provision applies to technical defects in appointment or qualification, such as a failure to obtain the director's share qualification within the prescribed time. An example is Rv Camps (67).

4.6 Disqualification of Directors

Table A, Article 88 provides, under the heading "disqualification of directors", that the office of director shall be vacated if the director –

- (a) ceases to be a director by virtue of s.183 (ie. failure to obtain a share qualification) or s.186 (ie. age limit); or
- (b) becomes bankrupt or makes any arrangement or composition with his creditors generally; or
- (c) becomes prohibited from being a director by reason of any order made under s.189 of the Act; or
- (d) becomes of unsound mind; or
- (e) resigns his office by notice in writing to the company; or
- (f) shall for more than six months have been absent without permission of the directors from meetings of the directors held during that period.

Regarding clause (e) above, it was held in Latchford Premier Cinema Co. V Ennion that a verbal notice of resignation which is given to, and is accepted by, the general meeting is effective and cannot be withdrawn. This is so because the general meeting would be deemed to have amended the company's articles by deleting the words "in writing". By implication, a purported oral notice of resignation which is given to, and purportedly accepted by, the board of directors would be invalid since the directors cannot legally alter the company's articles of association.

Regarding clause (f) , it should be noted that it does not say that the director in question shall vacate office if he "absents himself". Such a provision would have disqualified the director only if the absence in question was voluntary, as in cases where he was ill and could not attend the board meetings. On the other hand, the office would be vacated if the director was absent because his doctor had advised him to go abroad on medical grounds: McConnel's Claim.

4.7 Vacation of Office

In addition to vacating office under the aforesaid provisions of Article 88 a person may cease to be a director for various reasons, such as –

- (a) death; or
- (b) retirement by rotation under the articles; or
- (c) court order restraining him from acting as director; or
- (d) dissolution of the company.

4.8 Removal of Directors

By s.185(1) a company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in the articles or in any agreement between him and the company. Special notice must be given of any resolution to remove the director, or to appoint another director in his place.

On receipt of the special notice the company must send a copy to the director concerned who is entitled, if he so wishes, to make written representations (not exceeding a reasonable length) to the company. If the director so requests, the company must send the representations to the members with notice of the meeting unless the representations are received by it too late for it

to do so. In such a case the representations would be read out at the meeting at which the director would also be entitled to be heard. The representations need not be sent out by the company or read out at the general meeting if, on the application, either of the company or of any other person who claims to be aggrieved, the court is satisfied that they have been made in order to secure needless publicity for defamatory matter.

The removal will be effective if it is decided on by an ordinary resolution. In Bushell v Faith and Another (67) Harman, L J defined "an ordinary resolution" as "a resolution depending for its passing on a simple majority of votes validly cast in conformity with the articles".

4.9 Compensation for Removal

Subsection (6) provides that nothing in s.185 shall be taken as depriving a removed director of compensation or damages payable to him in respect of the termination of his appointment as director or of any appointment terminating with that as director. This provision which restates the common law rule, would enable a managing director to sue the company for damages for wrongful dismissal if the effect of his removal as director was to prematurely terminate his appointment as managing director, and was inconsistent with the contract. The director might also, if he is a member of the company, be entitled to an order for the winding up of the company by the court on the "just and equitable" ground: Ebrahimi v Westbourne Galleries Ltd.

4.10 Directors' Remuneration

For technical reasons the directors are not regarded as servants or employees of the company of which they are directors. They therefore have no right to be paid for their services unless there is a provision for payment in the articles. In the case of companies which have adopted Table A, Article 76 provides that "the remuneration of the directors shall from time to time be determined by the company in general meeting." In Re: Duomatic Ltd it was explained that a provision in the articles authorizing payment of directors' remuneration does not, per se, give the right to be paid any specific amount. There must also be a resolution passed by the company in general meeting authorizing the payment.

Provided the resolution has been passed, the remuneration is payable whether profits are earned or not: Re: Lundy Granite Co. Article 76 provides that "the remuneration shall be deemed to accrue from day to day". This means that a director who vacates office before completing a year or a month in office is entitled to a proportionate part of his yearly, or monthly salary: Moriarty v Regent's Garage Co.

S.190(1) provides that "it shall not be lawful for a company to pay a director remuneration (whether as a director or otherwise) free of income tax or surtax", except under a contract which was in force two years before the commencement of the Act on 1st January 1962 which provides expressly (and not by reference to the articles) for payment of tax-free payments. Any provision in the articles regarding tax-free payments "shall have effect as if it provided for payment, as a gross sum subject to income tax and surtax, of the net sum for which it actually provides".

4.11 Compensation for Loss of Office

- (a) Section 192 makes it unlawful for a company to make a director any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement, unless particulars of the proposed payment, including the amount, are disclosed to the members of the company and the proposal is approved by the company in general meeting. If the payment is not disclosed and approved, the director to whom it is paid shall be deemed to have received it in trust for the company. The directors who paid the money are liable to repay the money to the company : Re: Duomatic.
- (b) Section 193 makes it unlawful, in connection with the transfer of the whole or any part of

the undertaking or property of a company, for any payment to be made to any director of the company by way of compensation for loss of office or on retirement unless particulars are disclosed and approved. If such a payment is not disclosed the director holds it upon trust for the company.

- (c) Section 194 deals with the situation where the shares of the company are being transferred. It applies where the transfer results from—
- i. an offer made to the general body of shareholders;
 - ii. an offer made by another company with a view to the company becoming its subsidiary or a subsidiary of its holding company;
 - iii. an offer made by an individual with a view to his acquiring at least one-third of the voting power at any general meeting of the company; or
 - iv. any other offer which is conditional on acceptance to a given extent.

If a payment is made to a director as compensation for loss of office or on his retirement in any of the aforesaid circumstances, he must take reasonable steps to ensure that the particulars of the proposed payments are disclosed in the offer. If this is not done, the director holds the payment on trust for the persons who have sold their shares as a result of the offer.

Section 195(3) provides that references under sections 192, 193 and 194 to payments made to any director by way of compensation for loss of office do not include any bona fide payment by way of damages for breach of contract or by way of pension in respect of past services.

4.12 Loans to Directors

Section 191(1) renders unlawful any loan made by a company to a director of the company or its holding company. It is also unlawful for the company to guarantee a loan given to its director by any other person. These restrictions do not apply to—

- (a) a private company; or
- (b) a subsidiary whose director is its holding company; or
- (c) payments made to a director to meet expenses incurred or to be incurred by him for purposes of the company, or to enable him properly to perform his duties as an officer of the company; or
- (d) a loan given by a money lending company, such as a bank, in the ordinary course of its business.

4.13 Duties of Directors

The duties of directors are usually considered under two broad headings, namely—

- i. Duties of care and skill at common law, and
- ii. Fiduciary duties as enunciated by courts of equity.

1. Duties of Care and Skill

The directors' duties of care and skill have been formulated in a series of cases brought against directors in order to make them liable in negligence for the manner in which they

conducted the company's affairs. These duties were summarised by Romer, J. in RE CITY EQUITABLE FIRE INSURANCE CO LTD as follows:

- i. A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.

This rule prescribes a duty which is partly objective (the standard of the reasonable man) and partly subjective (the reasonably man is deemed to have the knowledge and experience of the particular director). It may also be expressed by saying that, if a foolish director makes foolish decisions resulting in loss to the company, he cannot be liable for negligence. It would be unreasonable to expect a foolish director to make wise decisions. However, if the director made very foolish decisions resulting in loss to the company, he will be liable in negligence since it is not reasonable to expect a foolish director to make very foolish decisions. On the other hand, a wise director will be liable if he makes unwise decisions, since it is unreasonable to expect him, a wise man, to make unwise or foolish decisions.

A directorship is not a professional job with a legally prescribed qualification. In the circumstances, anybody (even a six-months-old baby) can become a director. All that the law can expect him to do is to serve the company honestly and to the best of his ability. In RE: MARQUIS OF BUTE'S CASE the director became the director at the age of six months by inheriting the office from his father who had died.

- ii. A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so.

In RE MARQUIS OF BUTE'S CASE a director who had attended only one board meeting in thirty eight years was exonerated from liability for alleged negligence on the ground that "neglect or omission to attend meetings is not, in my opinion, the same thing as neglect or omission of a duty which ought to be performed at those meetings" (per Stirling, J.)

A company is, however, free to impose a duty on its directors to attend board meetings within a certain period of time and to prescribe the consequences of a breach of the duty. See, for example, Table A, Article 88(f).

- iii. In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

If a director is to be made liable, it can only be on the basis of his personal negligence, and it is not negligence to delegate some responsibilities to officials or employees of the company whose previous conduct has given no grounds for distrust or suspicion.

In DOVEY v CORY a director was held not liable for negligence merely because he had failed to verify false information regarding the company's accounts which he had been given by the company's manager and managing director. The court stated:

"Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as by those below them, until there is reason to distrust them. We agree that care and prudence do not involve distrust."

2. Fiduciary Duties

The fiduciary duties of directors arising from their fiduciary relation to the company have been the subject of consideration in an enormous body of case law but the ratio decidendi of the cases can be reduced to two fundamental propositions:

- (a) A director is not allowed to put himself in a position where his interest and duty conflict.

The application of this rule is illustrated by the following cases:

1. Aberdeen Rly Co v Blaikie Brothers (68). S.200(5) adopts this rule by providing that nothing in section 200(5) shall be taken to prejudice the operation of "any rule of law" restricting directors of a company from having any interest in contracts with the company".

S.200 requires a director who is in any way interested in a contract with the company to declare the nature of his interest at a board meeting. He must disclose the interest at the first board meeting at which the contract is to be discussed or, if he did not have an interest at that time, at the first board meeting after his interest arose. This provision is supplemented by Article 84 of Table A which provides that –

- i. The director shall not vote in respect of the contract. If he does vote, his vote shall not be counted; and
 - ii. The director shall not be counted in the quorum present at the meeting.
2. Industrial Development Consultants Ltd v Cooley (69) in which the director became personally interested in a contract he had been assigned to negotiate for the company.
 3. Cook v Deeks (70) in which some of the company's directors diverted to themselves a contract that was intended to be for the company. It was held that they had to surrender the benefit of the contract to the company. In law the benefit of the contract belonged to the company which the directors had formed for the purpose of obtaining the contract but in equity the contract belonged to the company for which it was intended.

In Bray v Ford Lord Herschell stated that the aforesaid rule is not "founded upon principles of morality" but is based on the consideration that human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty and thus prejudicing those whom he was bound to protect".

- (b) A director is not, unless otherwise expressly provided, entitled to make a profit: Boston Deep Sea Fishing Co v Ansell (71). This rule is essentially a restatement of the fundamental rule of the law of agency that an agent must not make a secret profit. The cases in company law are just examples of how a particular agent (the company director) committed a breach of his duties to a particular principal (the company).

In Percival v Wright (72) it was held that the directors owe their fiduciary duties to the company alone and not to the members. The decision raises a problem that has become known as "insider dealing".

4.14 Relief from Liability

Under s.402(1) the court has power in an action against an officer for breach of duty to grant relief where, although the officer is in breach, it appears that he has acted honestly and reasonably and, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust.

4.15 Directors Powers

Equity regards directors as holding their powers on trust for the company. They can only exercise those powers for the benefit of the company, otherwise the purported exercise will be regarded as "ultra vires" and invalid. In such cases the court would regard the transaction as having been entered into for an "extraneous purpose". This is illustrated by –

- i. Re Roith Ltd (73). The extraneous purpose was consideration of the widow's welfare rather than the company's benefit.
- ii. Hutton v West Cork Railway Co. (74). The resolutions had not given adequate consideration to the question whether the company would benefit from the proposed payments.
- iii. Hogg v Cramphorn (75). The extraneous purpose was the desire to pre-empt the take-over bid. The directors had not exercised their power for the benefit of the company.

4.16 Register of Directors' Shareholdings

Section 196(1) requires every company to keep a register showing the number, description and amount of any shares or debentures which are held by or in trust for the director, or of which he has any right to become the holder (whether on payment or not) in –

- (a) the company; or
- (b) the company's subsidiary or holding company; or
- (c) a subsidiary of the company's holding company.

The register shall be kept at the company's registered office and shall be open to the inspection of any member or debenture holder during business hours during the period beginning 14 days before the date of the company's annual general meeting and ending three days after the conclusion of the meeting (a day which is a Saturday, Sunday or public holiday being disregarded in computing the fourteen days).

4.17 Division of company's Powers

Article 80 of Table A states:

"The business of the company shall be managed by the directors who may... exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless, to any of these regulations, to the provisions of the Act and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the Company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made."

What this article means as far as the division of powers between a company's Board of Directors

and the Members in general meeting has been a controversial topic. It may be discussed with the aid of the following chart:

CHART OF COMPANY'S POWERS

<i>POWERS</i>	<i>ORGAN RESPONSIBLE</i>
1	DIRECTORS
2	DIRECTORS
3	GENERAL MEETING
4	GENERAL MEETING
5	GENERAL MEETING
6	? (Articles Silent)
7	? (Articles Silent)

LEGAL QUESTIONS

Can the General Meeting:

- a) Direct the directors regarding the exercise of Power 1 or 2?
- b) Overrule the directors regarding a decision made in exercise of Power 1 or 2?
- c) Direct the directors regarding the exercises of Power 6 or 7?
- d) Overrule the directors regarding a decision made pursuant to Power 6 or 7?
- e) Exercise Power 1 or 2?

ANSWERS:

The answers to questions (a) to (d) above are not clear and are controversial. According to Professor Gower, the answer to each of the above questions is NO. However, according to Goldberg, the answer to the above questions is YES.

It is hoped that the controversy will be ended by further litigation which will give conclusive judicial interpretation of Article 80. In England, however, the controversy was recently ended by a complete overhaul of Table A, Article 80 under the Company's Act of 1989.

Regarding question (e) above, the cases of BARRON V POTTER and FORSTER V FORSTER, in particular, establish the rule that, if the Board is unable to function because it is paralysed by personal feuds, between the directors, the powers normally reserved to it by the articles will revert to the members in general meeting who may exercise them so that the company's operations may continue rather than grind to a halt. There is no academic controversy over this proposition.

4.18 The Managing Director

4.18.1 Appointment

In Ellis v Bailey and Company (East Africa) Limited (76) it was stated that "without specific authority in the articles directors may not appoint one of their number to the position of managing director or other salaried office ... such an appointment would entail delegation of authority ... not authorised for directors".

This formulation of the law is a derivation from the general maxim of agency law, "delegatus non potest delegare".

4.18.2

In the case of companies which have adopted Table A, Article 107 empowers directors to appoint a managing director "for such period and on such terms as they think fit". In Craven-Ellis v Cannons Ltd it was explained that the words "the directors" at the beginning of Article 107 means "the de jure directors". Consequently, a purported appointment by de facto directors would be null and void. A managing director occupies a crucial position in the management of a company and as such it would be improper to allow people who are in fact illegally in office (the de facto directors) to appoint him. This decision is not inconsistent with s.2 of the Act which defines "director" as including a de facto director because the section provides that the definition will apply "except where the context otherwise requires".

4.18.3 Powers of Managing Director

Article 109 provides that "the directors may entrust to and confer upon a managing director any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers and may from time to time revoke, withdraw, alter or vary all or any of such powers".

The purport of this lengthy provision is not clear. However the phrase "either collaterally with or to the to the exclusion of their own powers" would have startling consequences if they were given their literal interpretation. That seems to be one of the reasons why they no longer appear in the current Table A of the English Companies Act 1989.

4.18.4 Remuneration

Article 108 provides that "a managing director shall receive such remuneration (whether by way of salary, commission or participation in profits, or partly in one way and partly in another) as the directors may determine". It was explained in Craven-Ellis v Cannons Ltd that, unless the articles provide otherwise, a managing director would be entitled to remuneration payable on a quantum meruit basis in respect of services rendered to the company, in those cases where the directors had not fixed his remuneration at the time of his appointment. No such payment would however be made if the articles, like Article 108, contain specific provisions pertaining to the payment of remuneration. This is illustrated by Re Richmond Gate Property Co Ltd in which it was held that the phrase "as the directors may determine" meant that the managing director would be entitled to no remuneration unless and until the directors actually decided it. A payment on a quantum meruit would be inconsistent with the express provisions of the articles regarding payment of remuneration.

4.18.5 Removal

Article 107 provides that the managing director's "appointment shall be automatically

determined if he cease from any cause to be a director". It was explained in Southern Foundries Ltd v Shirlaw (77) that if the appointment constituted a service agreement with the company the managing director would be entitled to sue the company for damages if the removal from directorship derogated from the terms of the agreement and constituted a breach of it, such as being removed before the period fixed in the service agreement expired. If on the other hand the appointment does not constitute a service contract the managing director would have no remedy for premature removal, as illustrated by Read v Astoria Garage Ltd (78).

4.19 The Company Secretary

4.19.1 Appointment of the Secretary

By section 179, every company must have a secretary but a sole director cannot be a secretary as well.

Table A, Article 110, provides that the secretary shall be appointed by the directors on such terms and conditions as they think fit and may be dismissed by them.

Section 179 provides that a corporation cannot be a secretary if its sole director is also the sole director of the company.

4.19.2 Powers and Duties

The powers and duties of the secretary depend on the size and nature of the company and the personal contractual arrangements that it makes with him. However, a company usually has the following powers and duties:

- (a) To be present at all meetings, including board meetings, and take the minutes of such proceedings.
- (b) On the instructions of the board, to issue notices of meetings to members and others.
- (c) To countersign instruments to which the company seal has been affixed (see Article 113 of Table A).
- (d) To conduct and record transfer of shares.
- (e) To keep the books of the company, particularly those relating to the internal administration of the company, eg. the share register, and register of charges.
- (f) To make all the returns of the company, eg. the annual returns, notice of special resolutions, etc.

Section 180 provides that a provision requiring or authorizing a thing to be done by or to a director and the secretary, is not satisfied by it being done by or to the same person acting as secretary and director.

4.19.3 Position in Relation to the Company

In 1882 Lord Esher in Barnett, Hoares & Co v South London Tramways Co stated that:

"A secretary is a mere servant; his position is that he is to do what he is told, and no person can assume that statements made by him are necessarily to be accepted as trustworthy without further inquiry."

Thus it was held in various cases that the secretary had no independent authority to bind the company by contract. However, in 1971 in Panorama Developments Ltd v Fidelis Furnishing Fabrics Ltd the Court of Appeal stated that in modern times the secretary is no longer a mere clerk; he is a chief administrative officer of the company and thus can make representations on behalf of the company and enter into contracts on its behalf as long as they concern the administrative side of the business such as contracts for the employment of staff, the acquisition of office equipment or the hiring of transport for visiting the company's factory, as the secretary had done in that case.

However, apart from such exceptions, the secretary still has no power and so he acts outside his authority if, for example, he borrows money in the company's behalf, or negotiates contracts other than those necessary for administrative purposes, or calls a general meeting on his own authority; of course the Articles empower the directors to delegate any of their powers to any agent they choose, they may delegate to the secretary and this is not uncommon, especially when the secretary is also a director.

4.19.4 Liability

The secretary is an officer of the company and thus he owes fiduciary duties to the company which are similar to those of a director, eg. he must act in good faith and must not make a secret profit. Moreover, in the event of a liquidation, the secretary as an officer of the company will be liable under section 323 if he has been guilty of a misfeasance. The secretary will also be liable to specific criminal penalties if he details or omits a wrongful act in respect of his statutory duties. Thus, for example, he can be made to pay a default fine if he fails to sign the annual return and accompanying documents and as the officer most clearly in default will be liable in the event of failure to keep and make available registers such as the registers of directors and secretaries.

4.19.5 Indemnity

Section 206 applies to the secretary and thus a provision in the Articles or any contract exempting him from liability is void. However, again the Court can relieve him from liability in certain cases (see section 402).

4.20 Unauthorized Contracts

It may sometimes happen that a company's agent, while entering into a contract on behalf of the company, exceeds his powers under the articles of association. To what extent is the company bound by the contract?

4.20.1 The Rule in Royal British Bank v Turquand

In Royal British Bank v Turquand (80) a company was ordered to repay a loan which its directors had borrowed on its behalf without the authority of an ordinary resolution prescribed by the articles of association. In the course of delivering his judgement Jervis, C J stated:

"The dealings with these companies are not like dealings with other partnerships, and the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. And the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorizing that which on the face of the document appeared to be legitimately done".

This statement can be reduced to two propositions which constitute what is compositely known as "the rule in Turquand's case", namely:

- i. A person dealing with a company is bound to read the relevant restrictive provisions of the Companies Act, the company's memorandum of association and the company's articles of association. If he does not do so, he will be deemed to have read them and, as a consequence, to have been aware of their provisions.
- ii. In so far as the articles provide that a transaction may be effected by some internal procedure, the person dealing with the company (called "outsider") may assume that the procedure has been duly complied with.

The effect of these propositions is that the company will be bound by the transaction even if the prescribed procedure was in fact not followed or complied with. An "internal procedure" for this purpose would usually be a decision of the company which is made by an ordinary resolution passed by the company in general meeting, or a resolution of the directors passed at a board meeting. Such a resolution is not registerable at the Companies Registry pursuant to s.143 or any other section of the Companies Act and the outsider who goes to the Registry would not be in a position to ascertain whether it had in fact been passed. Rather than compel him to go to the relevant office of the company to make enquiries, the courts decided to, as it were, "give him the benefit of the doubt" by holding that the resolution will be deemed to have been passed even if it had not actually been passed.

4.20.2 Examples

The following cases are some of the leading examples of the application of "the rule in Turquand's case:"

- (a) Mahoney v East Holyford Mining Co

The company "secretary" sent the company's bank what purported to be a final copy of a resolution of the board authorizing the payment of cheques signed by two of three named "directors" and by the named "secretary". The bank, relying on the "resolution", honoured cheques signed in accordance with its provisions. The company later went into liquidation and it was then realized that neither the "directors" nor the "secretary" had been properly appointed and no general or board meetings had ever been held. The liquidator's contention that the cheques which had been signed by the "directors" and the "secretary" had been wrongly paid and the bank must refund the money was rejected. The bank was not bound to enquire whether the "directors" and the "secretary" had been properly appointed and could rely on the rule in Turquand's case.

- (b) Freeman & Lockyer v Buckhurst Park Properties Ltd

The articles of a company formed to purchase and resell an estate empowered the directors to appoint one of their body managing director. Kapoor, a director, was never appointed managing director but, to the knowledge of the board, he acted as such. On behalf of the company he instructed the plaintiffs, a firm of architects and surveyors, to apply for planning permission with a view to developing the estate. The company later refused to pay the plaintiffs' fees on the ground that Kapoor had no authority to engage them.

Held, the company was bound by the contract and liable for the plaintiffs' fees.

The act of engaging architects was within the apparent authority of a managing director of a property company and the plaintiffs were not obliged to enquire whether the person they were dealing with (Kapoor) was properly appointed. It was sufficient that under the articles there was a power to appoint a managing director, and that the board of directors had allowed one of them (Kapoor) to act as such. In any case, a resolution of the board appointing a managing director is not registerable under s.143 and so its passing cannot be ascertained by a visit to the companies registry.

(c) Hely – Hutchinson v Brayhead Ltd (81)

4.20.3 Exceptions

The rule in Turquand's case will not apply if:

- i. The person suing the company is in fact an insider, such as a director of the company:

Howard v Patent Ivory Co (82). Such a person has access to the company's documents from which he may discover the lack of authority. Exceptionally, he may succeed against the company if he proves that he was a recently-appointed director and had not fully acquainted himself with the internal procedures of the company.

- ii. The company's articles prescribed a special resolution which had not been passed, as illustrated by Irvine v Union Bank of Australia (83).

A special resolution is registerable under s.143 of the Companies Act and if it had been passed a copy thereof would have been delivered for registration and would have been found among the company's documents at the companies registry. Its absence shall have warned the outsider that it had not been passed.

- iii. There were special circumstances which should have put the outsider on inquiry: Underwood Ltd v Bank of Liverpool (case No 5); Liggett v Barclays Bank (84).

- iv. The transaction is ultra vires the company, since a company's agent cannot have authority to transact a business which the company itself lacks capacity to transact.

- v. The transaction relates to the issue of a forged document, such as a forged share certificate issued by the secretary without the authority of the board, as illustrated by Ruben v Great Fingall Consolidated Ltd.

- vi. Knowledge of irregularity: Liggett v Barclays Bank

- vii As insider.

REINFORCING QUESTIONS

1. Explain the remedies which are available to an ultra vires lender.
2. Explain the regulations governing the appointment, disqualification and removal of directors.
3. "A" Ltd loans Shs 200,000/= to "B" Ltd on security to enable that company to purchase paper making machinery. What would the legal situation be in each of the following cases?
 - (a) B Ltd was not empowered by its memorandum to act as paper manufacturers.
 - (b) B Ltd's articles permitted the directors to borrow amounts in excess of Shs 100,000/= only with the consent of an ordinary resolution of the company's members. No such resolution had in fact been passed.
 - (c) B Ltd's articles permitted the directors to borrow amounts in excess of 100,000/= only with the consent of a special resolution of the company's members. No such resolution had been passed.

Check your answers with those given in Lesson 9 of the Study Pack

COMPREHENSIVE ASSIGNMENT No.2

TO BE SUBMITTED AFTER LESSON 4

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the College.

EXAMINATION PAPER. TIME ALLOWED: THREE HOURS. ANSWER ALL QUESTIONS

1. a. Section 22 of the Company's Act provides that "the memorandum and articles shall, when registered, bind the company and the members thereof ..."

 Explain this provision by reference to decided cases.
- b. What are the legal restrictions on a company's power to alter its articles of association?
2. a. What are the legal restrictions on a company's power to reduce its capital?
- b. How are the interests of the following safeguarded when a reduction of capital is proposed:
 - i. creditors;
 - ii. shareholders; and
 - iii. future investors?
3. Explain the different ways in which a person may become a member of a company.
4. a. What are the advantages and disadvantages of a floating charge as a form of security?
- b. What are the rules regarding the priorities between charges?
5. Explain the legal rules relating to the appointment of company's directors
6. Explain the legal status and duties of the company secretary.

END OF COMPREHENSIVE ASSIGNMENT No.2

NOW SEND TO THE DISTANCE LEARNING CENTRE FOR MARKING