

## THE BINDING EFFECT OF THE CONSTITUTIVE DOCUMENTS OF THE 1973 AND 2008 COMPANIES ACTS OF SOUTH AFRICA\*

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### 1 Introduction

South African company law is in the process of reform which has been necessitated by recent developments nationally and internationally. Nationally, in 2004 the Department of Trade and Industry (hereafter the “dti”) published a policy paper<sup>1</sup> which led to the enactment and publication of the new *Companies Act*<sup>2</sup> (hereafter the 2008 Companies Act). According to its Preamble, the aim of the 2008 Companies Act is, *inter alia*, to repeal the earlier *Companies Act*<sup>3</sup> (hereafter the 1973 Companies Act). It was, however, “not the aim of the [legislature] simply to write a new [Companies] Act by unreasonably jettisoning the body of jurisprudence built up over more than a century”.<sup>4</sup> Hence the need

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1 See GN 1183 in GG 26493 of 23 June 2004, titled “*South African Company Law for the 21st Century – Guidelines for Corporate Law Reform*”. It proposed the development of a “clear, facilitating, predictable and consistently enforced governing law” to give rise to “a protective and fertile environment for economic activity,” with the aim of achieving *inter alia* simplicity in the formation of companies, corporate efficiency, transparency and compliance with the Bill of Rights in the application of company law, 9 and 11.

2 Act 71 of 2008, which was signed into law by the President of the Republic of South Africa on 8 April 2009 and gazetted on 9 April 2009. The 2008 Companies Act will come into effect only on a date fixed by the President by proclamation in a Gazette, which date may not be earlier than one year following the date of its enactment: s 225 of the 2008 Companies Act. By implication, the 2008 Companies Act will come into effect on a date not earlier than 9 April 2010.

3 61 of 1973.

4 GN 1183 in GG 26493 (n 1) 7.

to address the law under the provisions of both the 1973 and the 2008 Companies Acts. The binding effect of the constitutive documents of South African companies is, for example, currently dealt with by section 65(2) of the 1973 Companies Act. A provision similar to section 65(2) is contained in section 15(6) of the 2008 Companies Act.

This contribution investigates the provisions under the two Companies Acts that regulate the binding effect of the constitutive documents of companies, with the aim of determining their legal nature, the persons bound by the documents, the circumstances giving rise to being bound and the effect thereof. The article proceeds to address the possible deficiencies posed by the relevant provisions in the two Acts and proposes possible solutions to the deficiencies so identified.

## **2 The legal nature of the constitutive documents: 1973 Companies Act**

### ***2.1 The binding effect of the constitutive documents***

The constitutive documents of a company incorporated under the 1973 Companies Act comprise of the memorandum and articles of association. The Registrar will upon registration of these documents issue a company with a certificate of incorporation, evidencing compliance with the registration requirements<sup>5</sup> and conferring upon it the status of a person in law (a juristic person).

In this regard section 65(2) of the 1973 Companies Act provides that:

The memorandum and articles shall bind the company and the members thereof to the same extent as if they respectively had been signed by each member, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act.

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5 S 64(1) of the 1973 Companies Act.

Section 65(2) has been referred to as “the only source from which the memorandum and articles derive a binding force” and as the source to which “one must turn to determine who can enforce a provision in the memorandum and articles and against whom”.<sup>6</sup> The Companies Act itself is another source to which one can turn to determine the extent to which the provisions of section 65(2) have a binding force. This section provides that the memorandum and articles shall bind parties to it subject to the provisions of the Companies Act.

It is accepted in our law that the constitutive documents under the 1973 Companies Act are contractual in nature.<sup>7</sup> Section 65(2) of the Act has also been referred to as “the contract section”, and the contract it creates as the “company contract”.<sup>8</sup> The contract arising out of the constitutive documents is a statutory one, deriving its force not from the general principles of the law of contract but from the Companies Act and common law.<sup>9</sup> This statutory contract is of a peculiar nature. The parties to it are contractually bound not because they mutually reached consensus but because section 65(2) deems them to be bound, as if they had respectively signed the constitutive documents. The subscribers to the constitutive documents are the only signatories thereto. There must be at least seven subscribers for a public company, and one or more but not exceeding fifty for a private company.<sup>10</sup> Hence the use of the words “as if they respectively had been signed by each member.”<sup>11</sup> The post-incorporation members who are parties to this contract are not signatories. They are deemed to have signed the documents.

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6 Blackman, Jooste and Everingham *Companies Act* 4-150-2.

7 *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* 1959 3 SA 873 (O) at 876 H; *Gründling v Beyers and Others* 1967 2 SA 131 (W) at 138 G; *Gohlke and Schneider v Westies Minerale (Edms) Bpk* 1970 2 SA 685 (A) at 692 E-F; *Rosslare (Pty) Ltd v Registrar of Companies* 1972 2 SA 524 (D) at 528 C; Cilliers *Corporate Law* 79; Blackman MS 1992 SA *Merc LJ* 1; Blackman, Jooste and Everingham *Companies Act* (note 6) 4-151. See also the English case of *Bratton Seymour Service Co Ltd v Oxborough* 1992 BCLC 693 at 696 F.

8 Blackman 1992 SALJ 225.

9 Papo *The Binding Effect* 25. See also *Bratton Seymour v Oxborough* 698 D, Blackman in Joubert (ed) *The Law of South Africa* par 73.

10 Ss 54(2) and 60(2) of the 1973 Companies Act.

11 S 65(2) of the 1973 Companies Act.

A company is also not a signatory to these documents. This is so for the documents are signed prior to the company's incorporation, and it is not a juristic person before its incorporation. A company is furthermore not deemed to be a signatory to the constitutive documents. Clearly deeming one to sign does not mean actually signing.<sup>12</sup> The legislature would have simply acknowledged the legal-personality nature of a company by deeming it to have signed the documents. The members are deemed to be aware of the contents of the statutory contract in terms of the common-law doctrine of constructive notice.<sup>13</sup>

The statutory contract arising out of section 65(2) is again of a peculiar nature in that, unlike an ordinary contract, its validity cannot be tested on the usual grounds of mistake, misrepresentation or undue influence.<sup>14</sup> Rectification of the statutory contract is not possible since its alteration requires special resolution of the members even without the consent of all contracting parties.<sup>15</sup> This is so, as only 75% of the members who are present and entitled to vote in person or by proxy representation is required for a special resolution to be passed and adopted.<sup>16</sup>

It is also accepted in our law that the constitutive documents bind the company and its members and members *inter se*.<sup>17</sup> Members are bound only in their capacity as members.<sup>18</sup> In this respect, Astbury J in the English case of

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12 See Freedman *Company Constitution As a Contract* 10 who submits that the statutory contract section under s 65(2) is an "undoubtedly obscure" section.

13 A doctrine deeming every person dealing with a company, including its members, to be fully acquainted with the constitutive documents, since the doctrine of disclosure makes them public documents. See Papo (n 9) 26. See also Cilliers *Corporate Law* (n 6) 190.

14 Papo (n 9) 29; *Bratton Seymour v Oxborough* (n 7) 698 E, Blackman, Jooste and Everingham *Companies Act* (n 6) 4-155.

15 Papo (n 12) 29-30; *Bratton Seymour v Oxborough* (n 7) at 698 E; Blackman, Jooste and Everingham *Companies Act* (n 6) 4-154- 4-154-1.

16 S 199 of the 1973 Companies Act.

17 *Gohlke and Schneider v Westies Minerale (Edms) Bpk* (note 7) 692 F; *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* (note 7) 876 H. See also the following English Law cases: *Hickman v Kent or Romney Marsh Sheep Breeders' Association* [1915] 1 Ch 881; *Beattie v Beattie Ltd* [1938] 3 AllER 214 (CA); *Wood v Odessa Waterworks Co.* (1889) 42 ChD 636; *Bratton Seymour v Oxborough* (n 7).

18 N 17.

*Hickman v Kent or Romney Marsh Sheep Breeders' Association*<sup>19</sup> illustrated the principle of the “capacity of member as such” by stating the following:

I think this much is clear, first, that no articles can constitute a contract between the company and a third person; secondly, that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as, for instance, as solicitor, promoter, director, can be enforced against the company; and, thirdly, that articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively.<sup>20</sup>

The above principle was confirmed by the South African courts too. Potgieter J in *De Villiers v Jacobsdaal Saltworks (Michael and De Villiers) (Pty) Ltd*<sup>21</sup> stated that:

It is clear that the articles of association do not create a contract between the company and a member except in his capacity as a member. The articles constitute a contract between the members *inter se* and between the company and the members but only in their capacity as members. They do not for instance constitute a contract between the company and a director in his capacity as such.<sup>22</sup>

## **2.2 The circumstances giving rise to being bound**

The question accordingly arises: when is a member bound by the constitutive documents in his capacity as a member? This question has been said to have received less attention in our law.<sup>23</sup> In *Rosslare (Pty) Ltd v Registrar of Companies*<sup>24</sup> Milne J pointed out that:

it seems clear, however, that what is meant by a contract with a member “in his capacity as such”, is a contract between him and the company which is connected with the holding of shares and which confers rights which are part of the general regulations of the company applicable alike to all shareholders.<sup>25</sup>

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19 N 17.

20 At 900.

21 N 7.

22 876H-877A.

23 Blackman (n 7) 7.

24 N 6.

25 528D-E.

It is submitted that Milne J's analysis of the circumstances under which members are bound as such is incorrect. It is incorrect to say that members are contractually bound in their capacities as such only if the rights and obligations from the statutory contract concern their shareholdings and only if their shareholding confers general rights applicable to all shareholders alike. This is so because the members of companies without share-capital have no shareholding and are also bound by these documents.<sup>26</sup> Milne J's analysis is incorrect in the second place in that rights cannot be said to be granted in one's capacity as a member if they are part of a general regulation applicable to all shareholders alike.<sup>27</sup> This is so because companies have different classes of shareholders, each class with rights unique to it. The preference shareholders, as an example, have a preferential right to be considered first, for a fixed percentage dividend, when declared. This is not a general right applicable to other shareholders, for example the ordinary shareholders.

The question to be addressed then is: when are rights and obligations granted to a member in his capacity as such? Put differently, under which circumstances will a member of a company in his capacity as such be bound by the constitutive documents? It is submitted that the rights and obligations are granted to a member in his capacity as a member if in the first place they are conferred on one by reason of his membership and secondly if they are membership rights.<sup>28</sup> Rights are given to one by reason of one's membership if they are given to one as a member. The rights given to one not by reason of one's membership and that are not membership rights are "outsider rights", which have no binding force and effect under section 65(2).<sup>29</sup> For example, the right given to one to be appointed as a company's legal advisor and to be remunerated for services rendered is not a membership right given to one by reason of one's membership. This would still be the case even if the legal advisor is also a member of a company.

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26 Blackman (n 7) 3, who holds the same view.

27 N 26.

28 Papo (n 9) 40; Blackman (n 7) 2.

29 Blackman (n 7) 2; Blackman, Jooste and Everingham *Companies Act* (n 6) 4-156.

A member under the 1973 Companies Act is in the first place a subscriber to the memorandum of association; secondly a person who consented to be included in the register of members; thirdly a person holding shares *nomine officii* on behalf of a beneficial shareholder; and lastly a holder of a share-warrant.<sup>30</sup> Membership rights and obligations are regulated by the 1973 Companies Act and the articles of association. The nature of a company also plays a role in determining the rights of members.<sup>31</sup> A member of a company with share-capital has, amongst other rights, certain financial rights by reason of his membership, namely the right to receive a dividend when declared, and the right to participate in the distribution of assets upon liquidation.<sup>32</sup> These rights do not inure to a member of a company without share-capital. The 1973 Companies Act also provides for management rights which are general to all members. Section 180(2) grants members the right to call meetings, to attend meetings in person or by proxy representation (section 189), to vote at meetings *etcetera*. The statutory contract under section 65(2) allows for the enforcement of only the rights and obligations that are granted to members by reason of membership and if they are membership rights.

### **2.3 The effect of being bound**

The implication of the existence of a statutory contract between the company and members and between members *inter se* is that the parties to this contract can compel one another to observe the provisions of the constitutive documents subject to the provisions of the 1973 Companies Act. Thus a member was held bound by the articles to refer a dispute between the company and himself to arbitration and not to a court.<sup>33</sup> The directors in their capacity as

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30 S 103 (1-4) of the 1973 Companies Act. Bearer securities in the form of share-warrants are seldom encountered in South Africa, due to a qualified prohibition of their issue and disposition. See Regs 15 (2) and (3) in GNR 1111 in GG 123 of 1 December 1961, a regulation made under the *Currencies and Exchange Act* 9 of 1933 (as amended by GNR 885 in GG 20299 of 23 July 1999), which prohibits the issue and disposition of bearer securities, except through the Treasury's exemption. See also Cowen *Negotiable Instruments* 256.

31 See Blackman (n 7) 11-15.

32 Table A of Schedule 1 a 85 and table A of Schedule 1 a 107 in the 1973 Companies Act.

33 *Hickman v Kent or Romney Marsh Sheep Breeders Association* (n 17) 903.

shareholders were held bound by the articles to take, for a fair value, the shares of a member who intended to transfer.<sup>34</sup>

## 2.4 *Deficiencies and possible solutions*

A member, as indicated above, can enforce the rights and obligations arising out of the constitutive documents only if they are granted to him in his capacity as a member. The courts have failed to provide a logical explanation of the concept “capacity of member as such”. The explanation given by Milne J in *Rosslare (Pty) Ltd v Registrar of Companies*<sup>35</sup> is incorrect. The better view is that rights and obligations are granted to a member in his capacity as such if they are granted by virtue of his membership and if they are membership rights. Thus a shareholder who was granted a right to be a company’s solicitor could not compel the company to observe the articles, since the right in question was held not to be granted to him in his capacity as a member.<sup>36</sup> It was further held in another case that a director appointed as such for life could not enforce the provisions of the articles since the right to be a life director was held to be conferred on him *qua* director and not *qua* member.<sup>37</sup>

The “*qua* member test” and the “outsider rights rule” plus the courts’ failure to provide a logical explanation of the concept “capacity of a member as such” create limitations in the interpretation of section 65(2) of the 1973 Companies Act.<sup>38</sup> For example, directors are, under section 65(2), regarded as outsiders and rights given to them in terms of the articles are regarded as outsider rights which are granted to them in some other capacity other than in their capacity as members. This is despite the fact that numerous provisions of the articles provide for their rights.<sup>39</sup> A director would not be able to enforce the rights flowing from the articles against the company if the rights contained in the articles were not entrenched in a separate contract, independent of the articles,

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34 *Rayfields v Hands* 1960 Ch 1.

35 See n 7.

36 *Hickman v Kent or Romney Marsh Sheep Breeders Association* (n 17) 897.

37 *De Villiers v Jacobsdaal Saltworks (Michaelis and De Villiers)* (n 7) 876H-877A.

38 Papo (n 9) 83.

39 Blackman, Jooste and Everingham (n 7) 4-156.



such as a contract of employment.<sup>40</sup> The company, on the other hand, can institute an action for breach of fiduciary duties and claim damages for loss suffered against a director who acts contrary to the provision of the company constitution. This is so, for a director who acts contrary to the provisions of the memorandum would be exceeding the limitations of power imposed on him.<sup>41</sup> The limitations created by the “outsider rights rule” under section 65(2) called for the redrafting of this section, which could be achieved by creating a section that clearly outlines the parties to it and the extent to which they are bound.<sup>42</sup> The question now is whether or not the 2008 Companies Act has addressed these gaps.

### **3 The legal nature of the constitutive documents: 2008 Companies Act**

#### **3.1 *The binding effect of the constitutive documents***

The 2008 Companies Act makes the formation of companies a fundamental right achieved simply via the adoption of the constitutive documents.<sup>43</sup> This gives effect to the wishes and intentions of the “dti”. The “dti” intended, in its policy paper, that the requirements for formation of companies should be simplified to allow any person including a layperson an opportunity to form a company without imposing unnecessary obstacles that may impede economic growth.<sup>44</sup> The constitution of a company incorporated under the 2008 Companies Act is the Memorandum of Incorporation (hereafter the MOI) and may include the rules.<sup>45</sup> The board of directors may make, amend or repeal the rules that are not inconsistent with the MOI and the 2008 Companies Act relating to governance of the company on matters not addressed in the Act or

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40 N 39; Papo (n 9) 47-48.

41 A discussion on directors’ fiduciary duties is beyond the scope of this paper. On the subject see Cilliers *Corporate Law* (n 7) 144, *S v De Jager* 1965 2 SA 616 A; *S v Hepker* 1973 1 SA 472 (W).

42 N 38.

43 S 13(1)-(2) of the 2008 Companies Act.

44 GN 1183 in (GG 26493 n 1) 31; Geach in Schoeman (ed) *Guide to Companies Act and Regulations* 19A-57.

45 S 15(6) of the 2008 *Companies Act*.

the MOI by publishing a copy of the rules and filing it with the CIPC.<sup>46</sup> The rules once made and published have an interim binding effect for twenty business days after their publication or until a date specified in the rules, and a permanent binding effect once approved by shareholders by an ordinary resolution.<sup>47</sup> The rules are not a requirement for the incorporation of a company, but may be made by directors, and if they are approved by shareholders section 15(6) gives them the same binding effect as the MOI.

Under the new Companies Act a company is incorporated with the CIPC by one or more persons in person or by proxy representation for a profit company, and three or more persons in person or by proxy representation for a non-profit company, by completing and signing the MOI and filing its copy together with a Notice of Incorporation (hereafter the NOI), accompanied by a prescribed fee.<sup>48</sup> The CIPC will, after accepting a filed NOI, deliver a registration certificate to the company,<sup>49</sup> conferring upon it the status of a juristic person, which exists continuously until its name is removed from the companies register in terms of the 2008 Companies Act.<sup>50</sup>

Section 15(6) of the 2008 Companies Act provides that

- A company's Memorandum of Incorporation, and any rules of the company, are binding—
- (a) between the company and each shareholder;
  - (b) between or among the shareholders of the company; and
  - (c) between the company and—
    - (i) each director or prescribed officer of the company; or
    - (ii) any other person serving the company as a member of the audit committee or as a member of a committee of the board, in the exercise of their respective functions within the company.

Section 15(6) simply provides that the MOI and the rules, if made, are binding without stating in which way they are binding. The Act must be interpreted and

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46 S 15(3)-(4) of the 2008 Companies Act.

47 S 15(4)(a)-(c).

48 S 13 (1) of the 2008 Companies Act.

49 S 14(1) of the 2008 Companies Act.

50 S 19(1) of the 2008 Companies Act.

applied in a manner giving effect to its purposes,<sup>51</sup> one of which is to promote the development of the South African economy by encouraging entrepreneurship and enterprise efficiency and creating flexibility and simplicity in the formation of and maintenance of companies.<sup>52</sup> The courts in determining a matter brought before them in terms of the 2008 Companies Act will be required to develop the common law to improve the rights provided for in the Act.<sup>53</sup> It is on this basis that the common-law contractual binding effect of the memorandum and articles of association should apply to the legal nature of the MOI and the rules.<sup>54</sup>

### ***3.2 Who is bound by the constitutive documents? Under which circumstances are they bound, and what are the effects of being bound?***

The questions remain: who is bound by the constitutive documents, under which circumstances are they bound, and what are the effects of being bound? The following contractual relationships arise out of section 15(6): firstly the relationship between the company and each shareholder; secondly the relationship between shareholders *inter se*; and thirdly the relationship between the company and each director or prescribed officer of the company or between the company and persons serving the company as members of the audit committee or as members of a committee of the board. Each of these relationships is examined in order to ascertain the circumstances in which one is bound and the effect thereof.

#### ***3.2.1 Relationship between the company and each shareholder***

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51 See ss 5(1) and 158 (b) (ii) of the 2008 Companies Act.

52 See s 7 (b)(i)-(ii) of the 2008 Companies Act.

53 S 158 (a). See also s 39 of the South African Constitution.

54 See n 38 in Delpont *New Companies Act Manual* 11, who holds the same view.

Does the existence of a binding relationship between the company and each shareholder imply that rights and obligations flowing from the constitutive documents are granted to holders of shares in profit companies only?<sup>55</sup> A shareholder under the 2008 Companies Act is defined subject to the provisions of section 57(1) as “the holder of shares issued by the company”.<sup>56</sup> Section 57(1) defines a shareholder as “a person entitled to exercise any voting rights in a company irrespective of the form, title or nature of securities to which voting rights are attached”.<sup>57</sup> A person who holds membership and specific rights in relation to membership in a non-profit company is referred to as a member.<sup>58</sup> Section 10(4) provides that “with respect to a non-profit company that has voting members, a reference in this Act to ‘a shareholder’, ‘the holders of a company’s securities’, ‘holders of issued securities of that company’ or ‘a holder of voting rights entitled to vote’ is a reference to the voting members of the non-profit company”.<sup>59</sup> It appears from the provisions of section 10(4) that reference to a “shareholder” in section 15(6) applies to both shareholders of profit companies and members of non-profit companies. The rights flowing from the constitutive documents are therefore granted to both shareholders in profit companies and members in non-profit companies.

When will rights flowing from the constitutive documents under the 2008 Companies Act be enforceable against shareholders/members? Will the common-law limitation that rights must be granted to members “in their capacity as members” find application under the 2008 Companies Act? These are the questions that our courts will be faced with in interpreting the provisions of section 15(6), once the 2008 Companies Act becomes effective. It is, however, submitted that the view that is likely to be taken by our courts is the one that rights are granted to shareholders/members in their capacity as such if they are membership/shareholdership rights and are granted to one by virtue of being a

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55 On the categories of companies under the 2008 Companies Act see s 8.

56 See the definition of shareholder, s 1.

57 Of the 2008 Companies Act.

58 See the definition of member, s 1.

59 Of the 2008 Companies Act.

shareholder/member. By implication, a shareholder/member should not be afforded enforcement of rights if rights so granted are not connected to his position as a shareholder/member and are not shareholdership or membership rights. The question then is: should non-members/ shareholders like directors be excluded as outsiders? This question is addressed in more detail in 3.2.3 below.

### 3.2.2 *Relationship between shareholders inter se*

A contractual relationship between and amongst shareholders (including members of non-profit companies) implies that they can enforce compliance with the provisions of the constitutive documents between and amongst each other. It still appears that the rights and obligations arising out of the constitutive documents will be enforced between and amongst shareholders if they are shareholdership/membership rights and if granted to shareholders/members by virtue of their being such. For example, a shareholder in a private company or a personal liability company may be allowed to bring an interdict enforcing his/her contractual rights flowing from the MOI if the MOI has a pre-emptive clause compelling a fellow shareholder to offer his/her shares to existing shareholders before they may be sold to non-shareholders.<sup>60</sup> However, as stated above, it is only until the courts will have an opportunity to provide an interpretation to the provisions of section 15(6) that we can know whether the *qua* membership limitation is retained or not.

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60 See s 39 which recognises the pre-emptive rights of every shareholder in private and personal liability companies to be offered and to subscribe, within a reasonable time, for a percentage of shares equal to the voting power of a shareholder's general voting right before any person who is not a shareholder of that company.

3.2.3 *Relationship between the company and each director or prescribed officer or a person serving the company as a member of the audit committee or as a member of a committee of the board*

The 2008 Companies Act, unlike the 1973 Companies Act, extended the application of the constitutive documents to persons who under the common-law position are referred to as “outsiders”. Directors under the 1973 Companies Act are obliged to comply with the provisions of the company’s constitutive documents, but acquire no rights from them. Failure on the part of the directors to act in accordance with the constitution of a company, under the 1973 Companies Act, makes them to incur personal liability for breach of their fiduciary duties.<sup>61</sup> The question here is to what extent the “outsider rights rule” has been relaxed under the 2008 Companies Act.

A director is defined under the 2008 Companies Act as “a member of the board of a company” or an alternate director and includes any person occupying the position of a director or alternate director, by whatever name designated.<sup>62</sup> A prescribed officer is defined as a holder of office as a result of a Minister’s regulation designating specific functions within a company to such officers.<sup>63</sup> An audit committee member is not defined under the definitions section of the 2008 Companies Act. Section 94(1) provides that a member of the audit committee must be a director of the company, but must not be involved in the day-to-day management of the company business, nor be a prescribed officer or full-time employee or a material supplier or customer of the company.<sup>64</sup> The company is contractually bound, together with the persons listed in this category, in “the exercise of their respective functions within the company, to observe the provisions of the company constitution, subject to the 2008 Companies Act”.<sup>65</sup>

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61 N 41.

62 See the definition of a director in s 1 of the 2008 Companies Act. The definition appears broad enough to cover *ex officio* directors and alternate directors. See s 66 in this regard.

63 See ss 1 and 66(10) of the 2008 Companies Act. It appears that prescribed officers are still to be determined via Ministerial regulation.

64 See s 94(4)(a) and (b)(i)-(iii). The audit committee seems to include non-executive directors.

65 See s 15(6)(c).

Directors, prescribed officers and members of the audit committee are contractually bound, together with the company, to observe the provisions of the MOI. They are not contractually bound to individual shareholders.<sup>66</sup>

The 2008 Companies Act does not provide an explanation of the words “the exercise of their respective functions”. The legislature might have intended the words to mean that the directors, prescribed officers or members of the audit committee can enjoy rights and perform obligations flowing from the MOI and the rules, if the rights and obligations are granted to them in their official capacities as directors, prescribed officers or members of the audit committee and not in their personal capacities. On this basis, it is submitted that the rights and obligations will be granted to the directors, prescribed officers or members of the audit committee in their official capacities, if the exercise of such rights is connected to the position so held as directors, prescribed officers or members of the audit committee. For example, if a director is also appointed to handle legal work on behalf of the company, any exercise of functions related to the provision of legal work for the company is not related to his official functions as a director, and rights and obligations flowing from that function cannot be contractually enforced via the MOI or rules. The rights relating to the provision of legal work should be exercised via a separate contract of service.

What is of concern is whether or not the appointment of a director in terms of the constitution of the company as a life director is connected to a director’s exercise of functions. It is submitted that one’s appointment as a director is connected to the functions of a director as such, since the functions generally flow from one’s appointment. By implication, a director appointed in terms of the

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66 N 65. See also s 77(3)(a), which makes directors liable to the company and not to individual shareholders for loss, damage or costs sustained by the company as a consequence of a director having acted contrary to the provisions of the MOI on the company’s capacity. See also s 20(6)(b) which allows each shareholder a claim for damages against any person (including a director) who fraudulently or due to gross negligence causes the company to do anything inconsistent with the limitation, restriction or qualification contained in the company’s MOI. This individual claim for damages is not contractual but delictual. See also s 218(2) which allows any person who suffered any loss or damage as a result of any person’s act of contravening the provisions of the Companies Act a claim of damages against such a person. This remedy is also not contractual but statutory.

MOI as a life director might be able to sue a company that removes him for damages incurred as a result of a breach of the statutory contract arising out of the MOI. Drafters of company constitutions (the MOI and the rules, if made) under the 2008 Companies Act may need to exercise care and avoid provisions that might result in a floodgate of litigation against companies, if the courts follow this suggested interpretation.

#### **4 Conclusion**

The courts' interpretation of the constitutive documents under the 1973 Companies Act is limited by the "*qua* membership test" and the courts failure to provide a logical meaning of the words. Hence the need for a redrafting of the section dealing with the statutory contract. The 2008 Companies Act attempted to provide a solution by clearly outlining who the parties to the constitutive documents are and by including in the category of persons bound by the provisions of section 15(6) persons who have been regarded by courts as outsiders in their interpretation of the provisions of section 65(2) of the 1973 Companies Act.

The 2008 Act has, however, failed to address the extent to which the parties listed in section 15(6) are bound by its provisions and the circumstances giving rise to being bound. The question whether the "outsider rights rule" or "*qua* membership test" will find application in the interpretation of the provisions of section 15(6) can be answered only once an opportunity arises for our courts to interpret the provision of this section. Still, the "*qua* membership test" may find application under the 2008 Companies Act. Members/ shareholders will be bound by the provisions of the constitutive documents if the rights are membership rights granted by virtue of their membership. The directors may be held bound if the rights and obligations from the constitutive documents are granted to them in their official capacities as directors. The 2008 Companies Act brought new concepts, new rules and therefore new challenges, which must be tested by the courts. It remains to be seen how the courts will interpret the provisions of the constitutive documents under the 2008 Companies Act.



What is of importance and should be noted is the “anti-avoidance section” of the 2008 Companies Act, which gives the courts, on application by the CIPC or the Take Over Regulation Panel, the power to declare the provisions of the MOI or rules void, for defeating or reducing the effect of the prohibition as provided for in the Act.<sup>67</sup> The drafters of the company’s Memorandum of Incorporation and the rules must be wary not to draft documents that defeat the effect of the prohibition of the Act in order to avoid such provisions being declaration void by the courts.

The provision of the 2008 Companies Act on civil actions should also be noted. In terms of the civil actions section, nothing in the Act shall render void, voidable or unlawful a provision in the MOI or the rules unless a court declares such a provision void.<sup>68</sup> It seems that even if the 2008 Companies Act declares certain acts unlawful or void,<sup>69</sup> they will remain valid and lawful until such time as a court has declared them otherwise. By implication, actions in conflict with the provisions of the MOI will be void only if a court of law declares them void.

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67 S 6(1).

68 S 218(1).

69 See s 44(5), which makes void the provision of financial assistance by the board contrary to the provisions of s 44. A provision in the MOI to grant financial assistance together with the resolution and agreement to grant financial assistance contrary to the s 44 requirements will be void only if declared void by a court of law in terms of s 218(1).

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## THE BINDING EFFECT OF THE CONSTITUTIVE DOCUMENTS OF COMPANIES: THE 1973 AND 2008 COMPANIES ACTS OF SOUTH AFRICA

TCR Morajane\*

### SUMMARY

This contribution examines the provisions of the constitutive documents of companies under two specific provisions, namely s 65(2) of the Companies Act 61 of 1973 and s 15(6) of the Companies Act 71 of 2008. The aim is to determine who is bound by these provisions, the circumstances which give rise to being bound by them, and the possible effect thereof on various parties.

The provisions of the constitutive documents under section 65(2) of the 1973 Companies Act are interpreted by courts and academic writers to amount to a statutory contract between a company and its members and between members inter se. The members are said to be bound by the provisions of these documents only in their capacity as members. It is submitted, however, that the rights and obligations are granted to members in their capacity as such if they are membership rights which are granted by virtue on one's membership.

So far the courts have failed to provide a logical explanation of the concept "capacity of a member as such". This failure and the "qua membership test" resulted in limitations in the interpretation of section 65(2): for example, the exclusion of persons who are regarded as outsiders. The directors, despite the fact that numerous provisions of the applicable article provides for their rights, have rights that are unenforceable via the articles, for being regarded as outsiders. The company on the other hand can enforce the obligations against

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the directors on the basis of breach of their fiduciary duties. These limitations called for a redraft of section 65(2).

This contribution raises the legal challenges raised by the above. It arrives *inter alia* at the conclusion that the “qua membership test” may find application under the 2008 Companies Act, since members/shareholders may be allowed to exercise rights that are membership rights granted to them by virtue of their membership, and directors may be allowed to exercise rights that are granted to them in their official capacities as such.

**Keywords:** Constitutive documents; Memorandum of Incorporation; Notice of Incorporation; binding effect of constitutive documents; legal nature of constitutive documents