A company without a memorandum of association: policy implications*

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This paper examines the policy bases underpinning changes to Zambia's company law in terms of which the Companies Act 1994, companies are no longer required to have a memorandum of association. In particular, the paper concentrates on the lack of statutory obligation in the Companies Act 1994 for companies to have an objects clause. Underscoring the views expressed, the argument that whereas under the English Companies Act 1985 the doctrine of ultra vires has been abolished, the position under the Zambian Companies Act 1994 is somewhat unclear. In the United Kingdom, company directors will bind the company in transactions with third-parties no matter how far removed the transaction is from the company's usual business. The directors will bind the company provided that they are dealing with a bona fide party who has no notice of limitations on their powers, and that party has given value.

In Zambia, provisions of the 1921 Zambian Companies Act, the statute which preceded the 1994 Zambian Companies Act, required every company incorporated under the 1921 law to have a memorandum of association. The Companies Act 1994, which repeals and replaces the 1921 Companies Act, is silent on the issue of a memorandum of association. What, then, are the implications of such innovations in Zambia's company law? One view is that the Companies Act 1994 has abolished the statutory requirement for a memorandum of association. This view, as we shall see below, is not free from difficulties.

It appears likely that what the drafters in fact intended was the abolition of the ultra vires doctrine in Zambia. However, a number of anomalies arise. What happens to existing companies incorporated under the repealed 1921 Companies Act — almost all of which have retained their memoranda of association? What happens to the common law position on the objects of a company given that the 1994 Companies Act does not state whether or not it has abolished the requirement of a memorandum of association? Does the common law position still apply in Zambia?

*Comments from colleagues who read through the earlier drafts of this paper are gratefully acknowledged. The interpretations and conclusions expressed in the paper are entirely those of the author. They do not necessarily represent the views of the World Bank, its executive directors, or the countries they represent.

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Under the 1994 Zambian Companies Act, a company will typically not have a memorandum of association although it may choose to have one. Where the company has no memorandum of association it will normally not have an objects clause. As seen in a number of foreign Companies Acts, the objects clause is traditionally spelt out in the memorandum of association. However, taking an extreme case for Zambia, it could be argued that an objects clause may be inserted in the articles of association. Challenging as it may seem, this view is overly superficial as for the most part Zambian companies tend to adopt the standard articles appearing in schedule 1 to the 1994 Companies Act. Indeed, such an approach reduces transaction costs surrounding an agreement on a different set of articles of association. The standard articles in schedule 1 to the 1994 Zambian Companies Act have make no provision for a standard objects clause. To this extent, the view that the objects clause may be contained in the articles of association may be questioned.

By comparison, section 35A of the English Companies Act 1985, the statutory provision which abolished the *ultra vires* doctrine in the United Kingdom, does not release companies from the obligation of having a memorandum of association. The section simply makes acts of company directors binding even where they exceeded the powers of the company as set out in the objects clause.

It is important to distinguish between section 35A of the English Companies Act 1985, and the situation under the Zambian Companies Act 1994, for the following reasons:

- In the United Kingdom, credit and finance companies are afforded the opportunity of having public 'notice' of the type of business that the borrowing company engages in. This notice can help financial institutions, such as banks, to craft a financial strategy should the debtor company become financially distressed and be unable to repay the debt. In the language of economists, this feature reduces agency costs of asymmetric information since the creditor company already has some valuable information on the business of the debtor company.

- Unlike the Zambian position, the position in the United Kingdom is likely to lead to a situation of reduced debt monitoring costs since the creditor company, as in the above paragraph, already has some valuable information on the business of the debtor company. The objects clause here serves as a 'signal' to the creditors on the likely purposes to which the debt is to be applied. In the case of Zambia, risk — averse investors may be hesitant to lend money to a debtor company whose objects clause is unknown. This feature might constrain liquidity on markets such as the Lusaka Stock Exchange, since venture capital funds that are risk averse and extra-sensitive to imperfect market conditions, might withhold their support for thinly capitalised companies. In general, however, the notion of signalling does not entirely eliminate the risks associated with debt monitoring until the debt is repaid in full.

- Interestingly, however, the Zambian case provides a pervasive incentive for directors of the borrowing company to engage in any form of business
which optimally enhances the allocation of resources within the company, from the company to the market and vice versa. This feature may, on the face of it, seem an absolute incentive. However, there are shortcomings. There is always the possibility of some recalcitrant directors abusing such a privilege by breaching their fiduciary duties to the company and pursuing their own idiosyncratic values. This would then pass the external and private costs of the directors on to the company. In a sense, the allocation of risks here could lead to a somewhat inefficient outcome, unless the directors are made to internalise their costs. This is what the ultra vires rule seeks to achieve, although it rarely succeeds because it often leaves the innocent party worse off than he would have been without the transaction.

- It would seem plausible to argue that in Zambia, unlike in the United Kingdom, the ultra vires doctrine has not been abolished. Companies that choose to have an objects clause, or those that already have one pursuant to provisions of the 1921 Companies Act, will be guided by the common law on the ultra vires doctrine. Companies that choose not to have an objects clause under the 1994 Act will, by contrast, not avail themselves of the ultra vires doctrine, unless perhaps such a company can show that a widely recognised custom is being relied on that the company has an implicit objects clause which is dictated by the nature of business it conducts. This is a very academic argument and whether or not it can be sustained is a matter for the Zambian courts.

- Since under the 1985 English Companies Act the doctrine of ultra vires has been abolished, company directors in England will bind the company by their acts no matter how remote these are from the company's usual business. The same applies to the Zambian companies without an objects clause. This provides an important safeguard for creditors. The creditors' costs of gathering information on the objects of the company are drastically reduced and the law raises the level of certainty on acts that will bind the company. But in another sense, the United Kingdom position, requiring an objects clause, places some constraint on the business avenues to be pursued by the directors, even if such pursuits would have maximised value for shareholders and creditors.

- In Zambia, the certainty of how broad-ranging terms can be to bind the company reduces the cost of information gathering for an investor investing in a company whose objects he or she does not know. A number of external factors are discounted. To some extent, the abolition of the ultra vires doctrine in the United Kingdom has the same effect here.