THE RAFFLES HOTEL LTD. v. MALAYAN BANKING LTD. LITIGATION: ITS IMPLICATIONS FOR COMPANY LAW

Two very interesting and important decisions of the High Court of Singapore, arising out of the litigation between Raffles Hotel Ltd. and Malayan Banking Ltd. and handed down more than ten years ago, have so far gone unnoted. The purpose of this comment is to review these decisions in the light of case-law from England and New Zealand and to show that they have important implications for two areas of Company Law: the nature and effect of the Articles of Association and the position of nominee directors.

The Facts of the Litigation

The plaintiff, Raffles Hotel Ltd. was the lessee of a piece of land on which a part of Raffles Hotel stood and of which the defendant, Malayan Banking Ltd., was the assignee of the reversion. Among the undertakings of the lessee contained in the lease was the following:

> "14. Not without the previous licence in writing of the lessors to assign or sublet the said premises or any part thereof such licence not to be unreasonably withheld. Provided nevertheless that (a) if the assignee or sublessee be a limited company no consent shall be given unless the articles contain a provision that from time to time during the continuance of this demise the lessors shall have power to appoint a director not subject to retirement by rotation, but any director so appointed shall not be a person interested in or connected with any business of a similar nature to the lessees . . . ."

The articles of association of the plaintiff had the following provision:

> "77. (i) The lessors to the company of part of the property known as Raffles Hotel Singapore... may from time to time so long as the property so leased is held by the company appoint himself or one of themselves or any other person to be a director of the company and may from time to time remove any director so appointed and appoint another in his stead. . . ."

The defendant first appointed their solicitor, Rayner, to the plaintiff's board. Rayner sought to exercise his rights as a director to inspect the books of the Company. The plaintiff rejected Rayner's request and obtained an interim injunction[1] from the High Court restraining him from disclosing any information relating to the affairs of the Company to any person or persons entitled to appoint a director under the terms of the Company's articles.

The defendant then removed Rayner and in his stead appointed itself as a director of the plaintiff. The plaintiff discontinued its first injunction suit and obtained an interim injunction[2] in the High

[1] Suit No. 848 of 1964.
[2] Suit No. 942 of 1964.

Court restraining the defendant from exercising its powers as a director of the plaintiff. In the same suit the plaintiff also asked for the following declarations:

(1) that article 77 of the plaintiff's articles of association must be read in conjunction with clause 14 of the lease and that the defendant's appointment as a director of the plaintiff under article 77 was in breach of clause 14 of the lease and thus invalid; or

(2) that the defendant cannot act as a director of the plaintiff and an injunction to restrain the defendant from so doing.

Winslow J. delivered two reported decisions in the course of the litigation. In *Raffles Hotel Ltd.* v. *L. Rayner; Same* v. *Malayan Banking Ltd. (No. 1)*,[3] his Lordship awarded costs to Rayner in the discontinued injunction suit against him and confirmed the interim injunction against Malayan Banking Ltd. In *Raffles Hotel Ltd.* v. *Malayan Banking Ltd. (No. 2)*[4] his Lordship granted the second declaration but refused to grant the first declaration sought by Raffles Hotel Ltd.

The Position of Nominee Directors

Although Raffles Hotel discontinued the injunction suit against Rayner, his Lordship had to decide in *Malayan Banking Ltd. (No. I),* the question of costs which he held to be dependent on whether Raffles Hotel had reasonable grounds for apprehension of irreparable injury in the first instance. This question he answered in the negative. In the course of answering the question, however, his Lordship made the following remarks:

> "It would seem well established on the authority of *Boulting* v. *Association of Cinematograph, Television and Allied Technicians* that a company is entitled to the undivided loyalty of its directors. A director who is a nominee of someone else should be left free to exercise his best judgment in the interests of the company he serves and not in accordance with the directions of his patrons. If the company is not prepared to relax the rule, then an action for an injunction would normally lie to restrain a nominee director from acting in any manner adverse to the interests of the company."[5]

His Lordship did not seek to assert that no nominee director (as opposed, presumably, to one elected by the shareholders) can take office; and this is consistent, on an *a fortiori* basis, with the view of Lord Blanesburgh in *Bell* v. *Lever Brothers Ltd*.[6] that a director may become a director of a rival company as well as become a proprietor of a rival business, so long as in his rival capacity he does not make us either of the property of the company or of some confidential information which has come to him as a director of the company. This, of course, makes nonsense of the whole rule. The nominee director may be appointed by a nominor with a rival business: it is extremely unrealistic to expect that he will when acting in one capacity completely eradicate from his memory confidential

[3] [1965] 1 M.L.J. 60.
[4] [1965] 1 M.L.J. 262.
[5] [1965] 1 M.L.J. 60.
[6] [1932] A.C. 161.

information that he obtained while acting in the other capacity. Lord Denning summed up the situation admirably, in relation to nominee directors appointed by a parent company carrying on a rival business: "So long as the interests of all concerned were in harmony, there was no difficulty.... But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position."[7]

The net result of these pronouncements (including that of Winslow J. in *Malayan Banking Ltd. (No. 1)* seems to be that a company cannot take any action against a director who has an outside position which may create conflicts with his duty as the company's director. The company has a remedy only if the director either acts "in any manner adverse to the interests of the company"[8] or makes use of "the property of the company or of some confidential information which has come to him as a director of the company."[9] Before any of these situations materializes, the company's only protection is section 131 of the Companies Act,[10] especially subsection (5) which requires every director of a company who holds any office or possesses any property whereby directly or indirectly duties or interests might be created in conflict with his duties or interests as director, to declare at a meeting of the directors of the company the fact and the nature, character and extent of the conflict. This is a helpful provision from the company's point of view, but it does not go quite far enough.

The *Boulting* [11] case cited by Winslow J. may, however, on one reading support a more drastic and clearcut solution: namely, that a director who whether because he is a nominee or a rival trader holds a position with interests potentially or actually inimical to those of the company, should not be permitted to assume office at all, despite the provisions of the articles of association, unless the company (in the form of an independent Board or a general meeting of shareholders) so consents. The *Boulting* case concerns the attempts of a trade union to compel the managing directors of a company to join their ranks. The English Court of Appeal held that they were eligible for membership. The main argument of the directors was that by becoming members of the union they would place themselves in a position where their interests as union members might conflict with their duty as directors of the company. This argument was dismissed by the Court of Appeal (Lord Denning M. R. dissenting) on the ground that the rule against a "conflict" situation is "one essentially for the protection of the person to whom the duty is owed,"[12] (in this case, the company), and therefore cannot be used "as a shield by the person owing the duty."[13] The implication of the decision is that the company (which was not a party to the action)

[7] *Scottish Co-operative Wholesale Society* v. *Meyer* [1959] A.C. 324 at p. 366.
[8] *per* Winslow J. in *Malayan Banking Ltd. (No. 1)* [1965] 1 M.L.J. 60.
[9] *per* Lord Blanesburgh in *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161 at p. 194.
[10] Cap. 185, Singapore Statutes, Rev. Ed. 1970.
[11] *Boulting* v. *Association of Cinematograph, Television and Allied Technicians* [1963] 2 Q.B. 606.
[12] *Ibid.*, at p. 636.
[13] *Ibid.*

might have prevented the directors from joining the union on the basis of the rule. Section 131(5) of the Companies Act does not exclude this possible approach as it is, by virtue of section 131(8), "in addition to and not in derogation of the operation of any rule of law... restricting a director from holding offices or possessing properties involving duties or interests in conflict with his duties or interests as a director."

Winslow J. did not pursue the point in depth basically because his Lordship thought that there was no ground for the apprehension that the action of Rayner would have resulted in irreparable injury to Raffles Hotel Ltd. In any case, his Lordship held that clause 14 of the lease implied that Raffles Hotel Ltd. had relaxed the rule in its favour. Without such a relaxation, however, it is difficult to see how a conflict can be avoided in a nominee directorship situation unless the nominating company appoints someone who is not in any legal relationship with it. This would automatically rule out the favourite appointees to such directorships *(viz.,* directors, solicitors and accountants of the nominating company) and many conceivably destroy the commercial purpose of the nominee director — unless, of course, the company giving the power to nominate in its articles or otherwise waives the benefit of the rule against conflict of duty and interests (but the nominee directors may still be liable for failing to act *bona fide* for the benefit of the company).[14]

The nature and effect of the article of association

The second question presented to Winslow J. in *Malayan Banking Ltd. (No. 1)* was whether the interim injunction restraining Malayan Banking Ltd. from acting as a director of Raffles Hotel Ltd. should be continued, pending trial of the substantive issues. At this stage, his Lordship was required not to make a final decision on the merits of the case, but merely to decide whether there was a triable issue as to whether Malayan Banking Ltd. should be permitted to exercise their powers as a director of Raffles Hotel Ltd. Winslow J. held that there was such a triable issue on two grounds: first, article 77 did not give Malayan Banking Ltd. any right to appoint a director to the Raffles Hotel Board, and second, even if there was such a right, it was doubtful whether the article contemplated the appointment of a legal person (a company in this case) as opposed to a human being.

In *Malayan Banking Ltd. (No.* 2),[15] his Lordship delivered his final decision on article 77 of Raffles Hotel Ltd.'s articles as well as clause 14 of the lease. The arguments submitted by Raffles Hotel Ltd. were as follows: first, article 77 of its articles of association did not confer any contractual rights on Malayan Banking Ltd. to appoint itself a director of Raffles Hotel Ltd.; second, Malayan Banking Ltd. could not be appointed director because it was a "person interested in or connected with any business of a similar nature" to Raffles

[14] *Cook* v. *Deeks* [1916] 1 A.C. 554. The scope of this principle of *"bona fide* in the interests of the company" is, however, unclear. See R.W. Parsons in (1967) 5 M.U.L.R. 395.

[15] [1965] 1 M.L.J. 262.

Hotel Ltd.; and third, the articles of Raffles Hotel Ltd. did not set out the necessary machinery to enable Malayan Banking Ltd. to act as a director of Raffles Hotel Ltd.[16] The last argument was based, presumably, on the fact that Malayan Banking Ltd. was a corporation.

Malayan Banking's answer to the first argument was that either article 77 or clause 14 of the lease conferred on it a contractual right to appoint a director to the Raffles Hotel Board. The judgment did not refer to Malayan Banking's answers to the second and third arguments, presumably because Winslow J.'s decision on the first argument was sufficient to dispose of the case.

His Lordship first cited the relevant statutory provision, Section 22(1) of the Companies Ordinance, which read as follows:

> "Subject to the provisions of this Ordinance, 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 his executors and administrators to observe all the provisions of the memorandum and of the articles."[17]

The learned judge then referred to the well-known proposition, established in relation to the United Kingdom counterpart of Section 22(1), that articles of association are a contract between company and shareholders and between the shareholders *inter se* and do not constitute any contract between a person who is not a party to them (i.e. a person who is not a member of the company) and the company. His Lordship distinguished the cases of *British Murac Syndicate Ltd.* v. *Alperton Rubber Co. Ltd.*[18] and *In re Anglo-Anglican Printing & Publishing Union*[19] on the ground that in both cases there were contracts binding on the companies outside the articles. His Lordship, citing *Palmer on Company Law,* further pointed out that an escape hatch from the rigour of the rule has been created by judges: in some cases, the courts have held that a clause in the articles is itself an implied term of a separate contract between the company and an outsider. His Lordship, however, declined to hold that article 77 amounted to such a clause as between Raffles Hotel and Malayan Banking. Accordingly, he concluded that the self-appointment of Malayan Banking as a director of Raffles Hotel was void.

On clause 14 of the lease, his Lordship held that it was irrelevant to the case since no question of assignment or subletting arose. He remarked however, that, were it necessary to decide the point, he would have been prepared to hold, on the facts before him, that Malayan Banking was interested in or connected with a business similar to that of Raffles Hotel by virtue of the fact that one of its subsidiaries held 68% of the shares in Goodwood Park Hotel Ltd.

[16] *Ibid*., at p. 263.

[17] The equivalent of this in the present Companies Act is Section 33(1). The wordings of the two sections are identical except for the omission of "his executors and administrators" from the present section,

[18] [1915] 2 Ch. 186.

[19] [1892] 2 Ch. 158.

I propose to discuss Winslow J.'s judgment on article 77 and clause 14 under the following heading: (a) Are the articles a contract and nothing else? (b) What is the relevance if any of clause 14 in relation to the articles, even when the facts fall within its scope of operation?

(a) *Are the articles merely a contract?*

Winslow J.'s decision on article 77 is postulated on the premise that the articles are a contract between the company and the members, as well as between the members *inter se,* so that no outsider can acquire any enforceable right under them. This proposition seems far too wide, and conflicts with the decision of the Supreme Court of New Zealand in *Woodlands Ltd.* v. *Logan.*[20] In that case, an article of the company provided that the managing director should have the power to appoint a successor by will, and that in default of such an appointment by will, the trustees of his estate might exercise the same power. The trustee exercised this power twice, the second time on the death of their first appointee. Cornish J. held that the second appointment was invalid as the power of appointment was exercisable only once. He held however that the first appointment was valid. While not disputing the correctness of *Eley's* case and related cases, he nevertheless said:

> "In the case now under consideration, the trustees have no need (as the plaintiff had in *Eley* v. *Positive Government Security Life Assurance Co.* or *Browne* v. *La Trinidad)* to take legal proceedings against the company. They are able to enforce their rights be merely exercising them. They appoint a managing director.... The company cannot challenge what he does in bona fide exercise of his powers. As managing director, he is in full control of the affairs of the company.... His authority is paramount; and, *while the articles remain unaltered, any attempt to dispossess him would be an attempt by irregular means to vary the constitution of the company....* "[21] (Italics mine).

Although this passage is still couched in terms of the contractual nature of the articles, the last sentence shows the way out of the theoretical problem posed to both Cornish J. and Winslow J. The articles may be a statutory contract — but it is more than a contract: it forms an integral part of the constitution of a company. The draftsman of the Companies Act included the provisions on both the memorandum and the articles under the general heading "Part III — Constitution of Companies". Indeed, it is traditionally the articles and not the memorandum which defines the composition, function and procedure of the Company's major organs: the general meeting and the board of directors. It follows that, subject to the Companies Act, articles of a company may define the procedure leading to the appointment of directors. As there is nothing in the Act which requires that directors be elected by members, it is surely within the province of the articles to vest the power of appointing one or more directors in outsiders. A director so appointed holds office validly, not because (as Cornish J. suggested) the appointer need not take legal proceedings to enforce his appointment, but because the articles as a constitutional document of the company have been correctly invoked in the ascertainment of one of the com-

[20] [1948] N.Z.L.R. 230.
[21] *Ibid.*, at p. 236.

pany's organs. Cornish J. in *Logan's* case clearly had this in mind when he said:

> ". . . I cannot think that while the articles of this company remain in their present form any attempt by the company or shareholders to act in contravention of them would be supported by the Court. I cannot see how either could found a successful suit on repudiation of the Company's constitution."[22]

If the submission here is correct, then the terminology of "outsider rights," which is used to describe situations similar to the present case should be confined to the situation when no question of the composition of the company's organs and other constitutional matters arises.[23]

(b) *What is the relevance of Clause 14 of the lease in relation to the article?*

Winslow J.'s judgment proceeded on the assumption that had it been applicable, clause 14 of the lease would have been sufficient to render Malayan Banking's appointment as director invalid. With respect, this assumption ignores the true nature of the articles of association. There seems to be no decision which holds that a company cannot be restrained from acting in breach of its contract with a third party, and in principle this should be a possible remedy. On the other hand, however, the constitution of an organ of the company is not a contractual matter, and there seems to be no objection in principle to a court's holding that the appointment of a director in accordance with the articles is valid despite the appointer's breach of contract. In the present case, the terms of article 77 are clear, and they are in conflict with clause 14 of the lease. The reason, as Winslow J. pointed out was that:

> "... article 77, and indeed all the articles of association of the plaintiff company, preceded the plaintiff company's acquisition of the lease by some four months. Clause 14 of the 1925 lease therefore did not affect the plaintiff company until four months after it had been formed, and it is therefore small wonder, perhaps, that a difference exists between clause 14 and article 77."[24]

In short, the only valid method of amending the articles was by invoking section 31 of the Companies Act, and any contract between the company and outsiders which purports to affect the constitution of the company as laid down in the articles is ineffective unless it is incorporated into the articles. Of course, the remedy for breach

[22] Ibid.

[23] G.D. Goldberg in "The Enforcement of Outsiders-Rights Under Section 20(1) of the Companies Act 1948" (1972) 35 M.L.J. 362 explained *Woodlands Ltd.* v. *Logan* on the basis 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, if (1) he sues *qua* member and not *qua* outsider and (2) the enjoyment of the 'outsider' rights is incidental to the exercise by a particular organ of the company of a power vested by the Act or by the Company's memorandum or articles in that organ. This basis is adequate to explain *Logan's* case (which involved a challenge by some members to the appointments made by the trustees) but would make the constitutional aspect of the articles subservient to its contractual aspect. It is moreover contrary to the explicit reasoning of Cornish J. in *Logan's* case.

[24] [1965] 1 M.L.J. 262 at p. 263.

of contract remains available; but this is not by itself sufficient ground for a qualification of the clear wording of the articles.[25] It is respectfully submitted that Winslow J.'s decision on this point should be reviewed when the occasion arises.

Conclusion

It is not uncommon for the articles of association of companies to contain provisions empowering "outsiders" to make appointments to their boards of directors. Until *Raffles Hotel Ltd.* v. *Malayan Banking Ltd.* — and, indeed, in spite of it — the legal profession and the business community have always assumed that this sort of provision is valid. This comment has attempted to show that there is sound legal basis for that assumption and that the *Malayan Banking* case in deciding to the contrary emphasised only the contractual aspect of the articles of association while completely ignoring its equally important constitutional aspect. It is hoped that the Court of Appeal will in the not too distant future clarify this rather unsatisfactory area of our law.

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[25] See *Nelson* v. *James Nelson & Sons Ltd.* [1914] 2 K.B. 770; *Southern Foundries (1926) Ltd.* v. *Shirlaw* [1940] A.C. 701; *Punt* v. *Symons & Co. Ltd.* [1903] 2 Ch. 506. Where the matter is one concerning only the contractual relation between the company and an outsider, *and does not affect the constitution of the company,* then it is perfectly consonant with this principle that in appropriate circumstances (where the contract is not subject to the articles) the contract with the outsider should operate despite inconsistency with the articles. This submission will adequately explain the decision of Sargant J. in *Baily* v. *British Equitable Assurance Co.* [1904] 1 Ch. 374 (C.A.). On the other hand, *British Murac Syndicate Ltd.* v. *Alperton Rubber Co. Ltd.* [1915] 2 Ch. 186 cannot be so explained, and should be regarded as incorrectly decided in view of the pronouncements in the House of Lords in *Shirlaw's* case and its inherent inconsistency with *Punt* v. *Symons & Co. Ltd.* which contrary to the assumption of Sargant J. was not overruled in *Shirlaw's* case.

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