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Title of Dissertation: *" The Turquand rule, corporate capacity and agency in South Africa"*

CONTENTS

CHAPTER THREE

3. Doctrine of constructive notice

CHAPTER FOUR

4. The Turquand rule:

CHAPTER FIVE

5. Representation by the directors of a company

CHAPTER 6:

DECLARATION:

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ABSTRACT:

The Companies Act 2008[1] ("the Act") has had a long and arduous path to come into existence. It started with the Guidelines for Corporate Law Reform published in Notice 1183 in *Government Gazette* 26493 of 2004-06-23, ironically marked "Confidential". After various draft bills, the Act was signed by the President on 08th April 2009 but only to came into operation on the date determined by proclamation, and from the general effective date then repealed most of the Companies Act of 1973[2] ("1973 Act").[3]

The Act[4] started a new era in South African corporate law and extensively changed the existing law, and the common law. It appears that the Act follows an eclectic approach in that it borrowed extensively from the corporate laws of other countries. This is not *per se* an unacceptable *modus operandi*, but rather the careful grafting into the existing common law was necessary, so as not to create problems and uncertainty.[5] A situation where this may be the case, and where the confusion may be exacerbated, is in respect of company capacity and representation. Capacity and representation of a company are some of the most important principles of company law as this is the interface with the outside world, and certainty for the company and third parties should be a given. However, in practice this has never been the case and the concepts have been confused with one another and on their own by the courts, academics and students. The confusion was not because of anything else but the extraordinary complexity of these concepts if one were to stray from the most basic principles.[6]

[1] The Companies Act 71 of 2008
[2] The Companies Act 61 of 1973
[3] Basil Wunsch "Disposing of the undertaking or the assets of the company" (1971) 88 SALJ 351

[4] See note 1
[5] Bekink, M. "An historical overview of the Turquand rule from the nineteenth century to the companies bill of 2007: analyses" (2008) 20 (1) *SA Mercantile Law Journal* 138

[6] Bekink, M. "An historical overview of the Turquand rule from the nineteenth century to the companies bill of 2007: analyses" (2008) 20 (1) *SA Mercantile Law Journal* 139

The Companies Act 2008[7] brought in many changes to the way in which the conduct of business will be regulated in South Africa. One of the aspects which have been the subject of much comment and debate is the way in which a company will regulate its internal affairs and procedures through the introduction of the Memorandum of Incorporation (MOI), which document will replace the Memorandum and Articles of Association[8] (Memorandum and Articles) under the Companies Act, 1973[9].

The Memorandum of Incorporation and Articles of Association has the function of, among other things, regulating the authority individuals within a company have to bind that company when contracting on its behalf with third parties. In terms of the New Act[10], it will become mandatory for all companies conducting business in terms of its Memorandum and Articles to adopt a MOI to replace the existing Memorandum and Articles. While the function of the Memorandum of Incorporation mirrors that of the Memorandum of Incorporation and Articles of Association, there are significant changes regarding the way in which this document is constructed and interpreted.[11] Of particular interest to companies, and something to keep in mind when conducting the exercise of converting the Memorandum of Incorporation and Articles of Association to a Memorandum of Incorporation, is the way in which certain clauses in the Memorandum of Incorporation will be treated in respect of third parties contracting with the company, and in particular how the Turquand Rule[12] and the Doctrine of Constructive Notice, two well established principles under the current regime, have been changed.[13]

Hence, an in depth analysis containing a re-statement of the law in respect of representation of a company is necessary to the extent that it is relevant for the discussion below.

[7] See note 1
[8] See note 3; 353
[9] See note 2
[10] See note 1
[11] See note 3; 353
[12] *Royal British Bank v Turquand* (1856) 6 E&B 327
[13] See note 5; 139

CHAPTER ONE:

1. Introduction

1.1. The title

"*The Turquand rule, corporate capacity and agency in South Africa"*

1.2. The topic:

The topic upon which the research will be conducted involves a company law aspect in which an in depth analysis of information relating to the Turquand Rule and its application in South Africa Further, an analysis of Corporate Capacity and Agency, the Doctrine of Constructive Notice and the *ultra vires* doctrine will be conducted.

1.3. The research design, methodology and ethical framework:

The research methodology for this paper is desk-based therefore, the research in respect of the Turquand Rule and corporate capacity and agency will be based on cases, common law and legislation analysis. Other literature such as journals, articles and textbooks will be considered as well.

The way in which this research will be done will involve research in terms of the various databases which are made available. The following databases will be used during the midst of the research namely, Juta, Lexis Nexis, Hein online, SAFLII and Sabinet.

The theoretical framework that will be adopted in the midst of this study is analytical doctrine research, also known as legal positivism.

This theoretical frame deals with the law which is posited by human and the validity of such law lies in its formal legal status and not in relation to morality or any other external validating factor. In other words, there is a separation of law and morality.

In relation to this, the broader theoretical perspectives hold that human knowledge is based upon that which can be experienced through the senses or through observation (empirically). As a result of this, law is thus the observable phenomenon of legislation, adjudication and other legal institutions.

Bearing this in mind legal positivism is suited to research questions which involve the description and explanation of the law as it is, including the analysis of legal texts to determine their meaning. There will be an examination of the Statutory and common law regimes which are applicable as well as the study of case law jurisprudence.

The study will be strictly law focused and will not at any point make reference to the aspect of morality in law.

1.4. The rationale or purpose conducting research in respect of this topic:

Leading South African academics have long been in favour of a change in South African company law to curtain the operation of the doctrine of constructive notice in regard to limitations on directors' authority in the Memorandum of Incorporation. Further, third parties who may be acting in good faith (*bona fide)* need to be aware of indoor or internal company procedures and the consequences of not complying with same. On the other hand, it is also important to be aware of *mala fide* third parties who contract with juristic personalities and the consequences thereof. With that being said, a very basic restatement of the law in respect of representation of a company and the current standard of the application of the Turquand rule is necessary.

1.5. The background of the topic:

1.5.1 Introduction:

The Companies Act of 2008[14] had a long and arduous path to come into existence. Capacity and representation of a company are some of the most important principles of company law as this is the interface with the outside world, and certainty for the company and third parties should be a given. However, in practice this has never been the case and the concepts have been confused with one another and on their own by the courts, academics and students. The

[14] See note 1

confusion was not because of anything else but the extraordinary complexity of these concepts if one were to stray from the most basic principles.[15]

Prior to 1 April 2011, the date on which the Companies Act 2008[16] came into force, the authority to enter into a contract on behalf of a company was governed by generally applicable agency principles supplemented by the common-law doctrine of constructive notice and the common- law *Turquand*[17] rule. This dissertation seeks to highlight some of the problems brought about by the changes made to the law in this regard by the Act.

It does not deal with the situation where authority to contract on behalf of the company is lacking because the contract is beyond the company's capacity. It is assumed, therefore, that the contract in question in this note is within the company's capacity.

1.5.2 The common law:

In terms of the common law, a person dealing with a company cannot assert as against the company that he did not know the contents of the public documents of the company. This is known as the doctrine of constructive notice. As a result of the doctrine, a person has no legal grounds for complaint if the transaction he enters into with the company is held not to be binding on the company because it patently conflicts with the company's requirements as laid down in the company's public documents, regardless of whether that person had in fact inspected those documents and became aware of those requirements.[18] The transaction may be invalid, however, not because it patently conflicts with a requirement of its public documents, but because some required condition has not been fulfilled, or because some required procedure has not been followed. An inspection of the public documents will not reveal whether it has been fulfilled or followed.[19]

[15].FHI Cassim.et al Contemporary Company Law.2ed. (2012) ;154

[16] See note 1

[17] See note 15; 155

[18] Ruthowski W. "Modifying common law Doctrines" (2009) 9 (8) *Without Prejudice* 31

[19] R.C. Williams *Concise Corporate and partnership law.* 2ed. (2013) 179.

In these circumstances the rule in the case of *Royal British Bank v Turquand*[20] ('the *Turquand* rule') provides that 'persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to enquire whether acts of internal management have been regular. Such protection by the *Turquand* rule[21] is understandably not available, however, if the person was aware of the irregularity or suspected such an irregularity.[22]

1.5.3 The statutory law:

Section 228 of the Companies Act 61 of 1973[23] at the time provided:

'Disposal of undertaking or greater part of assets of company.

(1) Notwithstanding anything contained in its memorandum or articles, the directors of a company shall not have the power, save with the approval of a general meeting of the company, to dispose of:[24]

(a) the whole or substantially the whole of the undertaking of the company; or[25]

(b) the whole or the greater part of the assets of the company.[26]

(2) No resolution of the company approving any such disposal shall have effect unless it authorizes or ratifies in terms the specific transaction.'[27]

Turning now to the 2008 Companies Act[28], some of the provisions of the Act relevant to the current status of the common law doctrine of constructive notice and the *Turquand*[29] rule are s 19(4)[30], s 19(5)[31], s 20(7)[32] and s 20(8)[33]. Section 19(4)[34] and 19(5)[35] deal with the doctrine

[20] See note 15;169
[21] See note 12
[22] See note 15; 156
[23] See note 2
[24] See note 2
[25] See note 2
[26] See note 2
[27] See note 2
[28] See note 1
[29] See note 15; 161
[30] See note 1
[31] See note 1

of constructive notice, and s 20(7)[36], read with s 20(8)[37], appears to create a statutory *Turquand* rule[38] while explicitly retaining the common-law *Turquand* rule. These provisions will be set out for the convenience of the reader and then discussed.

Section 19(4) and 19(5) provide[39]:

> '(4) Subject to subsection (5), a person must not be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document:[40]
>
> *(a)* has been filed; or
>
> *(b)* is accessible for inspection at an office of the company.'[41]
>
> '(5) A person must be regarded as having notice and knowledge of:
>
> *(a)* any provision of a company's Memorandum of Incorporation contemplated in section 15(2)*(b)* or *(c[42])* if the company's name includes the element ''RF'' as contemplated in section 11(3)*(b[43])*, and the company's Notice of Incorporation or a subsequent Notice of Amendment has drawn attention to the relevant provision, as contemplated in section 13(3)[44]; and
>
> *(b)* the effect of subsection (3) on a personal liability company.'[45]

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[32] See note 1
[33] See note 1
[34] See note 1
[35] See note 1
[36] See note 1
[37] See note 1
[38] See note 15; 164
[39] See note 1
[40] See note 1
[41] See note 1
[42] See note 1
[43] See note 1
[44] See note 1
[45] See note 1

Sections 20(7) and 20(8) provide:[46]

> '(7) A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.[47]
>
> (8) Subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers.'[48]

In terms of s 20(7)[49], it is arguable that delegation by the board of a company to an ordinary director of authority to enter into a transaction on behalf of the company in terms of the 'rules' of a company is a 'formal' or 'procedural' requirement and a third person dealing with such a director can, in terms of s 20(7)[50], presume that the company has complied with such requirement (s 20(7)[51] refers to 'formal and procedural requirements' in terms of, inter alia, 'rules' of the company). If so, s 20(7)[52] is in this respect, again, at odds with the common-law *Turquand* rule[53].

Section 20(7)[54] also clashes with the common-law *Turquand* rule[55] in relation to 'insiders'. Section 20(7)[56] does not protect a 'director, prescribed officer or shareholder of the company' (ie 'insiders'). The common-law *Turquand* rule's[57] protection, on the other hand, is not entirely out of an insider's grasp. There are clearly circumstances in which insiders will be

[46] See note 1
[47] See note 1
[48] See note 1
[49] See note 1
[50] See note 1
[51] See note 1
[52] See note 1
[53] See note 15; 165
[54] See note 1
[55] See note 13;165
[56] See note 1
[57] See note 11

protected. [58]

Section 19(4)[59] read with s 19(5)[60], it will be observed, abolishes the doctrine of constructive notice, except where the following requirements are met:

- the memorandum of incorporation contains restrictive conditions applicable to the company;

- the company's name includes the element ''RF'' (see also s 11(3)*(b)*); and

- the company's Notice of Incorporation or a subsequent Notice of Amendment has drawn attention to the restrictive conditions.[61]

It appears that a positive doctrine of constructive notice may be provided for by s 19(4)[62] in the circumstances set out in s 19(5)[63]. It follows that, unlike the common-law doctrine, the statutory doctrine may be of assistance to a third party in certain circumstances and not only the company. This could hardly have been intended by the legislature, but it seems that it can be construed in this way.

The knowledge that s 19(4)[64] says a person 'must not be regarded as having' does not include knowledge of provisions of the Act. Section 19(4)[65] only refers to knowledge of the contents of any document relating to a company. Hence, a person is regarded as having knowledge of, for example, provisions of the Act requiring a special resolution. This is, of course, in keeping with the general maxim 'ignorance of the law is no excuse'. Or perhaps more to the point, where the validity of a transaction is conditional on compliance with a statutory requirement, the issue is simply whether or not that requirement was fulfilled, and knowledge or the lack thereof is irrelevant.

[58] Basil Wunsch "Disposing of the undertaking or the assets of the company" (1971) 88 SALJ 351

[59] See note 1
[60] See note 1
[61] See note 15;158
[62] See note 1
[63] See note 1
[64] See note 1
[65] See note 1

Turning to s 20(7)[66], it is arguable that delegation by the board of a company to an ordinary director of authority to enter into a transaction on behalf of the company in terms of the 'rules' of a company is a 'formal' or 'procedural' requirement and a third person dealing with such a director can, in terms of s 20(7)[67], presume that the company has complied with such requirement s 20(7)[68] refers to 'formal and procedural requirements' in terms of, inter alia, 'rules' of the company). If so, s 20(7)[69] is in this respect, again, at odds with the common-law *Turquand* rule[70].

Section 20(7)[71] also clashes with the common-law *Turquand* rule[72] in relation to 'insiders'. Section 20(7)[73] does not protect a 'director, prescribed officer or shareholder of the company' (ie 'insiders'). The common-law *Turquand* rule's[74] protection, on the other hand, is not entirely out of an insider's grasp. There are clearly circumstances in which insiders will be protected.

1.5.4. Conclusion:

In the foregoing conclusion it can be established that both the common law and statutory law principles with regard to the Turquand Rule[75] and corporate capacity is of particular importance. The rationale behind these principles as encompassed in the statutory law involves and inculcates situations wherein a bona fide third party may be exploited or alternatively, an employee / director may not act within their due capacity. While criticisms will accordingly be jilted towards corporate capacity and the Turquand Rule[76], its high standing efficiency in the South African law seems to be worthy of its position.

[66] See note 1
[67] See note 1
[68] See note 1
[69] See note 1
[70] See note 15;154
[71] See note 1
[72] See note 15;154
[73] See note 1
[74] See note 15;155
[75] *Supra*
[76] *Supra*

CHAPTER TWO

2.1. Legal capacity of a company:

In order for a contract to be legally binding against a company, there are two company law requirements that must be fulfilled. The first requirement is that the company must have the legal capacity to enter into a contract. The second requirement is that the person (either a director or agent) representing the company must have the authority to enter into the contract on behalf of the company.[77]

Hence, both these requirements namely capacity and authority are essential prerequisites for a binding contract. However, these two terms, although being closely linked are two extremely different concepts. Capacity refers to the legal competency and powers of the company whereas authority refers to the power of the person representing the company. The company's representative may be a director or agent or any individual acting on behalf of the company. Authority may also be regarded as delegated power. [78]

2.2. The *ultra vires*[79] Doctrine:

2.2.1. What is the *ultra vires* doctrine?

The legal capacity of a company was previously determined as per the main objects of the company which were set out in the company's Memorandum of Incorporation. The objective of a company made it able to understand the existence of a company as a legal person. [80]

According to the *ultra vires* doctrine, a company existed in law, only for the purpose set out in the object clause of the memorandum of association. Beyond these limits, a company was deemed to have no legal existence. [81]

Hence, it is understood that previously if a company had performed a certain act or entered into a transaction and in doing so acted out of the objects set out in the memorandum of incorporation, then it was deemed so that the company exceeded its legal capacity and the company ceased to exist as a legal person for the purposes of the specific contract or transaction. The consequence of such a situation resulted in that contract being null and void

[77] See note 15; 154
[78] *Supra*
[79] *Ultra vires* refers to beyond or outside the powers
[80] See note 14
[81] See note 14

and there was certainly no possibility of ratification despite potential or possible consent or assent by the shareholders', directors' and/or other stakeholders'. [82]

In the case of *Re Horsley & Weight Ltd*[83] the court once again reiterated that a company had no power to act outside of its memorandum of incorporation. In this case it was held that "a power given to a company by its memorandum of association to grant a pension held to be capable of subsist as a substantial object and not merely as an incidental power. The pension was consequently not *ultra vires"*. [84]

Therefore, an *ultra vires* act refers to those transactions that were regarded as null and void due to the fact that they fell outside the scope of the company's powers as stated in the company's constitution and such an act could never become *intra vires* by reason of ratification. Nevertheless, such an act or transactions must never be regarded as illegal or unauthorised and the term *ultra vires* must be confined to its strict definition.[85]

2.2.2. The legal consequences of the *ultra vires* doctrine:

The legal consequence of an *ultra vires* contract resulted in a further consequence than simply rendering the contract null and void. This consequence was regarded as an external consequence. There were also two internal consequences to every *ultra vires* contract. Internal consequences refer to consequences that arise between the company, its directors and shareholders. These consequences still remain relevant to the modern company law and to the Companies Act of 2008[86]. [87]

The first internal consequence is that in every *ultra vires* contract entered into by any representative of the company could not possibly have had the authority to enter into that contract. If the company did not have the legal capacity to enter into the contract, its directors and other agents could not possibly have authority to enter into the contract on behalf of the company. It follows that the directors and or the agents would have exceeded their powers and authority and would, as a result, be liable to the company for damages for breach of their fiduciary duty not to exceed their authority. [88]

[82] See note 14
[83] *Re Horsely & Weight Ltd* (1982) 3 All ER 1045 (CA) 1050-1 (A power given to a company in terms of MOI)
[84] See note 14
[85] See note 15; 155
[86] See note 1
[87] See note 15;156
[88] *Supra*

The second internal consequence of an *ultra vires* contract was that, since, the company in entering into an *ultra vires* contract would inevitably have failed to comply with the requirements of its constitution, every shareholder of the company would have been entitled at common law to institute legal proceedings to restrain the company from entering into or performing an *ultra vires* contract due to the contractual nature of the company's constitution. The constitution of a company formed, and still forms the basis for a statutory contractual relationship between the company and its shareholders. The *ultra vires* doctrine consequently played and continues to play a pivotal role in internal disputes. [89]

2.2.3. The failure of the *ultra vires* doctrine:

Companies were easily able to circumvent the ultra vires doctrine by specifying in detail and as widely as possible in their object clauses all the business activities the company might wish to pursue, together with a comprehensive and detailed catalogue of ancillary powers. It was later on established by Lord Wrenbury in the case of *Cotman v Brougham*[90] that the function of the objects clause was not to specify or disclose but to bury beneath a mass of words the real object of the company with the intent that every conceivable form of activity shall be found included somewhere its terms. Hence, instead of disclosing the company's main business activities, the objects clause disclosed it. [91]

Drafting techniques thus enabled companies to evade the ultra vires doctrine. The ultra vires doctrine developed into an illusory protection for shareholders and a pitfall for unwary third parties dealing with the company. The original purpose of the ultra vires doctrine was frustrated and stifled by the independent objects clause.[92]

The acceptance by the House of Lords in *Cotman v Broughman*[93] was taken even further in the case of *Bell Houses Ltd v City Wall Properties Ltd*[94] where the court accepted the validity of a subjective objects clause. A subjective objects clause empowered the board of directors to carry on any business which, in the opinion of the board could be advantageously carried on by the company. [95]A subjective objects clause permitted the company to pursue any

[89] See note 14
[90] *Cotman v Brougham* (1918) AC 514 (HL) 522-53
[91] See note 15; 157
[92] *Supra*
[93] *Supra*
[94] *Bell Houses Ltd v City Wall Properties Ltd* (1966) 2 All ER 674 (CA)
[95] Ruthowski W. "Modifying common law Doctrines" (2009) 9 (8) *Without Prejudice* 32

activity that the directors considered to be related to the company's main object. In accepting the subjective objects clause, the court deprived the ultra vires doctrine of all its remaining validity. It was consequently observed that the victory of the subjective objects clause must be the beginning of the ultra vires doctrine. The case of *Bell House*[96]*s* reduced the ultra vires doctrine to obsolescence and this doctrine was no longer positive and it certainly did not serve a useful purpose. [97]

2.2.4. The reform of the *ultra vires* doctrine:

Pursuant to the decision in the *Bell House*[98]*s* case discussed above, almost all common- law jurisdictions that had adopted the ultra vires doctrine either abandoned or reformed the doctrine by statutory amendment.[99]

In South African law, this was done in terms of section 36 of the 1973 Companies Act[100]. Section 36[101] did not entirely abolish the ultra vires doctrine, instead, it abolished only the external requirements of an ultra vires contract while preserving the internal consequences. It remained mandatory for a company to state its objects clause in its Memorandum of Incorporation. In terms of section 36 of the 1973 Act[102], an ultra vires contract was no longer void by reason only of lack of authority or capacity on the part of the directors to enter into an ultra vires contract on behalf of the company. The directors' lack of authority did not affect the company provided that such lack of authority arose from a lack of capacity. Externally, the ultra vires contract was valid and binding between the company and the other party to the contract.[103]

The intention of section 36 of the 1973 Act[104] is incorporated in section 20 (5) of the 2008 Act[105] precludes that if a company in legal proceedings against a third party, cannot assert or rely on its lack of capacity. The dispute must be resolved as if the lack of capacity did not exist. While the external consequences of the ultra vires contract were abolished, the internal

[96] *Supra*
[97] See note 15; 157
[98] Supra; 157
[99] Supra; 158
[100] See note 2
[101] See note 2
[102] See note 2
[103] See note 15; 158
[104] See note 2
[105] See note 1

consequences were preserved by section 36 of the 1973 Act[106] and currently, the external consequences are still preserved by section 20 (5) of the 2008 Act.[107]

As between the company, its directors' and shareholders', the directors' would still be liable to the company for any breach of fiduciary duty not to exceed their authority and shareholders of the company are entitled to restrain the company and or its directors' from entering into an ultra vires contract. Once a contract is concluded, shareholders' lose their right to restraint of performance of the contract, hence, the contract is no longer void. The liability of the directors' for breach of fiduciary duty still applies to render directors' liable for damages to the company for any loss suffered as a result of the unauthorised contract.[108]

[106] See note2
[107] See note 15; 158
[108] See note 15; 168

CHAPTER THREE

3.1. What is the doctrine of constructive notice:

The doctrine of constructive notice is a common law doctrine which was laid down in the case of *Ernest v Nicholls*[109] in 1857. This doctrine illustrated that any person dealing with a company was deemed to be aware of the contents of the constitution and other documentation of the company which were public in nature and which was lodged with the Registrar of Companies and which documents were accessible and available for public inspection. [110] The doctrine of constructive notice was however abolished in terms of section 19 (4) of the 2008 act.[111]

3.2. The applicability of the doctrine of constructive notice in terms of the statutory and common law:

Section 19(4) and 19(5) provide:[112]

'(4) Subject to subsection (5), a person must not be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document:

(a) has been filed; or

(b) is accessible for inspection at an office of the company.'[113]

'(5) A person must be regarded as having notice and knowledge of:[114]

(a) any provision of a company's Memorandum of Incorporation contemplated in section 15(2)(b) or (c) if the company's name include the element ''RF'' as contemplated in section 11(3)(b), and the company's Notice of Incorporation or a subsequent Notice of Amendment has drawn attention to the relevant provision, as contemplated in section 13(3); and

[109] *Ernest v Nicholls* (1857) 6 HL Cas 401

[110] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal* 468

[111] See note 15; 168

[112] See note 1

[113] See note 1

[114] See note 1

(b) the effect of subsection (3) on a personal liability company.''[115]

Section 19(4) read with s 19(5), it will be observed, abolishes the doctrine of constructive notice, except where the following requirements are met:

- the memorandum of incorporation contains restrictive conditions applicable to the company;
- the company's name includes the element ''RF''; and
- the company's Notice of Incorporation or a subsequent Notice of Amendment has drawn attention to the restrictive conditions.[116]

It will be noted that the common-law doctrine of constructive notice does not, like s 19(4) and s 19(5), regard a person as having received notice or knowledge of the contents of any public document relating to a company. The doctrine is a negative doctrine operating in favour of a company, and not a positive doctrine in favour also of a third person dealing with the company. The doctrine operates against the person who has failed to inquire, but does not operate in his favour. [117]It operates to prevent the contractor from saying that he did not know that the constitution of the corporation rendered a particular act or a particular delegation of authority ultra vires the corporation. It does not entitle him to say that he relied on some unusual provision in the constitution of the corporation if he did not in fact so rely.[118]

It appears that a positive doctrine of constructive notice may be provided for by s 19(4)[119] in the circumstances set out in s 19(5)[120]. It follows that, unlike the common-law doctrine, the statutory doctrine may be of assistance to a third party in certain circumstances and not only the company. This could hardly have been intended by the legislature, but it seems that it can be construed in this way. The knowledge that s 19(4)[121] says a person 'must not be regarded as having' does not include knowledge of provisions of the Act. Section 19(4) only refers to knowledge of 'the contents of any document relating to a company'.[122]

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[115] See note 1
[116] See note 15; 168
[117] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal* 471

[118] See note 15; 168
[119] See note1
[120] See note 1
[121] See note 1
[122] See note 15; 168

Hence, a person is regarded as having knowledge of, for example, provisions of the Act requiring a special resolution. This is, of course, in keeping with the general maxim 'ignorance of the law is no excuse'.[123] Or perhaps more to the point, where the validity of a transaction is conditional on compliance with a statutory requirement, the issue is simply whether or not that requirement was fulfilled, and knowledge or the lack thereof is irrelevant. The provision of section 19 (4)[124] states that subject to the provisions of section 19 (5)[125], a person may not be regarded as having received notice or knowledge of the contents of any documents relating to the company merely because the document has been filed with the Registrar and available and accessible for inspection.[126]

Initially section 19 (5)[127] provided that a person was deemed to know of any special conditions which applied to the company provided that the company had drawn attention to these special conditions in the company's Memorandum of Incorporation. However, upon an investigation of the bill, it was concluded that such a provision would have provided uncertainty as the term special condition was undefined. Section 19 (5)[128] was therefore amended and it presently introduces a version of the doctrine of constructive notice which applies to two specific situations.

This section now provides that a person may be regarded as having knowledge of the provisions of the company's memorandum of incorporation as contemplated in section 15 (2) (b) or (c) of the 2008 act[129] if the company's name is inclusive of the expression "RF" and the company's memorandum of incorporation or a subsequent amendment thereto draws attention to the relevant provision as contemplated in section 13 (3) of the Act.[130]

Section 15 (2) (b)[131] of the Act provides that a company's memorandum of incorporation may contain any restrictive conditions which is applicable to a company in addition to the requirements set out in section 16 of the Act. Section 16 deals with the amendments of a

[123] Ruthowski W. "Modifying common law Doctrines" (2009) 9 (8) *Without Prejudice* 32

[124] See note 1
[125] See note 1
[126] See note 15; 168
[127] See note 1
[128] See note 1
[129] See note 1
[130] Bouwman N. "the "ring fenced" provisions: Company Law" (2011) 11(6) *Without Prejudice* 25

[131] See note 1

company's memorandum of incorporation. The memorandum of incorporation may even prohibit the amendment of any specific provision of the company's memorandum of incorporation.[132] Section 13 (3)[133] states that if a company's memorandum of incorporation includes any provision contemplated in section 15 (2) (b) or (c)[134] then the company's notice of incorporation must include a statement which draws attention to each provision and its location in the company's memorandum of incorporation. In addition thereto, the expression "RF" which means ring fenced must be suffixed to the name of the company. The expression "RF" is thus designed to alert third parties to restrictive conditions which are applicable to ring fenced companies.[135] If a third party ignores this warning, they will personally bear the consequences as they are deemed to be aware of the provisions.[136]

The second instance where the doctrine of constructive notice will apply is the case of a personal liability company. A profit company is a personal liability company if it satisfies the criteria for a private company and its memorandum of incorporation states that it is a personal liability company. Its memorandum of incorporation must prohibit it from offering any of its securities to the public and the transferability of its securities. The directors of a person liability company including the past directors are jointly and severally liable together with the company for any debts and liabilities of the company that are or were contracted. Persons dealing with a personal liability company are deemed to be aware of the effect of the directors' joint and several liability for the debts and liability of the company which was contracted during their periods of office. Despite the 2008 act[137], the rationale of this particular remains obscure. [138]

[132] See note 15; 168
[133] See note 1
[134] See note 1
[135] *Supra*
[136] See note 13; 168
[137] See note 1
[138] See note 15; 168

CHAPTER FOUR

4. The Turquand rule:

4.1. What is the Turquand rule:

The Turquand rule was formulated as an exception to the doctrine of constructive notice and was created to mitigate the harshness of the doctrine of constructive notice. The Turquand rule is also referred to as the indoor management rule as those dealing with the company are not affected by the company's internal rules and regulations.[139]

The Turquand rule was derived from the case of *Royal British Bank v Turquand*[140]. This case involved restrictions placed by the constitution of a company on the authority of the directors. Turquand was the liquidator of a mining company and this was an action for the return of the money which was borrowed from Royal British Bank who was the Plaintiff. In this case, the articles of association of the company authorised its board of directors to borrow money under the condition that the board obtained the prior approval by the ordinary resolution of the shareholders of the company. The board borrowed money from the Royal British Bank without obtaining the approval of the shareholders of the company. Royal British Bank had no knowledge of this. The court therefore ruled that even though the board of directors had failed to comply with the company's articles of association, the company was still bound by the loan taken from Royal British Bank. The approval of the shareholders as stipulated in the company's articles of association was an internal formality and the bank, which party acted in good faith, was entitled to assume that the internal formality in compliance with the company's articles of association was complied with.[141]

This rule was applied in South Africa in the case of *Mine Workers' Union v Prinsloo*[142].

The Turquand rule protects *bona fide* third parties who are unaware of any internal regulations that affect the validity of a contract with a company. Third parties' are protected by the rule provided that they act in good faith, which will then entitle them to assume that the internal requirements in order to have a contract have been complied with. The third party who is genuinely acting in good faith while contracting with a company is under no duty to ensure that all internal company procedures and formalities have been complied with.

[139] See note 15; 169
[140] Royal British Bank v Turquand (1856) 6 E & B 327, 119 ER 886
[141] See note 15; 169
[142] *Mine Workers' Union v Prinsloo* 1948 (3) SA 831 (A)

[143]Hence, the main basis of the Turquand rule is to ensure that innocent *bona fide* third parties' are not prejudiced by a company's failure to comply with its own internal procedures and formalities as set out in the company's memorandum of incorporation.[144]

The Turquand rule is deemed to be justified for the purposes of business convenience as business dealings would result in much difficulty if third parties were required to enquire as to the internal procedures of a company and ensure that those requirements have been complied with. A third party contracting with a company is entitled to assume that the internal formalities have been adhered to unless he or she is aware or suspects that they have not been complied with.[145]

The Turquand rule prevents a company from escaping liability under a valid contract solely on the grounds that a certain internal formality or procedure was not complied with. Proof by a company that it has failed to fulfil its own internal requirements is not a sufficient basis for escaping liability.[146]

In the case of *Mahoney v East Holyford Mining Co Ltd*[147], the court expressed the Turquand rule as:

"when there are persons conducting the affairs of a company in a manner that it appears to be perfectly consonant with the articles of association, then so dealings with them, externally, are not to be affected by any irregularities which may take place in the internal management of a company.[148]"

In the 1946 case of *Morris v Kanssen*[149] the court held that the Turquand rule is a rule designed for the protection of those entitled to assume, just because they cannot know, that the person with whom they deal with has the authority as he claims. The court went on to further state that the Turquand rule "cannot be invoked if he who would invoke it is put upon his inquiry."

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[143] Mthembu M. "the long arm of the Turquand Rule" (2005) 13(2) *Jutas's Business Law*. 58 – 60

[144] See note 15; 168
[145] See note 15; 170
[146] See note 15; 170
[147] *Mahoney v East Holyford Mining Co Ltd* (1857) LR 7 HL 869
[148] *supra*
[149] *Morris v Kanssen* (1946) AC 459

The Turquand rule applies to all internal irregularities that take place in the management of a company.[150] At common law, the Turquand rule would also apply to a situation whereby a defective appointment of a director of a company or alternatively any internal irregularity that may occur in the management of a company.[151]

The Turquand rule however does not protect a third party who is aware or suspects that an internal requirement or formality has not been complied with. The Turquand rule goes on to further renounce a third party of protection if the third party suspects that an internal requirement or procedure has not been complied with and deliberately turns a blind eye to such procedure.[152] This was formulated in the case of *Howard v Patent Ivory Manufacturing Co.Howard v Patent Ivory Manufacturing Co*[153].

In the case of *Moris v Kanssen* court stated that:-

"a person cannot presume in his own favour that things are rightly done if inquiry that he ought to make would tell him that they were wrongly done." Therefore, the rule cannot be invoked by a third party who is put on inquiry and fails to make inquiry.

In the case of *Northside Development (Pty) Ltd v Registrar- General*[154] the court stated that a third party who lacks knowledge but is nevertheless suspicious that an internal irregularity may have taken place, cannot rely on the Turquand rule. The circumstances of the third party in this case were such that the third party should have made the inquiry. At paragraph 619, the court held "if the nature of the transaction is such as to excite a reasonable apprehension that the transaction entered into for purposes apparently unrelated to the company's business, it will put the person dealing with the company upon inquiry".[155]

The Turquand rule does not protect a third party who relies on forged documents. In the case of *Reuben v Great Fingall Consolidated* [156]the Plaintiff lent money to the secretary of the Defendant company. The money was lent on the security of a share certificate that had been issued to the Plaintiff certifying that the Plaintiff was the registered transferee of certain

[150] Basil Wunsch "Disposing of the undertaking or the assets of the company" (1971) 88 SALJ 351

[151] See note 15; 170
[152] See note 15; 170
[153] *Howard v Patent Ivory Manufacturing Co.Howard v Patent Ivory Manufacturing Co(1888) 38 ChD 156*
[154] *Northside Development (Pty) Ltd v Registrar- General (1990) 8 ACLC 611*
[155] See note 15; 171
[156] *Reuben v Great Fingall Consolidated* (1906) AC 439 (HL)

shares. The secretary had issued the share certificate without any authority to do so, after having forged the signature of the directors of the Defendant company and thereafter affixing the seal of the Defendant company into the share certificate. The Plaintiff sued the Defendant for damages when the company refused to register him as the holder of the shares. The court in this case held that since the Defendant company had not held out that the company secretary had the authority to issue the share certificate, the company was not bound by this act. The Turquand rule did not apply to the forged share certificate and thus the forged share certificate was a nullity.[157]

Cassim[158] states that the Turquand rule is intended for the protection of outsiders who have no means of knowing whether internal formalities and procedures required under the company's constitution have been complied with. Directors and other insiders may however not rely on this rule. The directors of a company are deemed to have knowledge as to whether the internal requirements, formalities and procedures have been complied with. Directors are not entitled to assume that internal requirements, formalities and procedures have been complied with, when, due to their own misconduct or neglect, these internal requirements were not adhered to.[159]

In the case of *Hely – Hutchinson v Brayhead Ltd*[160], the court distinguished between a director acting in his or her capacity as a director or a director acting in his or her capacity as a director but rather as an outsider contracting with the company. The court suggested that in the latter instance, the director may rely on the Turquand rule. This attempt to narrow down the rule that insiders may not rely on the Turquand rule draws a distinction between inside and outside transactions.[161]

According to Cassim,[162] in such an instance, it is inevitable that the question regarding whether the Turquand rule is merely an application of agency principles and particularly ostensible authority or whether it is an independent and special rule of company law that imposes liability on the company for unauthorised transactions independently of estoppel and ostensible authority should arise.[163]

[157] See note 15; 169
[158] See note 15; 170
[159] See note 15; 171
[160] *Hely – Hutchinson v Brayhead Ltd* (1967) 3 All ER 98 (CA)
[161] See note 15; 171
[162] See note 15; 171
[163] See note 15;171

In South African law and according to the case of *Prinsloo*[164], the weight of authority leans towards the view that the Turquand rule is an independent and special rule of company law and relates to companies rather than an instance of general principles of agency law. The Turquand rule in South African law would impose liability on the company for unauthorised contracts where all that was lacking was compliance with internal formalities, procedures and requirements. Estoppel requirements consequently need not be satisfied in order to rely on the Turquand rule.[165]

4.2. The Turquand rule and the statutory law:

Sections 20(7) and 20(8)[166] provide:

> '(7) A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.[167]
>
> (8) Subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers.[168]

Section 20 (7) of the act [169]states that a person dealing with a company in good faith other than a director, prescribed officer or shareholder of the company, is entitled to assume that the company, in making any decision in the exercise of its powers has complied with all the formal and procedural requirements in terms of the Act[170], its memorandum of incorporation and any rules of the company unless, given the circumstances, the person knew or reasonably ought to have known of any failure of the company to comply with such requirements.

[164] *supra*
[165] See note 15;171
[166] See note 1
[167] See note 1
[168] See note 1
[169] See note 1
[170] See note 1

This is a statutory formation of what in essence is the common law Turquand rule.

Section 20(7)[171] applies to internal requirements and formalities even if they are prescribed by the Companies Act. The fact that internal formality is contained in the statute should make no difference to the application of section 20(7). This section is very wide and is also applicable to all of the company's formal and procedural requirements in terms of the company's Memorandum of Incorporation.[172]

Section 20(7)[173] also encapsulates the common-law rule concerning a third party being a director, prescribed officer or shareholder of the company, such a person will not be protected by section 20(7). The basis of this exception is that a director, prescribed officer or shareholder ought to have reasonably known of the company's compliance or non-compliance regarding the company's internal procedures. They have access to the company's records at any given time. A shareholder is deemed to have more information than an outsider in the form of notices of meetings and proposed resolutions at shareholder meetings. Section 20(7) refers to shareholders and not to the holders of a company's securities such as holders of the company's debt instruments who are not necessarily insiders of the company.[174]

Section 20(8)[175] preserves the Turquand rule as developed at common law. It provides that Section 20(7) must be construed concurrently with and not in substitution for the common law principle relating to the presumed validity of the actions of the company in the exercise of its powers. There is therefore, now, in our South African law, both, a common law and a statutory law indoor management rule.[176]

An unfortunate difficulty arises due to the fact that section 20(7) is not properly aligned with the common-law formulation of the Turquand rule. The overlap between the two is sometimes a source of difficulty in practice. Section 20 (7)[177] is likely to operate more widely in some respects than the common law rule and narrowly in other respects. The common law

[171] See note 1
[172] See note 15; 172
[173] See note 1
[174] See note 15; 172
[175] See note 1
[176] See note 15; 172
[177] See note 1

Turquand rule, as stated above, will not protect a third party who knew or suspected that an internal formality had not been complied with. [178]

Section 20(7) however, goes much further than this. Section 20(7)[179] excludes a party who ought to have reasonably known of non- compliance with an internal requirement or procedure. This test is an objective one. It displaces the presumption "if the third party ought to have reasonably known"[180]. This weakens the assumption that third parties may make regarding the compliance with a company's internal requirements, procedures and formalities. To this extent it is narrower than the common law rule. [181]

In this respect section 128 (4)[182] of the Australian Corporations Law 2001 unambiguously states that a third party may not assume that internal formalities have been complied with if he or she knew or suspected that the assumption was incorrect at the time of his or her dealings with the company. According to Cassim[183], it is this sort of provision that ought to have been adopted by section 20(7) of the Act[184].

One possible advantage of the approach adopted in the Act is that, if, for whatever reasons, the requirements of section 20(7) are not complied with, a *bona fide* third party may still, in terms of section 20 (8) of the Act[185], be entitled to rely on the common law Turquand rule.

As a result of the wording of section 20(7) in excluding third parties who reasonably ought to have known of the internal non – compliance of formalities, requirements and procedures, difficult distinctions would have to be drawn between being put on inquiry and ought to know. The provision would be understandable if it was aimed only at precluding reliance on section 20(7)[186] by a director, a prescribed officer or a shareholder. According to Cassim[187], this is clearly not the intention of the legislature in the provision.

[178] See note 15; 173
[179] See note 1
[180] Basil Wunsch "Disposing of the undertaking or the assets of the company" (1971) 88 SALJ 351

[181] See note 15; 171
[182] Australian Corporations Law 2001

[183] See note 15; 172
[184] See note 1
[185] See note 1
[186] See note 1
[187] See note 15; 173

Cassim[188] states "with respect, a much more lucid provision is to be found in section 18(1) and section 18 (2)[189] of the Canada Business Corporations Act. These sections exclude reliance on this presumption by an insider who has knowledge or ought to have knowledge by virtue of his position with or relationship to the corporation knowledge to the contrary[190].

It is significant that, unlike section 20(7)[191] the common- law Turquand rule is not confined to companies only. The courts have extended the rule to apply to technikons and trade unions. In the case of *F P W Engineering Solution (Pty) Ltd v Technikon Pretoria and Others*[192], it was established that the common law Turquand rule was applicable to Technikons and in the case of *Prinsloo*[193] the court held that the common law Turquand rule was applicable to trade unions. The common law Turquand rule went on further to incorporate municipalities as depicted in the case of *Potchefstroom se Stadsraad v Kotze*[194]. [195]

According to Cassim[196], the Turquand rule is growing in importance, however, perhaps due to the abolition of the doctrine of constructive notice, as discussed earlier, there may be less of a need for an indoor management rule. This is not to suggest in any way to come to a conclusion that the Turquand rule is no longer of importance. In terms of South African law, there would be nothing odd in preserving the indoor management rule and in doing so, simultaneously abolishing the doctrine of constructive notice as English law has adopted this approach several years ago.

Cassim [197] states that an important consequence of the abolition of the doctrine of constructive notice which must be emphasized is that the common law Turquand rule and section 20 (7) of the Act[198], will now, unlike the past, be applicable where a special resolution will be required as an internal requirement, formality or procedure. Since there is no longer any constructive notice of special resolution filed by the company with the Companies Commission, it follows that there is no longer any legal obstacle to applying Section 20 (7) or

[188] See note 15; 172
[189] Canada Business Corporations Act
[190] *supra*
[191] See note 1
[192] *F P W Engineering Solution (Pty) Ltd v Technikon Pretoria and Others* (2004) 1 All SA 204 (T)
[193] *supra*
[194] *Potchefstroom se Stadsraad v Kotze* 1960 (3) SA 616 (A)
[195] See note 15; 172
[196] See note 15; 172
[197] See note 15; 172
[198] See note 1

the Turquand rule to a special resolution required by the Act or the company's Memorandum of Incorporation to validate a particular act of management.

The meaning of s 20(7) and s 20(8),[199] which must be construed together, is obscure. Section 20(7) appears to be a 'statutory Turquand rule'. However, instead of simply creating a statutory Turquand rule in place of the common law Turquand rule, s 20(7) and s 20(8), when read together, appear to preserve the common-law Turquand rule. The Turquand rule is a 'common law principle relating to the presumed validity of the actions of a company in the exercise of its powers' and s 20(7) must therefore, as required by s 20(8), be 'construed concurrently with, and not in substitution for' the common law Turquand rule. The wording 'concurrently with and not in substitution for' in s 20(8) indicates that the statutory rule in s 20(7) and the common-law principle co-exist and the common law is not eclipsed in any way. It does not appear to be a case of the common law continuing to apply but subject to s 20(7), or vice versa. The wording does not appear to permit such a meaning. The words 'concurrently with', it is submitted, mean 'along with' and the phrase 'not in substitution for' reinforces the interpretation that the common law and the statutory rule co-exist.[200]

The problem with this interpretation is that s 20(7) and the common law Turquand rule conflict in certain respects, which will be apparent from the following discussion of s 20(7) Cassim[201] refers to the difficulty that s 20(7) 'is not properly aligned with the common law formulation of the Turquand rule'.

Unlike the common-law rule, s 20(7) protects the innocent third party where the formal or procedural requirement in question is laid down by the Act. As *Stand 242*[202] and *Farren*[203] show, the common-law Turquand rule does not apply in such a case, at least not in one instance, namely, the disposal by a company of the whole or the greater part of the

[199] See note 1
[200] See note 15; 171
[201] See note 14; 172
[202] *Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd and another v Göbel NO and others* [2011] 3 All SA 549 (SCA)

[203] *Farren v Sun Services SA Photo Trip Management* (Pty) ltd (2003) 2 All SA 406 (C)

company's assets. The basis on which the decisions was reached in *Stand 242*[204] namely the protection of shareholders, raises the question of the extent to which the ratio in these cases can be extended to the numerous other instances in the Act where a special resolution is required.

It will be recognised that in all these instances the special resolution requirement is aimed at the protection of shareholders, and it seems that on this basis the common law Turquand rule would not apply if the requirement is not met. It should also be borne in mind that in some of these instances in the absence of the special resolution it is expressly provided and that the resolution to enter into the particular transaction is void[205]. It follows that the common law Turquand rule clearly cannot apply in these instances, whereas it is arguable that there is a clash between these provisions and s 20(7)[206].

In terms of the common law, a person dealing with the managing director of a company can assume that authority has been delegated to the managing director if such delegation is possible in terms of the company's constitution. However, if in terms of a company's constitution, authority to act on behalf of a company can be delegated to an ordinary director, a third person dealing with the director cannot, generally, relying on the Turquand rule, assume that the internal requirement of delegation has taken place.

As Sargent LJ said in *Houghton & Co v Northard, Lowe and Wills Ltd* [207]at paragraph 267:
'I know of no case in which an ordinary director, acting without authority in fact, has been held capable of binding a company by a contract with a third party, merely on the ground that the third party assumed the director had been given authority by the board to make the contract.'[208]

Where the directors are empowered to delegate their powers, it cannot be assumed that a power has been delegated unless the power in question is one which is usually delegated to

[204] *Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd and another v Göbel NO and others* [2011] 3 All SA 549 (SCA)
[205] Mthembu M. "the long arm of the Turquand Rule" (2005) 13(2) *Jutas's Business Law*. 58 – 60

[206] See note 1
[207] *Houghton & Co v Northard, Lowe and Wills Ltd* [207]*[1927] 1 KB 246 (CA) at 267*

[208] supra

persons holding the office held (*de jure* or *de facto*) by the person purporting to transact on behalf of the company. Thus, for example, because powers to transact on behalf of the company are not usually delegated to ordinary directors, the rule in Turquand's case does not apply where an ordinary director purports to contract on behalf of the company even where the articles empower the board of directors to delegate their powers to an ordinary director. Thus the rule can apply in the case of such a director only where the power in question has in fact been delegated to him but his actual exercise of it is made subject to some act of internal organisation.

On the other hand, because the board of directors is ordinarily the organ of the company vested with plenary powers on matters intra vires the company, the rule applies where the board has contracted. And, because the boards of companies usually delegate all their powers to manage the business of the company to a managing director, a person who deals with a managing director may assume that the power to manage the business of the company has been delegated to him. Perhaps this limitation on the rule in Turquand's case is best understood as merely an instance of the principle that a person dealing with a company cannot invoke the rule if put on enquiry. He is put on enquiry, because the power in question is not usually delegated the person in the position of those purporting to exercise it. Where the person acting on behalf of the company acts beyond his usual authority, the company may, of course, be bound on the basis of estoppel if it held him out as having the necessary authority'.

Turning to s 20(7), it is arguable that delegation by the board of a company to an ordinary director of authority to enter into a transaction on behalf of the company in terms of the 'rules' of a company is a 'formal' or 'procedural' requirement and a third person dealing with such a director can, in terms of s 20(7), presume that the company has complied with such requirement (s 20(7) refers to 'formal and procedural requirements' in terms of, inter alia, 'rules' of the company). If so, s 20(7)[209] is in this respect, again, at odds with the common law Turquand rule.

[209] See note 1

Section 20(7) also clashes with the common-law Turquand rule in relation to 'insiders'. Section 20(7) does not protect a 'director, prescribed officer or shareholder of the company' The common law Turquand rule's protection, on the other hand, is not entirely out of an insider's grasp. There are clearly circumstances in which insiders will be protected where the vulnerability of insiders is equal to that of outsiders. It is to be noted that, unlike s 20(7), s 19(4)[210], in its abolition of the doctrine of constructive notice, does not discriminate between 'insiders' and 'outsiders'. It follows that where a person deals with a company which is not an 'Ring Fenced' company, that person is in the same position whether he is an insider or an outsider neither have constructive notice of the company's public documents.

A further difference between the statutory and common law Turquand rules is that, as Cassim[211] puts it 'the common law Turquand rule will not protect a third party who knew or suspected that an internal formality or procedure had not been complied with whereas, in striking contrast, s 20(7)[212] goes much further than this, in excluding a third party who ''reasonably ought'' to have known of non-compliance with a formality. In explaining the difference, Cassim[213] goes on to say 'The test is objective. It displaces the presumption if the third party''reasonably ought to have known''[214]. This weakens the presumption that third parties may make regarding compliance with internal formalities and procedures. To this extent it is narrower than the common law rule.'

In relation to the above perceived conflicts between the Act and the common law, if it was intended that s 20(7) is to take precedence, one would have expected the wording of s 20(8) to be different or else for the Act to state expressly how the conflict is to be resolved, as it has done in s 5(5) and s 5(6) of the Act[215].

Section 5(5) and 5(6) provide:

> '(5) If there is a conflict between a provision of Chapter 8 and a provision of

[210] See note 1
[211] See note 15; 173
[212] See note 1
[213] See note 15; 171
[214] *supra*
[215] See note 1

the Public Service Act, 1994 (Proclamation No. 103 of 1994), the provisions of that Act prevail.[216]

(6) If there is a conflict between any provision of this Act and a provision of the listing requirements of an exchange:

(a) the provisions of both this Act and the listing requirements apply concurrently, to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second; and

(b) to the extent that it is impossible to apply and comply with one of the inconsistent provisions without contravening the second, the provisions of this Act prevail, except to the extent that this Act expressly provides otherwise.[217]

The issue of the precise relationship between s 20(7) and the common law Turquand rule raises the question of the purpose of s 20(7) and s 20(8). Did the legislature, in enacting these provisions, intend changing the law or was the intention merely to make awareness and understanding of the common-law Turquand rule more accessible to the person in the street who is grappling with the law? If it is the latter, it would mean that the common-law Turquand rule prevails in the event of a conflict. With regard to the interpretation of s 20(7) read with s 20(8)[218], sight must also not be lost of the presumption in our law that legislation should be interpreted in such a way that is in accordance with the common law, or changes it as little as possible.[219]

A classical statement of the operation of the presumption in respect of alterations to the common law is to be found in a dictum in *Casserley v Stubbs*[220], at paragraph 312 Wessels J said:

'It is a well-known canon of construction that we cannot infer that a statue intends to alter the common law. The statute must either explicitly say that it is the intention of the legislature

[216] See note 1
[217] See note 1
[218] See note 1
[219] See note 15; 172
[220] *Casserley v Stubbs* 1916 TPD 310

to alter the common law, or the inference from the ordinance must be such that we can come to no other conclusion than that the legislature did have such an intention.'[221]

Section 20(7) and s 20(8) clearly do not 'explicitly' alter the common law and it is submitted that it could hardly be said that the inference from s 20(8) is such that one can come to no other conclusion than that the legislature intended s 20(8) to take precedence over the common-law Turquand rule. With regard to the fact that s 20(7) creates a 'presumption' it is submitted that s 20(7)[222] should expressly state that the presumption is irrebuttable. By doing so there will be no room for the argument that the company is able to rebut the presumption, and accordingly deprive the third person of protection, by showing that the formal or procedural requirement has not been complied with. The matter should be put beyond doubt by the legislature. It should be made clear that s 20(7) is not merely placing the onus of proof on the company to prove that the requirement has not been complied with, an interpretation that the wording of s 20(7)[223] is capable of having. The common law Turquand rule clearly creates an irrebuttable presumption.

As Kirby P said in *Registrar General v Northside Developments Pty Ltd*[224] at 547 held that : 'The whole point of the rule in Turquand's case is that the presumption is irrebuttable conflict between s 20(4) and s 20(7)[225].

A question demanding clarity is whether s 20(7) trumps s 20(4). Section 20(4) provides:
'One or more shareholders, directors or prescribed officers of a company, or a trade union representing employees of the company, may apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act[226].'

What would the position be if, for example, a company enters into a contract with a third person in terms of which the company disposes of the greater part of its assets to the third party and no special resolution is obtained? Before the transfer of the assets has taken place, a shareholder becomes aware of the contract and applies to the High Court in terms of

[221] *supra*
[222] See note 1
[223] See note 1
[224] *Registrar General v Northside Developments Pty Ltd*[224] (1988) 14ACLR 543 SC (NSW)
[225] See note 1
[226] See note 1

s 20(4) of the Act for an interdict preventing the company from transferring the assets on the basis that the transfer is inconsistent with s 112 of the Act[227], there having been no special resolution approving of the disposal. The third party contends that he is protected by s 20(7) on the basis that the special resolution requirement is a formal or procedural requirement and he is entitled to presume that the requirement has been complied with. Which provision is to prevail s 20(4) or s 20(7)? It is submitted that clarity is called for in this situation. The uncertainty caused by sections 20(7) and (8) is disconcerting and maybe the following caution in respect of *ultra vires* in the 1973 Act[228] should have been heeded when the *Turquand* rule was addressed.

Some doctrines, when they have outlived their usefulness, are easily removed others are so embedded in the law that force is necessary to pry them loose. A consideration of the new South African Companies Act suggests that the *ultra vires* doctrine was thought to be of the latter kind and that, rather than risk the use of force, the legislature has sought to render it harmless. This appears to be the safer approach. In fact, it is almost certainly the more dangerous. An error in the initial analysis of the doctrine may wreck the entire enterprise. Great skill is needed if the fabric of the law is in truth to remain intact. And then, even if that skill is achieved, the old structure is left standing and the old concepts and principles remain, looking for all the world as they did before, when in fact they are either redundant or, if they still function, do so in a radically different way.[229]

4.3. The Turquand rule and the delegation of authority:

In the case of *Houghton Co v Northard, Lowe and Wills*[230] the articles of association of the company had authorised the board of directors to delegate its powers to any ordinary director. An ordinary director, to whom no authority had been delegated to by the board of directors, had entered into an unauthorised contract with the Plaintiff. The Plaintiff sought to hold the Defendant liable on the contract on the basis that the Turquand rule had entitled the Plaintiff to assume, as a matter of internal formality, that the board of directors had delegated their

[227] See note 1
[228] See note 2
[229] (Blackman "The capacity, powers and purposes of companies: The commission and the new Companies Act" 1975 *CILSA* 1).
[230] *Houghton Co v Northard, Lowe and Wills* (1927) 1 KB 246 (CA)

powers to the ordinary director. The common law principle applied in this case may well continue to apply in practice in terms of section 20 (7) of the Act[231].

The court rejected this particular argument on the basis that the Turquand rule may have entitled the Plaintiff to assume that the board of directors had, as a matter of internal management delegated its authority but it did not, in the absence of any ostensible authority entitle the Plaintiff to assume that the board of directors had appointed that particular ordinary director as the authorised agent of the company. To apply the Turquand rule in this situation would be to place companies at the mercy of any agent who purports to contract on behalf of the company.

This approach was followed and applied in the case of *Wolpert v Uitzigt Properties (Pty) Ltd*[232] whereby on the same issue as the abovementioned case, the court stated that the Plaintiff may have been entitled to assume that someone had been appointed by the directors of the company as an authorised agent, but he cannot, by relying on the Turquand rule, assume that a specific person or persons has or have been appointed. In such a situation, the plaintiff would have to rely on ostensible authority. The issues must be resolved in accordance with the principles of agency law rather than being dealt with in terms of the Turquand rule.

The directors' power to enter into certain contracts may be limited or even excluded. The articles of association may, for example, provide that directors may not conclude particular contracts without the approval of the general meeting. The articles of association are regarded as a public document by virtue of their being registered and hence everyone dealing with the company is deemed to have knowledge of their contents. A third party who reads the articles would know that the approval of the general meeting is required, but would be uncertain whether it was actually obtained, because ordinary resolutions are not public documents.
But for the *Turquand* rule, he would not be able to hold the company liable under the contract. To limit the third party's duty to inquire, the *Turquand* rule provides that if that party deals with the company in good faith not knowing that the necessary approval was not given and the circumstances are not such that he should have suspected that the approval had not been given, then he is entitled to assume that all internal formalities have been complied

[231] See note 1
[232] *Wolpert v Uitzigt Properties (Pty) Ltd* 1961 (2) SA 257 (W)

with. So the company cannot argue that it is not bound to the contract because directors had no authority or exceeded their authority.

The question is then also who can act for the company for the *Turquand* rule to be effective. There have been many opinions and uncertainty however it has been stated in the case of *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief*[233] 1978 2 SA 11 (T) 15 and is accepted as the correct position that:

*"*In contracting with a company the following categories of person or persons acting or purporting to act on its behalf may be encountered:

(a) The board of directors;

(b) The managing director or chairman of the board of directors;

(c) Any other person or persons such as an ordinary director or branch manager or secretary."

Where someone contracts with a company through the medium of the persons referred to above, the company will usually be bound because these persons or bodies will, unless the articles of association decree otherwise, be taken to have authority in one form or another to bind the company in all matters affecting it. Moreover all acts of internal management or organisation on which the exercise of such authority is dependent may, in terms of the *Turquand* rule, be assumed, by a bona fide third party, to have been properly and duly performed. Indeed unless some such principle was accepted no one would be safe in contracting with companies.

The same does not apply where the company is represented by any other person or persons such as an ordinary director or branch manager or secretary. Here a third party is not automatically entitled to assume that such person has authority and the company is not precluded from repudiating liability on the ground that he had no authority to bind it. To hold the contrary would deprive a company of the rights which any natural principal would have of denying the allegation that a particular person is his agent. The application of the *Turquand* rule in this sphere is limited. It only comes into operation once the third party has surmounted the initial hurdle not present in cases falling under the board of directors or The

[233] *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* [233] 1978 2 SA 11 (T) 15

managing director or chairman of the board of directors' as stated above and proves that the director or other person purporting to represent the company had authority. Once this is proved then, if the actual exercise of such authority is dependent upon some act of internal organisation, such can, by a bona fide third party, be assumed to have been completed. But in dealing with the type of person in question the other contracting party cannot use the *Turquand* rule to help him surmount the hurdle mentioned."

4.4 The Turquand rule and the doctrine of constructive notice under the current regime:

The Turquand Rule and the Doctrine of Constructive Notice are two tools that work hand-in-hand and have been applied collectively by our courts for many years when deciding whether a company should be bound to a contract with a third party. This situation usually arises where the company will claim that they are not bound by a contract due to the fact that the party who contacted on the part of the company was not authorised to do so. As such, and according to Section 36 of the Old Act[234], such a contract would be considered to be ultra vires as the party entering the contract did not have the authority to do. When deciding such an issue, a court will further apply the Doctrine of Constructive Notice and the Turquand Rule.[235]

According to the Doctrine of Constructive Notice, a third party, when dealing with a company, is deemed to have knowledge of the contents of a company's public documents. As such, the third party, when contracting with the company, should appraise themselves with the contents of the Memorandum and Articles of that company in order to confirm that the individual representing the company in the contractual negotiations is, in fact, authorised to do so.[236] Should that individual not be so authorised then the person would be acting beyond the scope of their authority, and as such the contract would be ultra vires the rules of the company and, as such, is not enforceable against the company.

[234] See note 2

[235] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal* 471

[236] Basil Wunsch "Section 228 of the companies act and the Tuquand rule" (1992) TSAR 545

The Turquand Rule, however, which rule was established in the case of *Royal British Bank v Turquand*[237] , acts as a counter against the Doctrine of Constructive Notice. The Turquand Rule becomes applicable where the terms of the Memorandum and Articles provide for an internal procedure to be followed in order for an individual to have the authority to represent a company, for instance where a resolution needs to be passed by the company in order for the authority to be valid. In such instances, the Turquand Rule states that it is permissible for the third party contracting with the company to presume that such internal procedures have been complied with. Where such internal procedures have not been followed, and the person contracting on behalf of the company does not, in fact, have the authority to do so, such a contract is referred to as a limping contract and is enforceable, and capable of being cancelled, at the instance of the third party. [238]The ability of the third party to exercise this right was contingent on the finding that the third party, when contracting with this individual, believed in good faith that the individual was properly authorised to act on behalf of the company. Thus, under the current regime, both the company and the third party were afforded protection when contracting with each other. The company was protected by the Doctrine of Constructive Notice, and the third party by the Turquand Rule.[239]

The 2008 Act[240] has changed the way in which a court will approach such an issue. Section 36 of the 1973 Act has been retained in terms of Sections 20(1)(a) and 20(1)(b) of the New Act[241]. As such, a contract entered into by an individual on behalf of a company, where that individual did not have the requisite authority to enter into such a contract is considered to be ultra vires. The startling change, however, comes about in the modified version of the Doctrine of Constructive Notice[242].

According to Section 19(4) of the New Act, a third party is not deemed to have notice or knowledge of the contents of any documents relating to the company. As such, it is no longer presumed that, when contracting with a company, the third party has appraised themselves

[237] *Royal British Bank v Turquand*[237] (1865) 6 E&B 327

[238] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal* 468

[239] Retief, E. "Third party protection" (2005) 13 (3) *Jutas Business Law* 137

[240] See note 2

[241] See note 1

[242] Basil Wunsch "Section 228 of the companies act and the Tuquand rule" (1992) TSAR 545

with the MOI of that company. Section 19(5)[243] of the New Act contains an exception to this, in that a third is deemed to have notice and knowledge of any provision of a company's MOI under section 15(2)(b) of the New Act[244] (which section deals with special conditions applicable to the company and requirements for the amendments thereof) if the company's notice of incorporation or a notice of amendment has drawn attention to the provision. It may therefore be seen that the 2008 Act[245] abolishes the doctrine of constructive notice except in cases where attention is drawn to special conditions. These provisions are known as "Ring Fenced" provisions and in order to draw attention to such provisions they will be marked "RF". Therefore the doctrine of constructive notice is abolished to a certain degree.

Further, and in terms of clause 20(7) of the New Ac[246]t, the Turquand Rule has been legislated in a slightly modified version. In terms of this provision, "A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all the formal and procedural requirements in terms of this Act, its memorandum of incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with such requirement".

Thus, under the new regime, the company will only enjoy the protection of the Doctrine of Constructive Notice in respect of Ring Fenced clauses, whereas the third party will always have the benefit of the Turquand Rule unless it can be demonstrated that the third party had knowledge, or ought to have had knowledge of the company's failure to comply with their internal processes.[247]

As has already been mentioned, it will become mandatory for all companies to adopt a Memorandum of Incorporation. This exercise should not be one that is taken lightly. As can be seen from the exposition above, the 2008 Act[248] has reduced the ability of a company to rely on the doctrine of constructive notice as a defence unless the company's memorandum of incorporation is constructed with particular provisions. Should a company blindly convert it memorandum and articles to a memorandum of incorporation, without carving out certain

[243] See note 1
[244] See note 1
[245] See note 1
[246] See note 1
[247] Retief, E. "Third party protection" (2005) 13 (3) *Jutas Business Law* 135
[248] See note 1

provisions as ring fenced provisions, the company will effectively be depriving itself of a specific defence should it challenge an agreement entered into by an unauthorised individual, which may result in the company being bound to an onerous agreement.[249]

4.5.The Turquand rule in relation to the concept of estoppel:

It seems necessary to deal briefly with the possibility of construing s 20(8) in such a way that it is referring not only to the *Turquand* rule but also to estoppel. Is estoppel, in terms of s 20(8), a 'common law principle relating to the presumed validity of the actions of a company in the exercise of its powers'? It is submitted that s 20(8) is not referring to estoppel. It is true that when estoppel is successfully applied, the effect is that the action of the company is treated as valid, and on a first reading of s 20(8)[250] one might be tempted to include estoppel. However, strictly speaking what happens when estoppel applies in the current context is that the company is prevented (estopped) from arguing that the relevant 'formal' or 'procedural' requirement has not been met. It is prevented from raising that defence. Estoppel does not give rise to a presumption of validity, which is what s 20(8) is referring to. It will be recognised that if s 20(8) is in fact also referring to estoppel there is a clear conflict between the common law and s 20(7) in that s 20(7)[251], unlike the common law, can operate to allow a contravention of statute. It has been made abundantly clear that the common law doctrine of estoppel does not apply to statutory requirements. [252]

In the case of Stand 424[253] the seventh respondent ("Bubesi") was a company in which the second and fourth respondents were directors. Shares in Bubesi were owned by two trusts. The first three respondents were the trustees in one of the trusts (the "Göbel trust"), while the fourth to sixth respondents were the trustees in the other (the "Deutra trust"). In January

[249] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal* 471

[250] See note 1
[251] See note 1
[252] Jooste R. "Observations on the impact of the 2008 Companies Act on the doctrine of constructive notice and the Turquand Rule" (2013) 130(3) *South African Law Journal; 472*
[253] *Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd and another v Göbel NO and others* [2011] 3 All SA 549 (SCA)

2009, the second appellant, acting for the first appellant, which was then a company still to be formed, purchased immovable property from Bubesi. The latter was represented in the transaction by the second and fourth respondents, who had signed a document certifying that they were the directors of Bubesi, that the sale had been approved by the shareholders in a general meeting in terms of section 228 of the Companies Act 61 of 1973, and that the property did not constitute the whole or greater part of the assets of the company. As it turned out, those statements were false, and the property was Bubesi's sole asset. [254]

Shortly after the sale, various disputes arose between Bubesi and the first appellant, and, despite the conclusion of the agreement of sale, Bubesi let the property to a third party for a period of three years. The second appellant realised that Bubesi was not going to perform in terms of their agreement, and brought an urgent application in the High Court against Bubesi, for an order interdicting it from dealing with the property pending an action to be instituted against it. Although Bubesi opposed the application, relying, *inter alia*, on the fact that section 228 had not been complied with, the court granted the order sought.[255]

Apart from the second and fourth respondents, the trustees of the shareholding trusts claimed not to have been aware of the sale, or the order sought, until after it was granted. The trustees and Bubesi thus brought an urgent application seeking a declaratory order setting aside the order obtained by the second appellant, and an order that there had been non - compliance with section 228 and that the sale was thus unenforceable. [256]

The orders sought were granted, but leave was granted to appeal to the present Court.
The issue on appeal was whether section 228 of the Companies Act is qualified by the application of either the *Turquand* rule or estoppel.[257]

Section 228[258] provides that the directors of a company may not dispose of the whole or the greater part of its assets without the approval, by special resolution, of the shareholders.
The *Turquand* rule in essence, is that a person dealing with a company in good faith is entitled to assume that the company has complied with its internal procedures and formalities.

[254] *Supra*
[255] *supra*
[256] *supra*
[257] *supra*
[258] See note 1 and note 2

The Court was satisfied that the clear meaning of section 228 is that the shareholders must give their consent to, or ratify, the disposal of the sole asset, or the major assets, of a company. If the purpose of section 228 is the protection of the shareholders, then the application of the *Turquand* rule would deprive them of that protection. The section would then serve no purpose. The requirement that the shareholders' approval be obtained by way of special reaolution was introduced in terms of an amendment to section 228 in 2006. The Court held that the requirement of a special resolution does not change the principle as to the non- applicability of the *Turquand* rule to section 228.[259]

The argument based on estoppel was intended to advance the contention that the appellants' had relied on the document signed by the second and fourth respondents, certifying that the disposal of the asset had been properly approved. However, as the representation had not been made by the shareholders in question, the reliance on estoppel was abandoned. In any event, as pointed out by the Court, estoppel cannot operate to allow a contravention of a statute. The appeal was therefore dismissed with costs.[260]

[259] [2011] 3 All SA 549 (SCA)

[260] *supra*

CHAPTER 5:

5. Representation by the directors of a company:

5.1. Representation and the authority of the directors:

A company acts through the medium of its directors' and officers'. The principles of agency law are of particular importance to corporate law. Section 66 (1) of the Act[261] states that the business affairs of a company must be managed by or under the direction of its board which has the authority to exercise all the powers and perform any of the functions of the company, except to the extent that the company's Memorandum of Incorporation and the Act provides.[262]

The board of directors is likely to delegate its powers to manage the business of a company to individual directors and officers of the company. If such persons enter into contracts on behalf of the company, whether or not the company will be bound, by such contracts, depends on the principles of agency law, which require such individuals to have authority to contract on behalf of the company. Authority is a concept of agency law.[263]

According to the law of agency, if an agent contracts with a third party on behalf of the company, the contract will bind the third party and the company, known as the principal as if the company had concluded the contract personally. The agent is merely regarded as an intermediary. The agent acquires no rights nor will the agent incur any liabilities under the contract unless the contrary is agreed to between the parties. Once the contract with the third party is concluded, the agent falls away. An agent who contracts with a third party without any authority will not only fail to bind the principal to the contract but the agent will also incur liability to compensate a third party who suffers loss or any prejudice thereof for breach of warranty of authority or misrepresentation[264].

The same principles as discussed supra also apply to a director who contracts on behalf of a company. In order for a director or an agent to act on behalf of a company, they must have

[261] See note 1
[262] See note 15; 173
[263] *supra*
[264] Wunsch B. "Companies: Authority of representatives and minutes" (1975) 91 *De Rebus* 315

the necessary authority to do so. Such authority may be actual authority, usual authority or ostensible authority.[265]

5.2. Actual authority:

Actual authority consists of express authority and implied authority. Express authority refers to authority given in so many words, either orally or in writing. Where express authority is subject to compliance with some internal formality, the common law, the Turquand rule and section 20 (7) of the Act[266], entitle a bona fide party to assume that this formality has been complied with unless he or she knew or ought to have reasonably known that it has not been so. Implied authority is authority given in not so many words, but which arises as a result of a reasonable inference from the conduct of the principal. [267]

In the case of *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd*[268] it was held by the learned presiding officer, Diplock LJ that actual authority is a relationship between principal and agent created by a consensual agreement to which they alone are parties… Nevertheless, if the agent does enter into a contract pursuant to the "actual" authority, it does create contractual rights and liabilities between the principal and the contractor. [269]

In the case of *Hopkins v Dallas Group Ltd*[270] the court held that "the authority of an agent is actual where it results from a manifestation of consent that he should represent or act for the principal expressly or impliedly made by the principal to the agent himself". The court went on to further state that the grant of the actual authority should be implied as being subject to a condition that it is to be exercised honestly and on behalf of the principal. An agent is not authorised to act contrary to the interests of the principal.[271]

If the agent has express authority, or if the company is estopped from claiming lack of authority, the company is bound. However, a problematic situation may arise in that the company can have the standard articles but a provision is added that if the contract value is above 50% of the issued share capital of the company, prior authority from the general meeting is required but no contracts can be concluded under any circumstances above 100%

[265] Wunsch B. "Companies: Authority of representatives and minutes" (1975) 91 *De Rebus* 318
[266] See note 1
[267] See note 15; 174
[268] *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* (1964) 1 All ER 14 (CA)
[269] See note 15; 174
[270] *Hopkins v Dallas Group Ltd* (2005) 1 BCLC 543 (Ch) 572g
[271] See note 15; 174

of the issued share capital. The agents therefore have potential authority for the 50% issued share capital contract but no authority for the 100% share capital contract. If they now purport to conclude the latter, the company will not be bound because it was *ultra vires* the authority and the third party is deemed to have knowledge due to the doctrine of constructive notice. Estoppel can also not work, as the same doctrine precludes a misrepresentation by the company of something that the third party is deemed to know is not true.[272]

5.3. Ostensible authority:

Ostensible authority is sometimes also referred to as apparent authority or agency by estoppel. Ostensible authority arises where a person has by his or her words or conduct, created the impression that someone is his or her duly authorised agent thereby inducing an innocent third party to deal with the agent in that capacity. The agent's ostensible authority is as a result of the principal's statement or conduct but not necessarily via the consent of the principal. [273] In other words ostensible authority arises where a principal has made a representation, whether by words or conduct to a third party that the agent has the requisite authority to act on his or her behalf. If the third party has reasonably relied on this representation, the principal would be estopped or prevented from denying the authority of the agent. The representation however must be made by the principal and not only by the agent.[274]

According to *Freeman's*[275] case, the following three requirements must be satisfied for ostensible authority:

- a representation must have been made to a third party that the agent has the authority to enter into a contract;[276]
- such representation must be made a person who has actual authority to manage the company's business either generally or in respect of matters to which the contract relates to. A third party cannot rely on an agent's own representation that he or she has the required authority. The agent would also represent that he or she has

[272] *supra*
[273] *supra*
[274] *supra*
[275] *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* (1964) 1 All ER 14 (CA)
[276] (1964) 1 All ER 14 (CA)

authority but it is not the agent's representation that gives rise to ostensible authority.[277]

- The third party must have been induced by the representation to enter into the contract. In other words, the third party must have relied on such representation.[278][279]

If a third party dealing with an agent knows that the agent does not have actual authority to conclude the particular contract, the third party cannot rely on ostensible authority. If the third party knows or ha reason to know that the contract is contrary to commercial interests of the principal, it will be difficult for the third party to assert with any credibility that he or she believed that the agent had actual authority.[280][281]

In the case of *NBS Bank Ltd v Cape Produce Co (Pty) Ltd*[282] the court, in approving of *Freeman's* case laid down six requirements for ostensible authority as discussed below:

- A representation whether by words or conduct;
- Made by the principal or someone with actual authority;
- In a form such that the principal should reasonably have expected that outsiders would act on the strength of the representation;
- Reliance by the third party;
- Such reliance must be reasonable;
- There must be consequent prejudice to the third party.[283][284]

According to a third party perspective, it would not make a difference as to whether the agent has actual or ostensible authority because ultimately, the principal will be bound to the third party. It makes a vital difference however, between the principal and the agent. Since ostensible authority is no authority at all, the agent will be liable to the principal for any breach of fiduciary duty not to exceed his authority. If in the circumstance that the principal is not bound to the third party at all, the third party may have a delictual action against the director or agent based on misrepresentation or an action for breach of warranty of authority.

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[277] *supra*
[278] *supra*
[279] See note 15; 174- 175
[280] Wunsch B. "Companies: Authority of representatives and minutes" (1975) 91 *De Rebus* 321
[281] See note 15; 175
[282] *NBS Bank Ltd v Cape Produce Co (Pty) Ltd* 2002 (1) SA 396 (SCA)- in this case the court required the third party's reliance on the representation to be reasonable.
[283] 2002 (1) SA 396 (SCA)
[284] See note 15; 175

In the latter event, the director agent is not liable in terms of the contract. The measure of damages is that the agent must put the third party in the same position as if the principal had been bound by the contract.[285]

5.4. Usual authority:

Usual authority may form part of implied authority or it may be restricted to usual authority. In the latter instance, the principal appoints an agent to an office or a position that carries with it authority to contract on behalf of the principal but the principal has restricted this usual authority. The importance of usual authority in company law arises from the fact that the position or office occupied by a company officer who is an employee of the company may determine the extent of his or her authority. In other words, the authority of the agent may flow from the office held by the particular company officer in question. The appointment of a person may carry with it the implied usual authority to do whatever falls within the usual scope of that office.

In the *Hopkins*[286] case the court stated that where a board of directors' appoint one of their members to an executive position, they implicitly authorise that person to do all such things that fall within the usual scope of that office.

Thus, in the case of *Hely – Hurchinson*[287] the chairman of the company also acted as the *de facto* managing director of the company without having ever been asked to do so or formally appointed as such. The chairman entered into an agreement on behalf of the company under which he committed the company to giving a guarantee and an indemnity in respect of certain transactions. The board of directors subsequently refused to honour those undertakings on the ground that the chairman had no authority to act on behalf of the company. The court herein decided that as chairman of the board of directors, the chairman had no implied usual authority to enter into the agreements but he did have such authority in his capacity as a *de facto* managing director by his conduct and the acceptance of the board in that respect.[288]

In the case of *SA Securities Ltd v Nicholas*[289] the court stated that the mere fact of appointing a person as a managing director, gives him certain implied powers. Anyone dealing in good

[285] See note 15; 175
[286] supra
[287] Supra
[288] *supra*
[289] *SA Securities Ltd v Nicholas* 1911 TPD 450

faith with the managing director is entitled to assume that the managing director has all the powers which his or her position as such would ostensibly give him or her. [290]

In the case of *Panorama Developments Ltd v Fidelis Furnishing Fabrics Ltd*[291] Lord Denning held that a company's secretary is an officer of the company with extensive duties and responsibilities. A secretary is entitled to sign contracts connected with the administrative side of the company. [292]

Where a company officer acts within a certain scope of their usual authority, the company may in certain circumstances still be bound by their acts even though the company may have restricted the scope of their usual authority. Such restricted usual authority does not form a part of implied authority. The basis of liability in such cases would consequently be ostensible authority provided that the prerequisites for such authority are satisfied.[293]

5.5. Ratification:

Ratification refers to a retrospective authorisation or conferral of authority by the principal or the company. In effect, the company or principal forgives the agent and adopts the unauthorised contract usually with retrospective effect. If ratified, the contract becomes fully binding with retrospective effect on the company. [294]

[290] *supra*
[291] *Panorama Developments Ltd v Fidelis Furnishing Fabrics Ltd* (1971) 3 All ER 16 (CA)
[292] *supra*
[293] See note 15; 177
[294] See note 15; 178

CHAPTER 6:

Conclusion:

It is submitted that the protection of parties dealing with a company in circumstances where an internal irregularity in relation to the company has occurred, is an area of great complexity. Drafting legislation in this regard is no easy task as is indicated in the discussion in this note of relevant provisions of the Act. The large body of jurisprudence that has built up over the years dealing with this area of the law is testimony to its intricacy. It is submitted that the discussion in this study indicates the need for the legislature to re-visit the relevant provisions of the Act and either repeal them or amend them so as to provide the clarity that is called for. The optimum approach would be, it is submitted, to repeal s 20(7)[295] and (8)[296] altogether, leaving the common law and the development thereof to deal with the matter.[297]

The Turquand rule mitigates the unrealistic doctrine of constructive notice which deems anyone dealing with a company to know the contents of the company's memorandum, articles of association, resolutions and other documents recorded on the company's file with the Registrar of Companies. In its simplest form the *Turquand* rule, or indoor management rule, entails that if nothing has occurred which is obviously contrary to the provisions of the registered documents of the company, an outsider may assume that all the internal matters of the company are regular. It is unfortunate that a detailed and carefully articulated explanatory memorandum did not accompany the Bill preceding the Act. The attention that such an exercise would have demanded would no doubt have thrown up the kind of difficulties one has in interpreting, understanding and applying provisions of the Act such as s 19(4) and (5)[298] and s 20(7) and (8)[299].

[295] See note 1
[296] See note 1
[297] Bekink, M. "An historical overview of the Turquand rule from the nineteenth century to the companies bill of 2007: analyses" (2008) 20 (1) *SA Mercantile Law Journal* 121

[298] See note 1
[299] See note 1

Finally, if the provisions of s 20(7) read with s 20(8)[300] do have the effect that a person acquiring the whole or the greater part of the assets of a company may assume that the statutory special resolution requirement has been complied with, and the court in *Stand 242* was aware of the provisions of the 2008 Act[301], the conclusion that one must come to is that the court in *Stand 242*[302] disagreed with the view taken by the legislature. The Act and the Bill on which the Act[303] is based were in the public domain long before the judgement in *Stand 242* [304]was handed down, so it is likely that the court in *Stand 242*[305] was aware of the stance taken by the drafters of the Act. Be that as it may, the court a quo and the Supreme Court of Appeal in *Stand 242*[306] (all judges concurring) and the court in *Farren*'s[307] case all agreed that the protection of shareholders should trump the protection of the third party dealing with the company that the legislature has taken the opposite view.

This result, however, is not a foregone conclusion. It is imperative for the company to invest time, effort and expertise into this exercise, and not view it as a routine administrative process. Should it adopt this stance there is no reason why the company should not enjoy just as wide a protection under the new regime as it did under the 1973 Act[308].

[300] See note 1
[301] See note 1
[302] *Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd and another v Göbel NO and others* [2011] 3 All SA 549 (SCA)
[303] See note 1
[304] supra
[305] supra
[306] supra
[307] *Farren v Sun Services SA Photo Trip Management* (Pty) ltd (2003) 2 All SA 406 (C)

[308] See note 2

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