THE DEVELOPMENT AND REFORM OF THE RULES REGULATING AUTHORITY TO CONTRACT ON BEHALF OF COMPANIES IN SOUTH AFRICAN AND ENGLISH LAW

by

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Signed at Johannesburg on 26 January 2021

Julian Jesse van Niekerk

In loving memory of my father, Tian Minnaar van Niekerk

(2 May 1948 – 23 June 2021)

"*For we know that if our earthly house, this tent, is destroyed, we have a building from God, a house not made with hands, eternal in the heavens.*"

2 Corinthians 5:1 (NKJV)

To Eleni and Elenitsa.

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ABSTRACT

The rules regulating corporate representation relating to the conclusion of contracts have vexed courts for over a century. Even today this area of law is recognised as one of complexity, with the principles of agency, court-made company law doctrines and legislative provisions sitting side by side, with no sure guide as to their interaction. In South Africa, this sense of uncertainty is particularly acute, given the fact that there is disagreement over the nature of the applicable common law rules, the Companies Act No 71 of 2008 has introduced radical changes into this area of law and our Constitutional Court has recently made pronouncements which have brought settled agency law principles into question.

This thesis attempts to lay the groundwork for an understanding of corporate contracting under the Companies Act, taking into account relevant historical, judicial and legislative developments in English and South African law over the last 150 years. In particular, this thesis argues that an approach to corporate contracting which focusses on the third party's perspective, which is rooted in the appearances of (ostensible) authority of the company's representatives, came to dominate over the perspective of the company, which is rooted in the constitutional (actual) authority of its representatives. The implication of this shift has been the gradual de-emphasising of the corporate constitution in relation to corporate contracting. This shift has manifested in both judicial analysis (by courts placing the principles of agency, in particular ostensible authority, at the centre of unauthorised contracting cases) and statutory intervention (by the introduction of sections which expressly make constitutional provisions irrelevant to third parties).

Taking into account these developments, it is submitted that the Companies Act has continued the abovementioned trend by introducing sections which further entrench the 'third party perspective' of corporate contracting. Moreover, it is averred that the Companies Act may have overturned case law which limits the protection available to third parties contracting with companies in particular circumstances.

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ABBREVIATIONS

'Cape 1861 Act'	The Joint-Stock Companies' Limited Liability Act No 23 of 1861
'Cape 1892 Act'	The Companies Act No 25 of 1892
CC	A close corporation formed under the CC Act
'CC Act'	Close Corporations Act No 69 of 1984
'Companies Act'	Companies Act No 71 of 2008
'EEC'	European Economic Community
'European Communities Act'	European Communities Act of 1972 (c 68)
'First Directive'	EEC First Council Directive (68/151/EEC)
'MOI'	Memorandum of Incorporation
'SA 1926 Act'	The Companies Act No 46 of 1926
'SA 1973 Act'	The Companies Act No 61 of 1973
'Transvaal 1909 Act'	The Companies Act No 31 of 1909
'UK 1844 Act'	An Act for the Registration, Incorporation and Regulation of Joint Stock Companies (7 & 8 Vict c 110)
'UK 1855 Act'	The Limited Liability Act, 1855 (18 & 19 Vict c 133)
'UK 1856 Act'	The Joint Stock Companies Act, 1856 (19 & 20 Vict c 47)
'UK 1862 Act'	The Companies Act, 1862 (25 & 26 Vict c 89)
'UK 1908 Act'	The Companies Act, 1908 (8 Edw 7 c 69)
'UK 1929 Act'	The Companies Act, 1929 (19 & 20 Geo 5 c 23)
'UK 1948 Act'	The Companies Act, 1948 (11 & 12 Geo 6 c 38)
'UK 1985 Act'	The Companies Act of 1985 (c 6)
'UK 1989 Act'	The Companies Act of 1989 (c 40)
'UK Companies Act'	The Companies Act 2006 (c 46)

LIST OF DEFINED TERMS

'Ancillary Rule Approach'	The approach to the *Turquand* rule which regards that rule as a rule ancillary to the principles of agency (in particular ostensible authority), which principles remain the source of corporate contractual liability. See further paragraph 6.4.1.
'Board's General Authority Clause'	The clause, traditionally contained in the standard articles of association of companies, in terms of which the board is granted authority to manage the business of a company subject to, inter alia, the other provisions of that company's articles of association. See further paragraph 2.5.4.
'Business'	In the context of a discussion of the disposal by a company of the greater part of its assets or undertaking, such assets or undertaking are conveniently defined as 'Business' to avoid tedious repetition. See further paragraph 8.6.1.
'Company Perspective'	Corporate contractual representation viewed from the perspective of the company, as illustrated and explained in paragraph 5.1.1.
'Disposal Sections'	Section 228 of the SA 1973 Act and section 70*dec*(2) of the SA 1926 Act.
'Exclusion Clause'	A clause in a company's constitution which excludes in an unqualified manner the authority of a single representative to enter into an agreement on behalf of that company. See further paragraph 5.1.1.
'External Domain'	In the context of the Third Party Perspective, the facts relied on by a third party when dealing with a company. See further figure 2 on page 85.

'F/P Requirements'	The 'formal and procedural requirements' referred to in section 20(7) of the Companies Act.
'Independent Basis Approach'	The approach to the *Turquand* rule which regards that rule as an independent equity-based rule of company law, which constitutes a separate basis of contractual liability to that of the principles of agency. See further paragraph 6.4.2.
'Internal Domain'	In the context of the Third Party Perspective, the Internal Domain refers to facts relating to the flow of authority to a representative under a company's constitution, of which a third party does not have actual knowledge. See further figure 2 on page 85.
'Internal F/P Requirements'	An F/P Requirement contained in a company's MOI or rules.
'No Defects Clause'	A provision in terms of which, inter alia, the acts of a company's director are validated notwithstanding a defect in the appointment of that director. See further paragraph 8.7.
'Power-to-Delegate Clause'	A provision which expressly entitles the board of a company to delegate some of its authority to a single representative (or a committee). See further paragraph 2.5.5.2.
'Pro Third Party Stance'	The view that a bona fide third party should, in principle, be able to hold a company bound to a disposal of that company's Business, despite the shareholder approval required for such disposal in terms of the relevant Disposal Section not having been obtained. See further paragraph 8.6.2.

'Pro Shareholder Stance'	The view that a bona fide third party should, in principle, not be able to hold a company bound to a disposal of that company's Business in circumstances where the shareholder approval required for such disposal in terms of the Disposal Sections was not obtained. See further paragraph 8.6.2.
'Reserved Matters Clause'	A clause in a company's constitution in terms of which the authority to do a certain act is made subject to shareholder consent (either unanimous or at a specified threshold). See further paragraph 5.1.1.
'Statutory F/P Requirements'	An F/P Requirement contained in the Companies Act.
'Third Party Perspective'	Corporate contractual representation viewed from the perspective of the third party dealing with the company, as illustrated and explained in paragraph 5.1.2.

CHAPTER 1: INTRODUCTION

1.1 THIS THESIS

Companies rule the mercantile world and they do so by contract.[1] That companies, as independent legal persons, are capable of incurring liability under contract is not exactly a novel concept.[2] Neither is acknowledging that companies cannot themselves act, or more particularly contract, but have to do so through human hands.[3] Yet, between those two concepts – separate legal personality and the need to be represented in the world – lies a vast grey area, occupied by rules which either attribute human actions or mental states to companies directly[4] or render companies liable for the actions of their (actually or ostensibly) authorised representatives.

This thesis focuses on the second set of rules, as those are the most relevant to questions of corporate contracting.[5] In particular, this thesis deals with the perennial corporate law problem – what happens when a company's representative who lacks authority contracts on behalf of that company with an innocent third party? May the company raise constitutional authority restrictions against the third party, or does the law place the company at the mercy of its unauthorised representative?

The answer provided by the law has never really been satisfactory.[6] Historically, the rules addressing this situation comprised an apparently confusing[7] mix of general agency

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[1] Corporations dominate virtually all sectors of commerce, at least on a global and national level, including banking, insurance, Big Tech, pharmaceuticals, manufacturing and retail. See, further, DF Pennant 'The International Status of Modern Companies' (1903) 28 *Law Magazine and Review; a Quarterly Review of Jurisprudence* 5th series 161 at 167-8 and JE Parkinson *Corporate Power and Responsibility* (1995) at 5.

[2] For a general discussion of the consequences of separate legal personality, see HS Cilliers et al *Korporatiewe Reg* 3ed (2001) para 1.20 and MS Blackman et al *Commentary on the Companies Act Commentary on the Companies Act* (2002) (service issue 9 – March 2012) at 4-112 et seq.

[3] See *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 (2) SA 11 (T) at 14C and *Potchefstroom Dairies and Industries Co Ltd v Standard Fresh Milk Supply Co* 1913 TPD 506 at 512-3. See also JJ Henning 'Die aanspreeklikheid van ’n beslote korporasie vir die handelinge van ’n lid en enkele ander aspekte van eksterne verhoudings' (1984) 9 *TRW* 155 at 158 and P Delport 'Companies Act 71 of 2008 and the "Turquand" Rule' (2011) 74 *THRHR* 132 at 133.

[4] In *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] BCC 942 (at 506C) the 'rules of attribution' were regarded as including the principles of agency. However, it is agreed with Blackman et al (op cit note 2 at 4-125-129) that under agency law the actions of an agent are not directly atttributed to the principal – only the legal consequences of those actions.

[5] Infra para 1.3.1 regarding the use of the phrase 'corporate contracting'.

[6] See Yedidia Z Stern 'Corporate Liability for Unauthorized Contracts - Unification of the Rules of Corporate Representation' (1987) 9 *University of Pennsylvania Journal of International Business Law* 649 at 651.

principles and 19th century court-made corporate law rules, notably the doctrine of constructive notice and the *Turquand* rule. Then came the legislative provisions directly dealing with, or at least affecting, this situation – first in England and, more recently in South Africa, in the form of section 20(7) of the Companies Act No 71 of 2008 ('Companies Act').

In South Africa, the present state of the law remains one of confusion. There is still disagreement about the nature of the *Turquand* rule and the Constitutional Court's judgment in *Makate v Vodacom Ltd*[8] has brought into question agency principles which had previously been regarded as settled. Moreover, section 20(7), which has not to date received significant judicial attention, has been lambasted by commentators as, inter alia, 'obscure' and 'potentially dangerous'.[9] The Companies Act has also introduced other changes which affect this area of law, including granting original managerial powers to company boards, abolishing constructive notice and omitting provisions dealing with the acts of de facto directors. It is fair to say that the law relating to corporate contracting in South Africa currently lacks underlying unity and resembles a loose aggregation of independent principles and legislative sections, with no clear guide as to their application.

This thesis attempts to chart a path out of the mire, taking into account the historical development and evolution of the rules governing corporate representation in England and South Africa as well as lessons learnt from statutory intervention in the former jurisdiction. The main landmarks along this path are set out below.

Chapter 2 examines the emergence of the modern English company (and its South African counterpart) and illustrates that the legislative framework within which corporate contracting had to occur was remarkably consistent for over a century. The hallmarks of that framework were, inter alia, (i) the ability of shareholders to grant (or limit) the board's authority through the corporate constitution, (ii) the doctrine of disclosure, (iii) the inheritance of centralised collegiate management from corporations law (as opposed to the decentralised management

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[7] For example, infra quotations at notes 470 and 589.

[8] 2016 (4) SA 121 (CC).

[9] See, respectively, Richard Jooste 'Observations on the Impact of the 2008 Companies Act on the Doctrine of Constructive Notice and the Turquand Rule' (2013) 130 *SALJ* 464 at 469 and 475 and Etienne Aubrey Olivier 'The Turquand Rule in South African Company Law: A(nother) Suggested Solution' (2019) 5 (2) *Journal of Corporate and Commercial Law & Practice* 1 at 28. Delport (op cit note 3 at 138) lamented the uncertainty caused by the sections introduced by the Companies Act and compared these sections negatively with section 40 of the UK Act, stating that the latter section has 'successfully and efficiently' solved issues regarding representation and the *Turquand* rule. It is submitted that the analysis of Chapter 7 will show that this view of the English section is perhaps a bit rose-tinted. Lest we forget, also, that the English section has been half a century in the making.

model present in partnership law) and (iv) the recognition that companies could contract through agents.

Chapter 3 points out that agency principles lie at the heart of corporate contracting, at least partly as a result of the historical emphasis on the artificiality of the corporate person in English law. Indeed, even where a board collectively contracts on behalf of a company (including by seal), agency principles remain relevant.

Chapter 4 examines the principles of agency more closely, with particular attention to the concepts of actual and ostensible authority. This Chapter then addresses the controversial decision of the Constitutional Court regarding the latter concept in *Makate* and argues that the majority judgment in that case ought not to be followed.

Chapter 5 illustrates that, taking into account the legislative framework governing corporate contracting and the principles of agency, two perspectives emerge. The first is a 'Company Perspective', which is rooted in the constitutional (actual) authority of corporate representatives. The second is a 'Third Party Perspective', which is rooted in the appearances of (ostensible) authority relied on by third parties contracting with companies. It is argued the latter perspective has gained prominence over the years and that the shift to that perspective resulted in a gradual de-emphasising of the corporate constitution in relation to corporate contracting, either through judicial analysis or statutory intervention.

Chapter 6 deals with the first (and more subtle) of these changes, which took place *before* legislative intervention. This change manifested in the English courts, notably in the seminal decision in *Freeman & Lockyer (a firm) v Buckhurst Park Properties (Mangal) Ltd*,[10] taking an ever more pure agency-based approach to corporate contracting cases. In particular, key was the recognition that what mattered most to a third party was appearances (including the usual authority of corporate representatives) and not the corporate constitution. Ultimately, this resulted in English law placing the *Turquand* rule in its proper perspective, as merely an ancillary rule to the greater inquiry into the (ostensible) authority of corporate representatives. This Chapter makes the argument that there exists good authority and reasons for adopting a similar 'Ancillary Rule Approach' to the *Turquand* rule in South African law.

[10] [1964] 2 QB 480 (CA).

Chapter 7 examines the second manifestation of the Third Party Perspective in England, namely the introduction (and evolution) of statutory provisions which expressly aim to render the corporate constitution irrelevant to bona fide third parties.

Chapter 8 examines the provisions introduced by the Companies Act, with particular reference to the South African legislature's first attempt at third party protection in the form of section 20(7). This Chapter sets out in detail how, taking into account the historical, judicial and legislative developments identified in the preceding Chapters, corporate contracting should be approached under the Companies Act. In particular, this Chapter argues that the Companies Act should be interpreted as having further entrenched the Third Party Perspective of corporate contracting. The most obvious example of this is the abolishment of the doctrine of constructive notice, which has removed the ability of companies to raise their own constitutional provisions against third parties who are unaware of such provisions. Furthermore, this Chapter argues that, as with the *Turquand* rule, an Ancillary Rule Approach is to be preferred when interpreting section 20(7), as this aligns with the Third Party Perspective of corporate contracting. The rest of the Chapter explores the effects which such an interpretation would have and argues that, at least in certain instances, section 20(7) may have overturned the case law which limits the protection available to third parties contracting with companies. A summary of the recommendations made in Chapter 8 is contained in Chapter 9.

It is submitted that this thesis makes an original contribution to this field of study in that it not only examines the agency principles, company law doctrines and legislative provisions which regulate corporate contracting in South Africa, but attempts to illustrate in a systematic manner how those principles, doctrines and provisions ought to interact. Moreover, the suggestions made regarding the interpretation of the provisions introduced by the Companies Act contained in Chapter 8 (and summarised in Chapter 9) are, to the writer's knowledge, substantially novel.

1.2 METHODOLOGY

The approach taken in this thesis is both historical and comparative, in that the thesis examines the development and evolution of legal rules in South African and English law over a period spanning approximately 150 years. While the influence of English company law on

South African company law may have arguably waned over the last decades,[11] the representation of companies with respect to the conclusion of contracts has been one of the areas of law where our courts have most stubbornly clung to English jurisprudence.[12] Indeed, in *Makate*[13] much of the debate concentrated on the pronouncements of English courts.[14] That is not to say that there has been no divergence between the two legal systems on this issue. Whatever the extent of such divergence may be, however, any serious study of corporate contracting in South African company law cannot be made without an in-depth consideration of English law on this topic.[15]

As an aside, it should be noted that this thesis focuses on the law of England and Wales, which is distinct from Scots law and the law of Northern Ireland. Reference will therefore usually be made to 'English courts' and 'English law' throughout this thesis. When referring to the current legislation applicable in England, namely the Companies Act of 2006,[16] however, that legislation will be referred to as the 'UK Companies Act', since it applies across the UK. It should, however, be kept in mind generally that these references are not used in an overly technical way and that the (minor) differences between the company laws of the different countries which make up the UK is not of importance to this thesis. The main purpose of those references is to distinguish English law and South African law.

1.3 LIMITING THE SCOPE OF THIS THESIS

The field of corporate contracting is very wide and has a long history. Without sufficiently limiting its scope, this thesis will not be able to reach the depth necessary to fully explore relevant issues. The general principle governing the scope of this thesis is to deal with *the principles which are most relevant to most companies contracting in South Africa today*. With this in mind, the writer sets out below important limitations on the scope of research undertaken in this thesis.

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[11] For instance, the South African legislature has jettisoned the English-inspired capital maintenance rule and the common law derivative action. See Farouk HI Cassim et al *Contemporary Company Law* 2ed (2012) at 11-12. Infra, however, para 8.2.1.

[12] Our courts have in the past adopted English principles relating to representation more or less wholesale into our law. See Cilliers et al op cit note 2 para 2.03.

[13] Supra note 8.

[14] In particular, the decisions in *Freeman* supra note 10, *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549 (CA) and *Armagas Ltd v Mundogas SA* [1986] AC 717 (HL).

[15] It is also worth pointing out that the Companies Act specifically allows for the taking into account of foreign company law in its interpretation – see section 5(2).

[16] c.46.

1.3.1 Corporate representation relating to contracts (ie 'corporate contracting')

The concept of 'corporate representation' generally deals with how companies incur liability for actions undertaken by their representatives. This includes not only contractual liability, but also delictual and criminal liability. This thesis focusses on the conclusion of contracts and references to 'corporate representation' should be understood in this context. Alternatively, this thesis uses the shorthand 'corporate contracting' to refer to corporate representation in relation to the conclusion of contracts.

1.3.2 Focus on intra vires acts

The issue of corporate capacity is not entirely unrelated to the subject matter of this thesis. In particular, limitations of corporate capacity and the ultra vires doctrine played an important part in early company law, especially in conjunction with the doctrine of constructive notice. The issue of corporate capacity is, however, excluded from this thesis for two reasons. First, the most drastic effects of the ultra vires doctrine, including the effect of capacity restrictions on the authority of corporate agents, have already been curbed for a long time by legislation in both England and South Africa.[17] Although the Companies Act does arguably strengthen the third party's position in this regard, its provisions as they relate to companies in general are to a large extent a continuation of the old. Secondly, and more importantly, outside of the specialised banking and finance world, capacity limitations are rare in practice.

Accordingly, unless the contrary is stated, it must be assumed when reference is made to the conclusion of a contract on behalf of a company in this thesis that such a contract falls within that company's capacity. Constitutional limitations on a representative's authority to conclude a contract should therefore be understood to refer to restrictions on that representative's authority in respect of the conclusion of a contract which that company otherwise has the capacity to enter into.[18]

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[17] See, for instance, section 39(1) of the UK Companies Act and section 20(1) of the Companies Act. Generally, regarding the statutory reform of this doctrine in English law, see Eilis Ferran 'The reform of the law on corporate capacity and directors' and officers' authority: part 1' *Company Lawyer* (1992) 13(7) 124, Stephen Griffin 'The effect of the Companies Act 1989 upon ultra vires and unauthorised transactions' 42 *N Ireland Legal Q* (1991) 38 and Jill Poole 'Abolition of the ultra vires doctrine and agency problems' (1991) 12(3) *Company Lawyer* 43. See also Natania Locke 'The legislative framework determining capacity and representation of a company in South African law and its implications for the structuring of special purpose companies' 2016 *SALJ* 160 at 164.

[18] Infra note 830 and see *Boschoek Proprietary Company Limited v Fuke* [1906] Ch 148 at 163 and Andrew Griffiths *Contracting with Companies* (2005) at 77.

1.3.3 Only South African public and private companies

This thesis will focus on the two main types of company active in commerce in South Africa, namely public and private companies (and their predecessors). While corporate representation is, in principle, governed by the same rules for all types of companies, special rules do apply, either in English law or South African law, to representation of charities/non-profit companies[19] and personal liability companies.[20] These companies represent special cases, however, and are therefore excluded from this thesis. Representation of external companies is also excluded, since this would necessitate wading into International Private Law principles, which would distract from the main purpose of this thesis.

Importantly, 'Ring-Fenced' or 'RF' companies will not be discussed in this thesis.[21] An RF company is a classification of company introduced by the Companies Act, which is subject to different rules relating to their representation.[22] A company may qualify as an RF company if, inter alia,[23] its constitution contains any 'restrictive conditions' applicable to the company and any requirement for the amendment of any such condition in addition to the requirements set out in the Companies Act.[24]

There has been some doubt as to what exactly constitutes a 'restrictive condition', with some authors arguing that only limits on capacity qualify,[25] while others argue that authority limitations are also included.[26] The Companies and Intellectual Property Commission appears to support the former position.[27] If this view is correct, then consideration of 'RF' companies may be excluded merely on the basis that this thesis does not address capacity limitations.

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[19] Generally, see Griffin op cit note 17 at 43-44 and Poole op cit note 17 at 49.

[20] See section 19(5)(b) of the Companies Act.

[21] For a discussion of the representation of these companies, see Etienne Olivier 'Section 19(5)(a) of the Companies Act 71 of 2008: Enter a positive doctrine of constructive notice?' (2017) 3 *Stellenbosch Law Review* 614.

[22] In particular, the doctrine of constructive notice applies to the so-called restrictive conditions contained in the constitutions of such companies – see section 19(5) of the Companies Act.

[23] A company may also qualify as an RF company if its constitution prohibits the amendment of any of its provisions. Naturally, this category of RF company is less relevant to a thesis on representation than the category dealing with 'restrictive conditions'. See section 15(2)(c) of the Companies Act.

[24] See section 15(2)(b).

[25] Olivier op cit note 21 at 620.

[26] Locke op cit note 17 at 185.

[27] See practice note 4 of 2012 and, for criticism of that practice note, Locke op cit note 17 at 185.

However, even if restrictions on authority could qualify as restrictive conditions, it is submitted that 'RF' companies should still fall outside the scope of this thesis. This is because restrictive conditions are on their own not enough to qualify a company for 'RF' status - those restrictions must also be made subject to additional requirements for their amendment.[28] Even on the more permissive interpretation of 'restrictive condition', therefore, the 'RF' regime only applies to a particular type of company, the founders of which have included specific provisions in its Memorandum of Incorporation ('MOI') (and have complied with other requirements)[29] with the aim of allowing those companies the (perceived) advantages of 'RF' status. This sense of particularity is confirmed by the writer's practical experience – in practice the use of 'RF' companies is mainly limited to the banking and finance world, where such companies are used as 'special purpose companies'.[30] RF companies are therefore excluded from this thesis.

1.3.4 Focus on company liability to 'outside' third parties

The focus of this thesis is on the common scenario where an existing company purports to contract with a third party on an arm's length basis and then seeks to raise internal irregularities against that third party. Pre-incorporation contracts are therefore not covered. Neither is the ratification of a contract by the company nor the liability of an unauthorised agent to the third party. Furthermore the focus of this thesis is on a third party who is an 'outsider' (ie not a director or a shareholder of the company).[31]

1.3.5 Seals and deeds

The conclusion of contracts through the use of the corporate common seal will not be covered in depth in this thesis, as seals have, at least in South Africa, fallen into disuse.[32] Furthermore, English law recognises the execution of certain documents as deeds and the UK Companies Act contains provisions relating to the execution of documents as deeds.[33] These

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[28] Locke op cit note 17 at 187 and Kathleen Van der Linde 'The validity of company actions under section 20 of the Companies Act 71 of 2008' 2015 *TSAR* 833 at 837.

[29] See sections 11(3)(b) and 13(3) of the Companies Act. See also *One Stop Financial Services (Pty) Ltd v Neffensaan Ontwikkelings (Pty) Ltd* 2015 (4) SA 623 (WCC) para 49.

[30] Locke op cit note 17 at 162-3.

[31] Regarding the position of directors contracting with their companies, see section 75 of the Companies Act and section 41 of the UK Companies Act.

[32] The Companies Act does not even mention the term.

[33] Section 46 of the UK Companies Act.

provisions will not be examined in this thesis, as South African legislation does not contain any similar provisions.

CHAPTER 2: THE DEVELOPMENT OF THE ENGLISH AND SOUTH AFRICAN COMPANY AND THE LEGISLATIVE FRAMEWORK FOR CORPORATE REPRESENTATION

2.1 INTRODUCTION

English jurisprudence historically emphasised the artificiality of the corporate form – that a company's existence was by virtue of some written instrument, issued with the imprimatur of the Crown.[34] If we are to inquire as to how companies were intended to be represented in the real world, then we should have regard to the written laws which created them in the first place.[35] The primary purpose of this Chapter is therefore to identify the legislative framework which was put in place to regulate corporate representation at the birth of the modern English company (and its South African counterpart) and the century thereafter.

First, the development of the modern English company is set out in paragraphs 2.2 and 2.3, with a focus on the legislation promulgated between 1844 and 1948.[36] Secondly, in paragraph 2.4, attention is shifted to the development of company law in South Africa and, in particular, legislation promulgated between 1861 and 1973.[37] While these paragraphs may, at first blush, appear to have little connection with the questions researched in this thesis, they are of vital importance. It would simply be impossible to make observations regarding how companies have historically been represented in English and South African law without referring to the historic legislation promulgated in those jurisdictions. Paragraph 2.5 then focuses the reader's attention on important features of the legislative framework (identified in the earlier paragraphs) which affected corporate contracting. Those features, however, only receive substantive attention in subsequent Chapters.

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[34] Infra para 3.2.1.

[35] More generally regarding the importance of history in relation to corporate law, in the 6th edition of *Gower's Principles of Modern Company Law* it was emphasised that of all the branches of English law, company law 'is perhaps the one least readily understood except in relation to its historical development'. See Paul L Davies & DD Prentice (contributor) *Gower's Principles of Modern Company Law* 6ed (1997) at 18. Ironically, the comprehensive summary of the history of English company law which was contained in that edition was jettisoned in the next edition.

[36] Legislative provisions dealing directly with corporate representation were introduced in 1974. These provisions and their evolution are dealt with in Chapter 7.

[37] Given that South African corporate law has taken inspiration from English corporate law, it is apposite that the period of focus in this Chapter is later than the English period.

2.2 THE ENGLISH COMPANY PRIOR TO 1844

Before 1844, the main *legal forms* of commercial undertaking in England were partnerships and corporations formed by royal charters of incorporation.[38]

Partnerships in the form used in England in the early nineteenth century could be traced back to the Roman *societas*.[39] These partnerships could be formed without permission of the State and were not regarded as separate legal entities. Each partner had to be joined to legal proceedings by or against the partnership.[40] The partners traded jointly, were personally liable for partnership debts and each partner could contract as agent on behalf of the partnership (within the scope of the partnership agreement).[41] The ability of every partner to bind the partnership meant that partnerships would find it difficult to establish a centralised governance structure – while limits could be placed on a partner's authority, these would only be binding internally between partners.[42] Interests in partnerships were not transferable – any change in the identity of a partner would require a new partnership agreement.[43] While all of these features may at first glance be seen as commercial disadvantages, it should be noted that the partnership form was widely used during the Industrial Revolution, especially in the manufacturing sector.[44]

Conversely, charter corporations, which could be incorporated not only by royal charter but also by Act of Parliament and, later, letters of patent, were deemed to be separate legal

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[38] From medieval times there were also guilds regulating certain trades, but these guilds had more to do with protecting the monopoly of their members in a certain area than trading as entities. See Pennington R *Pennington's Company Law* 5ed (1985) at 6. The outline of the history of company law found in the fifth edition of *Pennington's Company Law* was omitted from the 6th edition onwards. See also Ryan Bubb 'Choosing the Partnership: English Business Organization Law during the Industrial Revolution' (2015) 38 *Seattle U L Rev* 337 at 341.

[39] Regarding the two Roman law-based types of partnership which were prevalent in medieval Europe, namely the *commenda* and the *societas*, see Istvan Sandor 'The Medieval History and Development of Company Law' (2017) 8 *Journal on European History of Law* 34 at 44, Davies & Prentice op cit note 35 at 19 and Susan Watson 'How the company became an entity: a new understanding of corporate law' (2015) 2 *Journal of Business Law* 120 at 128.

[40] Ron Harris *Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844* (2000) at 21 and Bubb op cit note 38 at 344.

[41] Davies & Prentice op cit note 35 at 19 and Bubb op cit note 38 at 343-4. This was, however, not initially the case, as the *societas* in Roman law was subject to the general rule that no man could contract on behalf of another - see SD Girvin 'The Antecedents of South African Company Law' (1992) 13 *J Legal Hist* 63 at 63.

[42] Bubb op cit note 38 at 344.

[43] Ibid at 343. This was also true if one of the partners died – see Armand Budington DuBois *The English Business Company after the Bubble Act 1720-1800* (1938) at 217.

[44] Ibid at 337, 339 and 352 et seq.

entities.[45] By the sixteenth century, this was the only mode of incorporation open to investors in England.[46] These corporations were initially only used for ecclesiastical or public bodies but over time charters were issued to commercial undertakings, most commonly merchant adventurers trading overseas.[47] These merchant charter corporations initially traded on an individual basis, with each member trading his own stock and being liable separately from the charter corporation.[48] The main reason incorporation was sought during this time was *not separate legal personality* of the charter corporation, but the economic advantage of having a monopoly granted over a specific area by charter.[49] By the seventeenth century, merchant charter corporations started trading jointly, with each member contributing stock to the joint stock fund of the charter corporation (hence 'joint stock').[50] Initially, this pooling of stock was done on a per-voyage basis, but later these companies formed fixed capitals which were divided into transferable shares.[51] Sometimes charters of moribund charter corporations were bought and used for joint stock trading.[52]

Incorporation meant that a charter corporation became a separate legal person.[53] Such separateness ostensibly provided several benefits, including perpetual succession, the ability to sue or be sued in its own name, the right to have a common seal and the right to govern itself through making by-laws and private statutes.[54] Whether incorporation automatically translated to limited liability of shareholders in the initial stages of corporate law is still subject to scholarly debate.[55] Unlike partnerships, the management of charter corporations

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[45] Some have connected charter corporations with Rome - see Pennant op cit note 1 at 163-4. See, however, Leonard W Hein 'The British Business Company: Its Origins and Its Control' (1963) 15 *U Toronto LJ* 134 at 135, M Schmitthoff 'The Origin of the Joint-Stock Company' (1939) 3 *U Toronto LJ* 74 at 79 and DuBois op cit note 43 at 1. See further Harris op cit note 40 at 16 et seq regarding other theories on the origins of the corporation.

[46] Harris op cit note 40 at 17 and Bubb op cit note 38 at 341. See Hein op cit note 45 at 134.

[47] Pennington op cit note 38 at 6 and Watson op cit note 39 at 127.

[48] Davies & Prentice op cit note 35 at 20.

[49] Hein op cit note 45 at 135. Other advantages included securing governmental authority over a region for the relevant charter corporation and the ability to discipline members. See Davies & Prentice op cit note 35 at 21 and Watson op cit note 39 at 128.

[50] Pennington op cit note 38 at 6.

[51] Ibid and Davies & Prentice op cit note 35 at 21.

[52] Davies & Prentice op cit note 35 at 24 and Pennington op cit note 38 at 7.

[53] See Harris op cit note 40 at 18.

[54] Hein op cit note 45 at 134 and Harris op cit note 40 at 19.

[55] See Stefania Gialdroni 'Incorporation and Limited Liability in Seventeenth-Century England: The case of the East India Company' in D De Ruysscher, A Cordes, S Dauchy and H Pihlajamäki (eds) *The Company in Law*

was undertaken by a board of directors, separate from the shareholders, who were left to oversee the decisions of the board through the general meeting and attempt to rein in board power through constitutional provisions.[56] This centralised governance structure was seen as an advantage of incorporation, especially in big companies with many shareholders.[57]

Incorporation by charter or Act of Parliament was, however, neither cheap nor easy to obtain.[58] Many undertakings rather opted to trade on a joint stock basis in unincorporated form, with members entering into 'deeds of settlement' governing those undertakings. These companies went further than a mere agreement between investors: a trust was set up to hold the property of the undertaking with investors as beneficiaries, in order to mimic the way that a charter corporation owned assets on behalf of shareholders.[59] The idea was that through the use of the deed of settlement and such trust, investors could obtain some benefits of incorporation (and limit some of the inconvenient features of partnership law), without actually being incorporated.[60]

So the unincorporated joint-stock company was born. Although unincorporated companies were arguably partnerships in legal form,[61] it has to be said that the use of trusts by these companies muddied the waters considerably.[62] It seems, however, to be accepted that unincorporated companies were, unlike charter corporations, not recognised as separate persons in law.[63]

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and Practice: Did Size Matter? (Middle Ages–Nineteenth Century) (2017) at 119 et seq and JJ Henning & MS Wandrag "n Oorsig van die herkoms van die private maatskappy en die huidige posisie in enkele regstelsels' (1993) 26 *De Jure* 14 at 18.

[56] See, in general, Mark Freeman, Robin Pearson and James Taylor *Shareholder democracies? Corporate Governance in Britain and Ireland before 1850* (2012) regarding the power balance between shareholders and directors in British companies prior to general incorporation legislation. See also CA Cooke *Corporation, Trust and Company: An essay in legal history* (1951) at 56-7.

[57] See DuBois op cit note 43 at 91.

[58] Bubb op cit note 38 at 341-2 and Pennington op cit note 38 at 6.

[59] See Bubb op cit note 38 at 345 and Davies & Prentice op cit note 35 at 29.

[60] Bubb op cit note 38 at 341.

[61] Watson op cit note 39 at 129 and 'The Law of Limited Liability Joint Stock Companies' (1888) 5(5) *Cape LJ* 231 at 232.

[62] See Harris op cit note 40 at 141.

[63] Ibid at 167 and Pennant op cit note 1 at 164.

If these companies were legally partnerships, then the members, at least in theory,[64] remained personally liable for company debts. This, too, company founders sought to combat through inventive ways. First, provisions were included in the deeds of settlement limiting liability of shareholders.[65] Secondly, these companies attempted to contract with outsiders on the basis that liability was limited to the funds of the company and the amounts unpaid on members' shares.[66] Some companies even started including 'limited' in their name.[67] Even if limitations were found to be invalid, the practical complications of suing and levying execution against a fluctuating body of members de facto limited the liability of the members.[68]

Unincorporated companies followed charter corporations in two further important ways. First, shares in these companies were, according to their deeds of settlement, freely transferable.[69] Secondly, and crucially for the purpose of this thesis, unincorporated companies followed a centralised governance system, in that management was delegated to a management committee.[70] This was, of course, not surprising, given that most unincorporated companies had a large member base and a separation between management and ownership.

The efficacy of all of these measures has been doubted, but the general view seems to be that the unincorporated joint stock company imitated incorporation fairly successfully.[71] These 'deed of settlement' companies became ever more sophisticated, with well-drafted deeds of settlement which gave rise to many of the standard clauses in the modern memorandum and articles of association.[72]

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[64] The real position was actually one of confusion – see Freeman, Pearson & Taylor op cit note 56 at 180-1. See further Harris op cit note 40 at 167.

[65] See Freeman, Pearson & Taylor op cit note 56 at 182-3 and Bubb op cit note 38 at 346.

[66] Davies & Prentice op cit note 35 at 31-2 and Pennington op cit note 38 at 8.

[67] Bubb op cit note 38 at 346.

[68] Davies & Prentice op cit note 35 at 32.

[69] Bubb op cit note 38 at 345.

[70] Ibid at 346.

[71] Ibid at 345. See also Sulette Lombard "n Historiese Perspektief op die Ontwikkeling van die Maatskappy as Ondernemingsvorm, met Besondere Verwysing na die Posisie van Maatskappyskuldeisers en die Aanspreeklikheid van Direkteure (Deel 1)' (2002) 35(2) *De Jure* 236 at 239.

[72] Pennington op cit note 38 at 8.

Importantly, both charter corporations and unincorporated joint stock companies were referred to as (joint stock) companies.[73] The meaning of the word 'company' was therefore not initially, as it is today, an indicator of being *incorporated or a separate legal person*. Calling an undertaking a joint stock company during that time did not give any clue as to its legal form, only its economic form (ie that it traded with a joint stock).[74] A joint stock company could therefore be a charter corporation (whether incorporated as such or having bought a second-hand charter) or an unincorporated deed of settlement company.

The transferability of (incorporated and unincorporated) joint stock shares gave rise to fervent speculation.[75] This led to the English government seeking to curb such speculation during the period between 1720, when the Bubble Act was promulgated, and 1825, when the Bubble Act was repealed, by prohibiting freely transferable shares.[76] Prosecutions under the Bubble Act were, however, rare,[77] and its promulgation did not deter unincorporated joint stock companies from being formed in the long-run.[78]

The twenty years after the repeal of the Bubble Act saw fairly minor developments being made in corporate legislation.[79] Eventually, however, pressure built on government to make the advantages of formal incorporation more widely available, which led to the promulgation of the first general incorporation statute in 1844.[80]

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[73] See DuBois op cit note 43 at 87 and Lombard op cit note 71 at 239.

[74] See Paddy Ireland 'Capitalism without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' (1996) 17 *J Legal Hist* 41 at 42-43.

[75] Davies & Prentice op cit note 35 at 24.

[76] Regarding the effect of the Bubble Act of 1720 (6 Geo 1, c 18), see Davies & Prentice op cit note 35 at 32-3, Girvin op cit note 41 at 66-7, Susan Watson 'Conceptual confusion: Organs, agents and identity in the English Courts' (2011) 23 *Singapore Ac LJ* 762 para 22 and Freeman, Pearson & Taylor op cit note 56 at 24. See, in general, DuBois op cit note 43 at 1-83 and Cooke op cit note 56 at 80 et seq.

[77] See Bubb op cit note 38 at 348 and Freeman, Pearson & Taylor op cit note 56 at 29.

[78] Unincorporated companies represented more than 40% of all joint stock companies formed in Britain and Ireland between 1720 and 1850 - Freeman, Pearson & Taylor op cit note 56 at 2. Pennington op cit note 38 at 8.

[79] See Girvin op cit note 41 at 67, Davies & Prentice op cit note 35 at 36 and Lombard op cit note 71 at 247 et seq.

[80] Pennington op cit note 38 at 9.

2.3 GENERAL INCORPORATION STATUTES IN THE UK: 1844-1948

2.3.1 The first generation: 1844-1855

In 1844, the first general companies legislation was promulgated in the form of An Act for the Registration, Incorporation and Regulation of Joint Stock Companies ('UK 1844 Act'), which consisted of 80 sections.[81] This Act provided for the registration of 'joint-stock companies', which were defined to include, inter alia, partnerships with freely transferable shares and partnerships with more than 25 members.[82] In the immediate aftermath of the UK 1844 Act, three types of entities were therefore available to investors: a chartered company (to which the UK 1844 Companies Act did not apply),[83] a partnership which had less than 25 members and non-transferable shares or a joint-stock company formed under the UK 1844 Act.[84]

The UK 1844 Act introduced two principles fundamental to modern company law, namely incorporation by registration (as opposed to incorporation by charter)[85] and publicity of company documents (ie requiring the filing of documents, including deeds of settlement, which were open to inspection to the public).[86] Once incorporated under the UK 1844 Act, a company could, subject to its deed of settlement, inter alia, use its registered name, have a common seal, sue and be sued, enter into intra vires contracts and purchase and hold lands.[87]

Limited liability was, however, not granted upon incorporation under the UK 1844 Act - members remained personally liable in the event that execution against the company did not

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[81] 7 & 8 Vict c 110. In 1845 the Company Clauses Consolidation Act 8 & 9 Vict c 16 was passed. This act essentially contained a model constitution for companies incorporated by statute for carrying on undertakings of a public nature. Many of the provisions of this act were later to find their way into the standard articles of companies. It is, however, not discussed in detail here, given that it was not of general application, but only applied to companies which were incorporated by act of parliament for the purpose of public undertakings. See Davies & Prentice op cit note 35 at 39 and Pennington op cit note 38 at 9 (footnote 2).

[82] Assurance and insurance companies were also included - see section 2 of the UK 1844 Act.

[83] The UK 1844 Act also did not aply to any company 'for executing any Bridge, Road, Cut, Canal, Reservoir, Aqueduct, Water work, Navigation, Tunnel, Archway, Railway, Pier, Port, Harbour, Ferry, or Dock which cannot be carried into execution without obtaining the Authority of Parliament' - see section section 2 of the UK 1844 Act.

[84] Davies & Prentice op cit note 35 at 41.

[85] See section 7.

[86] See section 18 read with section 7. See further sections 33 and 57 of the UK 1844 Act regarding shareholders' information rights and Davies & Prentice op cit note 35 at 38.

[87] See section 25.

realise sufficient assets.[88] The UK 1844 Act also provided for a two stage registration process, unfamiliar to modern eyes, including a requirement that a minimum number of shares had to be taken up prior to final registration.[89] Although shares taken up did not have to be fully paid-up, the deed of settlement had to contain a covenant in terms of which shareholders undertook to pay the outstanding amount on their shares.[90] The onerous registration process meant that most companies which were formed under the 1844 UK Act did not complete registration.[91]

In 1855, however, The Limited Liability Act, 1855 ('UK 1855 Act')[92] was passed. This Act, which formed part of the UK 1844 Act,[93] allowed shareholders 'for the first time in the commercial history of the world'[94] to limit their liability to the amount unpaid on their shares.[95] A new company wishing to make use of this option would, however, have to comply with certain requirements, including, (i) its capital had to be divided into shares of a nominal value of £10 each and (ii) its deed of settlement had to be executed by at least 25 shareholders, who held shares in the aggregate of at least three fourths of the nominal capital of the company, with each shareholder having paid up at least 20% of his shares.[96] Companies which had duly limited their liability were required to have 'Limited' at the end of

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[88] Sections 66 and 67. See further section 25 of the UK 1844 Act, Frank Evans 'Evolution of the English Joint-Stock Limited Trading Company' (1908) 8 *Colum L Rev* 461 at 463, Girvin op cit note 41 at 67, Pennington op cit note 38 at 9 and Sulette Lombard "n Historiese Perspektief op die Ontwikkeling van die Maatskappy as Ondernemingsvorm met Besondere Verwysing na die Posisie van Maatskappyskuldeisers en die Aanspreeklikheid van Direkteure (Deel 2)' (2003) 36(1) *De Jure* 32 at 33.

[89] See sections 4 and 7 and Evans op cit note 88 at 462.

[90] Claims by companies against their shareholders for unpaid amounts on their shares was one of the biggest issues in early company law. See Derek French, Stephen W Mayson and Christopher L Ryan *Mayson, French & Ryan on Company Law* 34ed (2017) at 53-4.

[91] See Susan Watson 'The significance of the source of the powers of boards of directors in UK company law' (2011) 6 *Journal of Business Law* 597 at 604.

[92] 18 & 19 Vict c 133.

[93] See section 16 of the UK 1855 Act.

[94] See the *Cape LJ* op cit note 61 at 232. As pointed out by De La Rey, this statement was technically incorrect if it was intended to mean that shareholder liability was a new concept since charter corporations could have limited liability. It was, however, the first time in which shareholders could limit their liability without specific permission from the State or by resorting to dubious private measures. See De La Rey 'Aspekte van die vroeë maatskappyereg: 'n Vergelykende Oorsig (Deel 1)' (1986) 27(1) *Codicillus* 4 at 14 (footnote 118).

[95] In addition, creditors were first required to execute against the company before proceeding against shareholders. See sections 7 and 8 of the UK 1855 Act. See Lombard op cit note 88 at 33.

[96] See section 1 of the UK 1855 Act. The UK 1855 Act also provided a procedure for companies already registered to obtain limited liability – see section 2 of the UK 1855 Act.

their name, which would serve as a warning to third parties.[97] The UK 1855 Act therefore gave birth to the limited company, the forerunner of today's public company.

2.3.2 The second generation: 1856-1859

Barely a year after the passing of the UK 1855 Act, the English legislature promulgated the Joint Stock Companies Act, 1856 ('UK 1856 Act').[98] Although touted as an act of consolidation, this Act, which contained 116 sections, was in reality completely different from the UK 1844 Act. This Act is recognisable to modern eyes: the number of shareholders necessary to form a company with limited liability was decreased to seven,[99] the minimum capital requirements for registration were scrapped[100] and the deed of settlement was replaced with the memorandum and articles of association (of which model versions were attached).

2.3.3 The first grand consolidation: the Companies Act 1862

After the passing of the UK 1856 Act (and a flurry of legislation amending it), English company law was in a relatively complex state, because the UK 1856 Act did not completely repeal the UK 1844 Act, which still applied, inter alia, to insurance companies. In 1862, the legislature decided to wipe the slate clean and introduced the Companies Act, 1862 ('UK 1862 Act'),[101] which repealed, inter alia, the UK 1844 Act, the UK 1856 Act and the Acts passed between 1857-1859.

This Act, which was the first act to be called a 'Companies Act', contained 212 sections and further built the foundation of modern company law. Although it would be frequently amended, it was to remain the main company law in England until the twentieth century.[102] The basic aspects of company law did not change from the UK 1856 Act: seven persons could incorporate a company with limited liability, with model articles applicable to that company unless excluded or modified.

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[97] The name of the company was required to be painted or affixed to its place of business, engraved on its seal and used in all correspondence and advertisements – see sections 4 and 5 of the UK 1855 Act.

[98] 19 & 20 Vict c 47.

[99] See section 3 of the UK 1856 Act.

[100] See Lombard op cit note 88 at 38 and *Cape LJ* op cit note 61 at 233.

[101] 25 & 26 Vict c 89.

[102] Lombard op cit note 88 at 34.

2.3.4 *Salomon v Salomon and Co Ltd*

Although not a legislative development, it is apposite here to make brief mention of the landmark decision of the House of Lords in *Salomon v Salomon and Co Ltd*.[103] This case, which was decided in 1897, dealt with a company incorporated under the UK 1862 Act. The facts were that Salomon had sold his business to a company in return for shares and secured debentures. Pursuant to that transaction, he held 20,000 shares and his wife and five of his children held one share each. This was therefore de facto a one-man company. The only reason for the other shareholders was to comply with the requirement under the UK 1862 Act that a company had to have seven shareholders.

When the company was liquidated, there were only sufficient funds available to pay the secured debentures. The liquidators, however, argued that this amounted to a fraud on the 'real' creditors of the company, since the holder of the debentures in this case was Salomon himself. The House of Lords, however, affirmed the efficacy of separate legal personhood of Salomon and Co Ltd.[104] It was irrelevant that Salomon was also in control of the company - the company was a separate person and its obligations were different from those of Salomon. It therefore owed Salomon on the debentures. The separate personhood of companies formed under the UK 1862 Act was therefore confirmed by the highest authority in the UK, in a decision which still reverberates today.[105]

2.3.5 The first half of the twentieth century: the Companies Acts of 1908, 1929 and 1948

In the first half of the twentieth century, every two decades a company law committee was established with the purpose of reviewing the state of company law. The recommendations of these committees would then lead to amendments and consolidated legislation.[106] Three such consolidations took place between 1900 and 1950, namely the Companies (Consolidation) Act 1908 ('UK 1908 Act'),[107] the Companies Act 1929 ('UK 1929 Act')[108] and the Companies Act 1948 ('UK 1948 Act').[109]

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[103] [1897] AC 22 (HL).

[104] See *Salomon* op cit 103 at 51 and Watson op cit note 39 at 135.

[105] Cilliers et al op cit note 2 para 1.18 et seq.

[106] Davies & Prentice op cit note 35 at 48-9.

[107] 8 Edw 7 c 69. This Act implemented the report of the Loreburn Committee (1906 Cmnd 3052).

One of the most important developments during this time was the formal introduction of the private company by the UK 1908 Act.[110] These companies, which could be formed by only two persons,[111] would come to dominate the corporate landscape in the twentieth century.[112] Although, as *Salomon* showed, one-man companies were possible even before the introduction of this legislation, the concept of a private company certainly facilitated the use by small businesses of the corporate form instead of partnership form. From a corporate representation perspective, however, there were no real differences between public and private companies, notwithstanding the fact that the latter were far less likely to involve a separation of ownership and control than the former.

2.4 THE SOUTH AFRICAN COMPANY

2.4.1 Before 1861

In its 2004 report regarding the need for the reform of South African company law, the Department of Trade and Industry asserted that 'company law has existed in South Africa since 1861'.[113] This is, of course, true in one sense, because that was the year in which the first general incorporation legislation was introduced in the Cape Colony.[114]

However, as has been shown above, in the early part of the nineteenth century the company was still very much in embryonic form, straddling the divide between a partnership and a charter corporation. If we allow for a wider, and more historically accurate, concept of the company of the late eighteenth and early nineteenth centuries, then the contention that South African company law came into existence in 1861 appears to be an oversimplification. Indeed, European settlement on these shores in 1652 was undertaken by a charter

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[108] 19 & 20 Geo 5 c 23. This Act implemented the report of the Greene Committee (1926 Cmd 2657) and the Wrenbury Committee (1918 Cd 9138).

[109] 11 & 12 Geo 6 c 38. This Act implemented the report of the Cohen Committee (1945 Cmd 6659).

[110] Technically, private companies were introduced by the Companies Act of 1907, only to be consolidated a year later in the UK 1908 Act. See Hein op cit note 45 at 146.

[111] See section 1 of the UK 1908 Act.

[112] In the UK, there were 16,263 public companies and 95,598 private companies in 1930. By 1944 the number of public companies had decreased to 13,303 while the number of private companies had increased to 169,205. See Henning & Wandrag op cit note 55 at 22.

[113] South African Company Law for the 21st Century: Guidelines for Corporate Reform GN 1183 *GG 26493* of 23 June 2004 para 2.1.

[114] Infra para 2.4.2.

corporation, namely the *Vereenigde Oostindische Compagnie*.[115] Further charter corporations were also formed at the Cape[116] and Roman-Dutch law already recognised other forms of undertaking which, although not separate juristic persons, contained elements of limited liability.[117]

With the second British conquest of the Cape in 1806, the course of South African law irrevocably changed. The British approach to its new Colony was to formally retain the existing Roman-Dutch law, but gradually and systematically increase English influence.[118] This would be done by the introduction of English as the exclusive language of Government, the interpretation of existing law to fit the spirit of English law, and the recommendation that new judges be barristers of English, Scotch or Irish Bars of not less than five years standing.[119] The process of Anglicisation was, however, not simply a top-down dictate by the new rulers of the Cape - Roman-Dutch law advocates were already accustomed to citing English precedent before the aforementioned measures were taken.[120] Furthermore, commerce in South Africa came to be dominated by English-speakers, who naturally proliferated English mercantile usages.[121] Finally, there was a prevailing sense that English law was further advanced than Roman-Dutch law in mercantile law, including agency and company law.[122]

The first general incorporation legislation would, however, only be passed half a century after British annexation. In the intervening period, charter corporations continued to be formed through ordinances and there is evidence of unincorporated joint stock companies formed at the Cape.[123] Ultimately, as in England, the Cape legislature elected to promulgate

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[115] See De La Rey op cit note 94 at 6-8 regarding the features of the *VOC*.

[116] Ibid at 8.

[117] Ibid at 6 and JJ Henning 'Partnership' in WA Joubert (founding ed) *The Law of South Africa* vol 19 2ed (2016) paras 255 and 260.

[118] The retention of Roman-Dutch Law was according to established principle – see C Graham Botha 'The Early Influence of the English Law upon the Roman-Dutch Law in South Africa' 1923 39 *SALJ* 396 at 404 and Pennant op cit note 1 at 162. See also De La Rey op cit note 94 at 9.

[119] See Botha op cit note 118 at 402 et seq.

[120] See HDJ Bodenstein 'English Influences on the Common Law of South Africa' (1915) 32 *SALJ* 337 at 339. See further Botha op cit note 118 at 406.

[121] Bodenstein op cit note 120 at 352.

[122] See Botha op cit note 118 at 403. See also Bodenstein op cit note 120 at 353-4 and Girvin op cit note 41 at 70. Some have, however, questioned this narrative - see Rob McQueen 'The Flowers of Progress - Corporations Law in the Colonies' (2008) 17 *Griffith L Rev* 383 at 402.

[123] See De La Rey op cit note 94 at 10-3.

general legislation allowing for the incorporation of companies. These laws would, inevitably, be based on English precedent. This strong legislative influence would last for exactly 150 years, from the passing of the first general incorporation legislation in the Cape in 1861 until the coming into effect of the Companies Act in 2011. We now turn to a brief survey of South African corporate legislation between 1861 and 1973.

2.4.2 The first generation: the Cape 1861 Act

The Joint-Stock Companies' Limited Liability Act ('Cape 1861 Act') was promulgated in 1861 in the Cape Colony.[124] This short piece of legislation essentially amounted to a pared down version of the UK 1844 Act and the UK 1855 Limited Liability Act. The Cape 1861 Act consisted of only 19 sections, whereas the two English acts it drew from contained just shy of 100 sections. To say that the South African legislation was merely a 'carbon copy' of its English counterparts[125] is therefore inaccurate – the version adopted in the Cape was seriously thinned out.[126] The sections which the Cape 1861 Act did contain, however, were taken over from the English legislation with few changes.

The basics of the Cape 1861 Act were accordingly in sync with the first generation English legislation described above: partnerships with more than 25 members could gain incorporation by registering their deed of settlement with the registrar of deeds and such incorporation allowed shareholders to limit their liability to the amounts unpaid on their shares.[127] Investors were still required to pay up a portion of their shares prior to registration, although that portion was only 10% under the 1861 Cape Act, half of that required under the UK 1855 Act.[128]

It is a curious fact that the Cape legislature saw it fit to promulgate an act based on the first generation of English legislation, when the much improved second generation had already been promulgated in England in 1856-9.[129] Notwithstanding this deficiency, the Cape 1861 Act was substantively taken over in Natal, the *Zuid-Afrikaansche Republiek* (hereafter

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[124] No 23 of 1861.

[125] DTI report op cit note 113 at 14.

[126] It was said in 1888 that '[t]o compare the English and Colonial Acts, and to enumerate the defects of our Colonial law, would occupy a small volume'. See *Cape LJ* op cit note 61 at 236.

[127] See section 2 read with section 8 of the Cape 1861 Act.

[128] The Cape 1861 Act also did not require a company's capital to be divided into shares of a nominal value of £10 each.

[129] See *Cape LJ* op cit note 61 at 236.

referred to as the 'Transvaal') and the Orange Free State.[130] The legislation in the other territories did, however, contain some interesting, if minor, deviations. For instance, in the Limited Liability Companies Law of the Transvaal,[131] companies were defined as 'associations' and not partnerships and the act referred to 'articles of association' instead of a deed of settlement. In Natal, companies could be formed by as few as ten investors and only 5% of shares had to be paid up prior to registration.[132] The Free State legislation, on the other hand, contained some provisions dealing with the independence of directors.[133]

This legislation would remain the main corporate legislation in Natal and the Free State until the introduction of national legislation in 1926, leaving those territories seriously behind the times.[134] In the Cape and the Transvaal, however, important steps would be taken to modernise corporate legislation.

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[130] Infra notes 131, 132 and 133. See Elmarie De La Rey 'Aspekte van die vroeë maatskappyereg: 'n Vergelykende Oorsig (slot)' (1986) 27(2) *Codicillus* 18 at 18 regarding the law of Griqualand West.

[131] Act 5 of 1874.

[132] See section 2 of the Joint Stock Companies' Limited Liability Law No 10 of 1864. This legislation originally did not contain the crucial section which limited the liability of shareholders in the event of execution against a company, but this section was added later by Act 18 of 1865.

[133] See sections 19 to 21 of De Wet over Beperkte Verantwoordelijkheid van Naamloze Venootschappen in Chapter C of the Law Book of the Orange Free State.

[134] Although, it should be mentioned that these acts were amended from time to time. For instance, in Natal the Winding up Law of 1866 No 19 of 1866 was passed, containing 47 sections dealing with the winding-up of companies. See De La Rey op cit note 130 at 19.

2.4.3 The Cape 1892 Act

Although it was amended in the meantime, the Cape 1861 Act remained the main corporate legislation in the Cape Colony until 1892.[135] In 1892, the Cape legislature promulgated the Companies Act, 1892[136] ('Cape 1892 Act'), which was based on the UK 1862 Companies Act and the amendments subsequently made thereto.[137] Naturally, this Act, which contained 228 sections, was a big improvement on its predecessor. Cape corporate law had thus been modernised: companies could now be formed by only seven persons, minimum capital requirements for registration were done away with and model articles of association were made applicable to companies for the first time in South Africa.

2.4.4 The Transvaal Act of 1909

In the wake of the Second Anglo-Boer War, Britain took control of the Orange Free State and the Transvaal. Legal opinion appeared to be in favour of recognising companies formed within these territories, notwithstanding the overthrow of their governments.[138] Naturally, British dominance over the entire South African territory brought with it a new impetus towards creating a unified law 'from the Cape to the Zambesi'.[139] This included a drive toward a unified and modern English company law being adopted in South Africa.[140] In 1909 the Transvaal adopted the Companies Act of 1909 ('Transvaal 1909 Act').[141] This legislation, the most comprehensive up to that date in the territory of South Africa, was based on the UK 1908 Act and accordingly introduced the private company into South African law.[142]

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[135] See De La Rey op cit note 94 at 14.

[136] No 25 of 1892.

[137] See H Tennant *The Companies Act, 1892 with marginal references to the English Statutes* (1894) and Girvin op cit note 41 at 70.

[138] See Pennant op cit note 1 at 167.

[139] See 'The Inter-Colonial Conference on Company Law' (1903) 20 *SALJ* 57 at 59.

[140] In 1903 an inter-colonial conference on company law was held between representatives of the four colonies of South Africa and Rhodesia, at which it was accepted that English company law should form the basis for a unified South African company law. See *SALJ* op cit note 139 at 58.

[141] No 31 of 1909.

[142] Just as in England, private companies would come to dominate the corporate landscape – by 1972 90% of South African companies were private companies. See Henning & Wandrag op cit note 55 at 27.

2.4.5 The Companies Acts of a unified South Africa: 1910-1973

In 1926, the first national companies legislation was passed, namely the Companies Act of 1926[143] ('SA 1926 Act'). This Act was largely based on the Transvaal 1909 Act, which meant that it was indirectly based on the UK 1908 Act.[144] After its promulgation, the English approach of appointing commissions every couple of decades to investigate the state of company law and make recommendations was adopted in South Africa.[145] The report of the last of these commissions, namely the Van Wyk De Vries Commission, led to the promulgation of the Companies Act No 61 of 1973 ('SA 1973 Act').[146] Already in 1972, that commission commented on a growing divergence between underlying corporate concepts in England and South Africa and noted that 'The time has passed that South Africa can simply rewrite into its own legislation what it finds in the corresponding English legislation.'[147] The SA 1973 Act, however, was still largely English-based and made no radical changes to the provisions governing the entering into of intra vires contracts by corporate agents.[148]

2.5 THE LEGISLATIVE FRAMEWORK FOR CORPORATE REPRESENTATION

Having set out the relevant legislative history, it now becomes necessary to highlight the relevant features put in place by such legislation.

2.5.1 The importance of the articles of association and their disclosure

After the deed of settlement had been jettisoned, the memorandum of association became the founding document of the company.[149] The contents of this document were fairly strictly

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[143] No 46 of 1926.

[144] Cilliers et al op cit note 2 paras 2.06 and 2.14 and De La Rey op cit note 130 at 24. There were some deviations, from English law, however, notably in relation to judicial management and pre-incorporation contracts. See Girvin op cit note 41 at 70.

[145] Three main commissions reported on the state of South African company law in the twentieth century, namely, the Lansdown commission in 1936 (the report of which led to the passing of the Companies Act No 23 of 1939) the Millin commission in 1948 (the report of this commission led to the passing of the Companies Act No 46 of 1952) and the Van Wyk de Vries commission in 1972.

[146] Main Report of the Commission of Enquiry into the Companies Act (RP 45 of 1970).

[147] RP 45/1970 para 9-04. In 1984, Naudé refered to the SA 1973 Act as the 'now rather emancipated offspring' of the English Companies Act. See SJ Naudé 'The South African Close Corporation' (1984) 9 *TRW* 117 at 117.

[148] See Girvin op cit note 41 at 71-2.

[149] The very act of incorporation was done by persons 'subscribing their names to a memorandum of association'. See section 3 of the UK 1856 Act, section 6 of the UK 1862 Act, section 2 of the UK 1908 Act, section 1 of the UK 1929 Act, section 1 of the UK 1948 Act, section 23 of the Cape 1892 Act, section 5 of the Transvaal 1909 Act and section 5 of the SA 1926 Act.

prescribed and included the notorious objects clause, which gave rise to controversy regarding the application of the ultra vires doctrine. Assuming intra vires contracts, however, the memorandum of association usually had little relevance to corporate contracting.[150]

The articles of association, on the other hand, would prove to be crucial in this regard. These were intended to 'prescribe regulations for the company',[151] and usually included important provisions regarding the authority hierarchy within a company. Starting with the UK 1856 Act in England[152] and the Cape 1892 Act in South Africa,[153] model articles of association were annexed to corporate legislation and were deemed to apply to a company unless that company excluded the model articles or adopted other provisions. A company's articles of association had to be registered with the relevant registrar and could only be amended by special resolution of the shareholders of the company (which also had to be registered).[154] In English and South African law, the articles of association were historically interpreted to be of contractual nature, binding between members and the company and members *inter se*, but not between the company and directors.[155]

Importantly, the articles of association, as well as special resolutions passed by the shareholders of a company, were open to public inspection.[156] The regime envisaged by the legislature was therefore one of transparency and disclosure, whereby a party contracting with a company would have (limited) insight into the internal authority hierarchy of a company.[157] This onerous disclosure regime has been regarded as a trade-off for the privilege

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[150] In the event of any conflict between the memorandum and the articles, the former would take precedence – see Cilliers et al op cit note 2 para 6.35.

[151] See section 9 of the UK 1856 Act, section 14 of the UK 1862 Act, section 10 of the UK 1908 Act, section 6 of the UK 1929 Act, section 6 of the UK 1948 Act, section 12 of the Transvaal 1909 Act and section 12 of the SA 1926 Act. See also section 53 of the Cape 1892 Act.

[152] See section 9 of the UK 1856 Act, section 14 of the UK 1862 Act, section 11 of the UK 1908 Act, section 8 of the UK 1929 Act and section 8 of the UK 1948 Act.

[153] See section 54 of the Cape 1892 Act, section 13 of the Transvaal 1909 Act, section 13 of the SA 1926 Act and section 59 of the SA 1973 Act.

[154] See sections 33 and 35 of the UK 1856 Act, sections 50 and 53 of the UK 1862 Act, sections 13 and 70 of the UK 1908 Act, sections 10 and 118 of the UK 1929 Act, sections 10 and 143 of the UK 1948 Act, sections 15 and 68(1) of the Transvaal 1909 Act, sections 15(1) and 65(1) of the SA 1926 Act and sections 62(1) and 200(1) of the SA 1973 Act.

[155] Cilliers et al op cit note 2 paras 6.36-41.

[156] See section 106(5) of the UK 1856 Act, section 174(5) of the UK 1862 Act, section 243(6) of the UK 1908 Act, section 314 of the UK 1929 Act, section 426 of the UK 1948 Act section 59 of the Cape 1892 Act, section 213(4) of the Transvaal 1909 Act, section 222 of the SA 1926 Act and section 9(1) of the SA 1973 Act.

[157] The principle of disclosure covers ground much wider than the memorandum and articles of association of companies. See Henning & Wandrag op cit note 55 at 16 et seq.

of corporate personality,[158] but its interpretation by the courts, which led to the doctrine of constructive notice, was distinctly pro-company. This is dealt with in more detail in Chapter 6.

2.5.2 Freedom to manage affairs: a caveat against generalisation

An important caveat to the general discussion below is that companies were, from the beginning, given a lot of leeway to regulate their own internal authority hierarchy. The first generation legislation did not even contain model articles.[159] The model articles included from the second generation onwards were not mandatory –[160] companies could make the exercise of authority subject to any internal thresholds or requirements. Of course, the articles could not trounce legislation, but on matters of representation, legislation generally tended to be silent, at least initially. The model articles also evolved over time and became more comprehensive.[161] Modification of, or addition to, the model articles may therefore have been as much of a necessity as a choice.

It may therefore be questioned whether examining the model articles is of any value. It is submitted that there is great value in considering these clauses, notwithstanding the fact that they may not have been mandatory. First, the model articles applied by default if they were not expressly excluded or supplanted, which meant that there were many companies in respect of which the model articles applied. Indeed, seminal cases in the field of corporate representation concerned companies which had to a greater or lesser extent adopted model articles.[162] Second, the model articles were not conjured up in an academic ivory tower, but were adopted from constitutional provisions which had long been used by charter

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[158] See Delport op cit note 3 at 133.

[159] The UK 1844 Act did, however, list certain purposes which deeds of settlement were required to make provision for in order for final registration to be granted. The UK 1844 Act also made provision for shareholders to make bye laws regulating the affairs of the company, which bye laws had to be registered at the registration office - see sections 25 and 47 of the UK 1844 Act. The first generation legislation South African legislation did not contain any of these provisions.

[160] Supra notes 152 and 153.

[161] Writing in 1859, Wordsworth was of the opinion that the standard articles omitted 'many provisions of importance which are absolutely necessary for the proper regulation of a company'. See Charles Wordsworth *The New Joint Stock Company Law* (1859) at 45. The model regulations annexed to the UK 1856 Act contained 87 clauses, while the model regulations for public companies under the UK 1948 Act contained 136 clauses.

[162] For example, see *Houghton & Co v Nothard, Lowe and Wills Ltd* [1927] 1 KB 246 (CA) at 248, *Freeman* supra note 10 at 489 and *Insurance Trust and Investments (Pty) Ltd v Mudaliar* 1943 NPD 45 at 47.

corporations and unincorporated joint stock companies.[163] While the model articles could have been said to be incomplete, the provisions which they did contain were by no means alien to incorporators. Thirdly, the model articles also give some indication of how the legislature intended or understood authority to be delegated within companies. Fourthly, courts have also noted on the generality of some of the clauses contained in the standard articles.[164] The following paragraphs will therefore discuss the authority hierarchy of a company within the framework of the model articles enacted by the legislature, notwithstanding the fact that these articles could be modified or excluded.

2.5.3 The adoption of centralised management

As we have seen, the two legal forms preceding the UK 1844 Act, namely partnerships and charter corporations, represented two distinct ways in which representation could occur. Partnerships were intended to be managed in a decentralised fashion, with each partner being able to contract on behalf of the partnership.[165] Charter corporations, on the other hand, were managed separately from shareholders by directors.[166] Obviously, the decentralised management model was more suited to small businesses owned and managed by the same people, whereas the centralised governance system suited large undertakings with many shareholders and a separation between ownership and control.

Unincorporated joint stock companies, usually being large undertakings, accordingly adopted a centralised management system based upon the model provided by charter corporations. When the legislature finally promulgated general incorporation legislation, it was therefore no surprise to find that it chose to impose a centralised management system on companies, since they were initially intended to have many shareholders (the first generation of corporate legislation required at least 25 shareholders in order to form a company).[167]

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[163] Watson op cit note 91 at 608.

[164] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 217.

[165] *Cape LJ* op cit note 61 at 232. It is a *naturale* of the partnership agreement that each partner has equal rights to represent the partnership. This is known as *mutua praepositio* or mutual mandate. Regarding representation of partnerships generally, see See Henning op cit note 3 at 162-3.

[166] Initially, this model of management was criticised by economists as less efficient than the partnership model, because directors would never be as careful with other people's money as with their own. See Freeman, Pearson & Taylor op cit note 56 at 77.

[167] Supra paras 2.3.1 and 2.4.2.

Accordingly, despite companies at first being seen as big partnerships, new entities registered under general registration would not follow the partnership model of representation (when it comes to contracting).[168] In fact, the legislature in both the UK[169] and South Africa[170] would make it illegal for persons to form partnerships for gain exceeding a specified number of partners. The authority to represent a company would vest in the board, who would manage the affairs of the company independently from the shareholders.[171]

The number of persons required to form a company was decreased to seven in the second half of the nineteenth century and, as *Salomon* showed, the corporate form became more feasible to smaller businesses through the use of nominee shareholders. The minimum number of persons was dropped even further in the first decades of the twentieth century, when only two persons were required to incorporate a private company.[172]

From a corporate representation point of view there would, however, be no distinction made between companies with large numbers of shareholders (and a genuine separation between ownership and control) and companies owned and managed by a small number of people – both would be managed by a board of directors. Predictably, this gave rise to highly artificial situations in small companies, where the same person could be owner, director and creditor of a company. Perhaps company law's great foolishness was to try to regulate the representation of companies with large numbers of shareholders and owner-managed companies by the same standard. The die was, however, cast - companies would, regardless of whether there was any actual separation between ownership and control, be managed by the board of directors, quite apart from the shareholders.

2.5.4 The Board's General Authority Clause and collegiate management

It is one thing to choose the policy of centralised management, but quite another to implement it. Initially, the UK 1844 Act contained a provision in the Act itself which

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[168] This fact was not lost on the courts, see *Ernest v Nicholls* (1857) 6 HL Cas 401 at 418-9, *Heiton v Waverley Hydropathic Co Ltd* (1877) 4 R 830 at 843 and *Re Sea, Fire & Life Assurance Company* (1854) 3 De Gex, Macnaghten & Gordon 459 at 477.

[169] See section 4 of the UK 1856 Act, section 4 of the UK 1862 Act, section 1 of the UK 1908 Act, section 357 of the UK 1929 Act and section 434 of the UK 1948 Act.

[170] See section 22 of the Cape 1892 Act, section 4 of the Transvaal 1909 Act, section 4 of the SA 1926 Act and section 30(1) of the SA 1973 Act.

[171] Infra para 2.5.4.

[172] See section 1 of the UK 1929 Act and the UK 1948 Act.

delegated the authority to manage the day to day business of a company to the board of directors collectively (subject to the deed of settlement and general meeting).[173] Such a clause shall, for purposes of this thesis, be referred to as a 'Board's General Authority Clause'.[174]

However, under the 1856 UK Act, the Board's General Authority Clause was no longer contained in the relevant legislation but rather in the model articles attached to the Act, clause 46 of which read:

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

This trend would continue in the UK to the present day.[175] In South Africa, substantially similar clauses were included from the second generation until the coming into effect of the Companies Act in 2011, the text of which now contains a Board's General Authority Clause.[176]

The positioning of the Board's General Authority Clause in the model articles instead of the legislation itself, suggested that the board derives its authority from the shareholders – that the board is an agency of the shareholders and does not act as an 'organ', at least in external relations. For the purposes of this Chapter, it suffices to say that *at least initially*, this was the prevailing view in English law. This issue is addressed in more detail in Chapter 3.[177]

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[173] See section 27 of the UK 1844 Act.

[174] Board's General Authority Clauses were already present before 1844. See Freeman, Pearson & Taylor op cit note 56 at 128 and 137. See also Watson op cit note 91 at 608-9.

[175] Substantially similar clauses were included in the model articles attached to the UK 1862 Act (see clause 55 of Table A to the first schedule to that Act), the UK 1908 Act (see clause 71 of Table A to the first schedule to that Act), the UK 1929 Act (see clause 67 of Table A to the first schedule to that Act) and the UK 1948 Act (see clause 80 of Table A to the first schedule to that Act). The Model Articles to the UK Companies Act contains a Board's General Authority, although the wording has changed somewhat. The model articles for both public and private companies stipulate that, subject to a company's articles, 'the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.' See article 3 of both the Model Articles for Public Companies and the Model Articles for Private Companies Limited by Shares and section 154 of the UK Companies Act.

[176] See clause 54 in Table A to Schedule 3 to the Cape 1892 Act, clause 83 in Table A to Schedule 4 to the Transvaal 1909 Act, clause 83 in Table A to Schedule 1 to the SA 1926 Act and clause 60 in Table B to Schedule 1 to the SA 1973 Act. Infra para 8.3 regarding the position under the Companies Act.

[177] Infra para 3.2.3.

It is important to note two further things about the Board's General Authority Clause. First, this clause envisaged collegiate management – the board would take decisions collectively, unless delegated to a single representative. That, indeed, was (and continues to be) the general position in company law in England and South Africa - boards act jointly and a single director may only bind a company if authorised to do so.[178] Another way to sum up this principle is to note that in company law, a single director does not, without more, have any authority to represent his/her company.[179]

Secondly, the board's authority was made subject to the oversight of the general meeting either in the form of regulations made at shareholders meetings or other provisions contained in the articles. While there is nothing inherently objectionable about this, as we shall see in Chapter 6, the inclusion of limitations on authority in companies' articles coupled with the right of inspection mentioned above gave rise to enduring confusion.

2.5.5 Two ways of concluding contracts

Corporate legislation essentially recognised two ways in which companies could conclude contracts, namely through the use of the common seal or through a person (or more properly, an agent) acting under the authority of the company signing the contract on behalf of the company.

2.5.5.1 Use of the common seal

Seals have a long history and were once synonymous with corporate personality.[180] Indeed, the efficacy of using a seal to conclude a contract was (and still is in England)[181] expressly recognised by corporate legislation.[182] Company's articles also usually contained a procedure

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[178] Infra para 8.3. See *Obadina Derek ADE 'Irregular, intra-vires corporate transactions and the protection of third parties in the UK and the Commonwealth - the case for reform: Part 2' (1997) 18(3) Company Lawyer* 76 at 80 and Stern op cit note 6 at 657 regarding criticism of collegiate management.

[179] So, for instance, per Mellish LJ in *In re Marseilles Extension Railway Co, ex parte Credit Foncier and Mobilier of England* (1871-72) LR 7 Ch App 161 at 168: '… a director is simply a person appointed to act as one of a board, with power to bind the company when acting as a board, but having otherwise no power to bind them.' Further infra para 4.4.2.

[180] Blackman et al op cit note 2 at 4-166.

[181] See section 43(1)(a) of the UK Companies Act.

[182] Infra sections listed in note 187.

for the affixing of a company's seal.[183] As mentioned in Chapter 1, however, this thesis does not deal with seals.

2.5.5.2 The delegation of authority to a single representative

That boards had the collective power to manage a company's affairs did not mean that contracts on behalf of that company would be negotiated and signed by all the members of the board. Usually, the board would delegate its authority to a single person for such purposes.[184] This is strictly a matter of agency law,[185] but it is apposite to note that in both English and South African legislation such delegation was expressly acknowledged. For instance, section 41(2) of the UK 1856 Act provided that:[186]

> 'Any contract which if made between private persons would be by law required to be in writing, and signed by the parties to be charged therewith, may be made on behalf of the company in writing signed by any person acting under the express or implied authority of the company, and such contract may in the same manner be varied or discharged.'

Oral contracts could likewise be concluded by a person 'acting under the express or implied authority of the company'.[187] South African corporate legislation included similar provisions until the promulgation of the Companies Act in 2011.[188]

The abovementioned sections only referred to implied or express authority – what about ostensible authority? It is submitted that Nestadt J was correct in *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief*[189] when he remarked that this must be

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[183] See clause 76 of Table A to the first schedule to the UK 1908 Act, clause 71 of Table A to the first schedule to the UK 1929 Act and clause 102 of Table A to the first schedule to UK 1948 Act.

[184] Infra para 5.1.1.

[185] See Chapter 4. In *Perpellief* supra note 3 at 14C it was noted, correctly, that the statutory provision was merely a reinforcement of the common law principles of agency.

[186] The wording of the SA 1926 Act and the SA 1973 Act followed English example. See, however, section 74 of the Transvaal 1909 Act.

[187] See section 41(3) of the UK 1856 Act. These provisions were initially left out in the UK 1862 Act, but were added by section 37 the Companies Act 1867 (30 & 31 Vict c 131). See further section 76 of the UK 1908 Act, section 29 of the UK 1929 Act, section 32 of the UK 1948 Act and section 43(1) of the UK Companies Act. Bills of exchange or promissory notes were also expressly deemed to have been made, accepted or endorsed on behalf of a company if, made, accepted or endorsed in the name of, or by or on behalf or on account of, the company by any person acting under its authority. See section 43 of the UK 1856 Act, section 47 of the UK 1862 Act, section 77 of the UK 1908 Act, section 30 of the UK 1929 Act, section 33 of the UK 1948 Act.

[188] See sections 74 and 75 of the Transvaal 1909 Act, sections 72 and 73 of the SA 1926 Act and 69 and 70 of the SA 1973 Act.

[189] Supra note 3 at 14E.

because 'where agency by estoppel operates there is in fact no agency but the defendant, because of his conduct, is precluded from asserting this.'[190]

The model articles also contained clauses facilitating delegation of authority by the board. For instance, the following clause appeared in the model articles attached to legislation promulgated in the UK from 1856,[191] in the Cape in 1892,[192] the Transvaal in 1909[193] and South Africa from 1926:[194]

> 'The directors may delegate any of their powers to committees consisting of such member or members of their body as they think fit: Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on them by the directors.'

The model articles would later also include a similar clause expressly facilitating the delegation of authority to the managing director of a company.[195] These clauses serve the same purpose, namely to expressly enable the board of a company to delegate some of its authority to a single representative (or a committee). Another example of this type of clause from case law was a clause granting the power to the directors determine who shall sign bills, cheques and contracts on a company's behalf.[196] All of these clauses will be referred to as 'Power-to-Delegate Clauses'. The effect of these clauses on parties dealing with companies is dealt with in Chapter 3.

2.5.6 Recognition of acts of defectively appointed directors: 'No Defects Clauses'

From the first generation legislation, provisions were included in the statutes and/or standard articles validating the acts of, inter alia, directors who had purportedly been appointed but

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[190] Infra para 4.5.1. The traditional notion, as expressed in *Perpellief*, that ostensible authority is not a form of actual authority has, however, become controversial in the wake of the Constitutional Court's decision in *Makate* (CC) supra note 8 – infra para 4.7 for a detailed discussion of this topic.

[191] See clause 57 of Table B to the schedule to the UK 1856 Act, clause 68 of Table A to the first schedule to the UK 1862 Act, clause 91 of Table A to the first schedule to the UK 1908 Act, clause 85 of Table A to the first schedule to the UK 1929 Act and the clause 102 of Table A to the first schedule to UK 1948 Act.

[192] Clause 67 of Table A of the Third Schedule to the Cape 1892 Act.

[193] Clause 109 in Table A to Schedule 4 to the Transvaal 1909 Act.

[194] Clause 109 in Table A to Schedule 1 to the SA 1926 Act and clause 79 in Table A to Schedule 1 to the SA 1973 Act.

[195] See clause 109 of Table A to the first schedule to UK 1948 Act and clause 85 in Table A to Schedule 1 to the SA 1926 Act and clause 63 in Table B to Schedule 1 to the SA 1973 Act.

[196] See *Mudaliar* supra note 162 at 47 and *Wolpert v Uitzigt Properties (Pty) Ltd* 1961 (2) SA 257 (W) at 262-3.

whose appointment was defective in some way. These provisions, which are elaborated on in Chapter 8,[197] shall be referred to as a 'No Defects Clauses' in this thesis.

2.6 CONCLUSION

What emerges from the historical analysis of general incorporation statutes introduced in England and South Africa is a remarkably consistent set of provisions which governed and affected corporate contracting. The next Chapter will shed more light on how this common legislative framework was interpreted by courts.

[197] Infra para 8.7.

CHAPTER 3: PLACING AGENCY AT THE CENTRE OF CORPORATE CONTRACTING

3.1 INTRODUCTION

Considering the history of the modern company and identifying the legislative provisions which affected corporate contracting is a necessary step to properly understanding corporate representation. It is, however, not sufficient on its own – the provisions in legislation were actually quite scant given the importance of the topic. Corporate representation was mainly dealt with by the courts and it is necessary to examine the common law legal principles which regulated this issue. This Chapter is the first step of that examination.

3.2 AGENCY AS BASIS FOR CORPORATE REPRESENTATION

3.2.1 Emphasis on artificial aspects of corporate personality

Corporate law historians have commented on the relative lack of interest in the nature of corporate personality of the practice-orientated English jurists of the seventeenth and eighteenth centuries.[198] Nevertheless, it is clear that the approach historically taken to companies in English law was to emphasise the artificial nature of corporate personality, in accordance with Roman-Canonist theories.[199] Harris concludes as follows regarding the English corporation of the eighteenth century:[200]

> 'English corporations of this period can be seen in retrospect as entities made by the State, by way of franchise or concession of the King and later also Parliament. They were not conceived as being pre-State and pre-law natural persons, spontaneously created by the mere association of individuals, nor were they conceived as the aggregation of autonomous individuals, contracting to form a new entity.'

The emphasis on the artificiality of corporate personality continued in the nineteenth century after the general incorporation statutes and still has a strong (but not uncontroversial) foothold in English law.[201] Indeed, Lord Hoffman in the influential case of *Meridian Global*

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[198] This may be contrasted with the theoretical discussions undertaken on the Continent, first by the Romanist and Canonist schools and later by the German jurists of the nineteenth century. See Harris op cit note 40 at 111 et seq and DuBois op cit note 43 at 86-7.

[199] Infra para 7.2 regarding the agency-based approach followed in Continental countries other than Germany. See also DuBois op cit note 43 at 1.

[200] Harris op cit note 40 at 112-3.

[201] See Mayson, French & Ryan op cit note 90 at 152-6 and Watson op cit note 39. See also Griffiths op cit note 18 at 1.

Funds Management Asia Ltd v Securities Commission[202] affirmed an artificial view, by stating that a company exists 'because there is a rule (usually in a statute) which says that a *persona ficta* shall be deemed to exist and to have certain of the powers, rights and duties of a natural person'.[203]

3.2.2 Agency as basis for corporate contractual liability

A company may hold rights and be subject to obligations, but obviously cannot act for itself. How, then, are those legal obligations and rights accrued? Like other countries which were heavily influenced by the Romanist fictional view of corporate personality, English law has generally dealt with this problem through the lens of agency, by regarding a company as a principal which acts in the world through its authorised agents.[204] So, for instance, in 1866, Cairns LJ stated in *Ferguson v Wilson*: [205]

> 'What is the position of directors of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent.'[206]

This is especially so in the sphere of corporate *contractual* liability. Indeed, it may be confidently stated that agency law has formed the basis for explaining the contractual liability of companies in England,[207] Australia,[208] New Zealand[209] and South Africa[210].[211]

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[202] Supra note 4 at 945. This case was an appeal to the Privy Council from the Court of Appeal of New Zealand. *Meridian* was confirmed as being part of English Law by the House of Lords in *Stone & Rolls Ltd (in liquidation) v. Moore Stephens (a firm)* [2009] 3 WLR 455. See, generally, Jennifer Payne 'Corporate Attribution and the Lessons of Meridian' in PS Davies and J Pila (eds) *The Jurisprudence of Lord Hoffmann* (2015) and Ross Grantham 'Corporate knowledge: Identification or attribution' (1996) 59 *Mod L Rev* 732. The impact of this judgment has, however, been questioned – see Eilis Ferran 'Corporate attribution and the directing mind and will' (2011) 127 *LQR* 239 at 240.

[203] Supra note 202 at 945. The Lord Justice (at 946) also eschewed any notion of a company existing acting 'as such' in the world.

[204] Infra para 7.2.

[205] (1866) LR 2 Ch App 77 at 89.

[206] See also *Aberdeen Rly Co v Blaikie Bros* (1854) 1 Macq 461 at 471. Similar pronouncements have been made by South African courts. For instance, in *Cohen v Directors of Rand Collieries Ltd* 1906 TS 197 at 201 it was said: 'The directors of a company are its agents and in the case of this company as of most companies their agency extends to all acts which are within the powers of the company itself'. See also *Robinson* supra note 164 at 216, *Lipschitz and Another NNO v Landmark Consolidated (Pty) Ltd* 1979 (2) SA 482 (W) at 488 and *Mudaliar* supra note 162.

[207] Griffiths op cit note 18 at 11, Mayson, French & Ryan op cit note 90 at 611, Stephen D Girvin, Sandra Frisby and Alastair Hudson *Charlesworth's Company Law* 18ed (2010) para 6-011, Vanessa Edwards, 'Ultra Vires and directors' authority – an EC perspective' (1995) 16(7) *Company Lawyer* 202 at 203, DD Prentice 'Section 9 of the European Communities Act' (1973) 89 *Law Quarterly Review* 518 at 529 and Derek ADE Obadina 'Irregular, intra-vires corporate transactions and the protection of third parties in the UK and the Commonwealth - the case for reform: Part 1' (1997) 18(2) *Company Lawyer* 45 at 46.

It appears as though agency already governed corporate contracting prior to the general incorporation statutes.[212] In any event, as we have seen in Chapter 2, the first generation of those statutes expressly recognised contracts entered into via agency.[213] Agency is obvious when a company contracts through a single representative to whom authority has been delegated.[214] Initially, however, even the collective board of a company was regarded as the agent of the collective body of shareholders (which was regarded as the company).[215] This is not surprising if one considers that the source of board authority and power, namely the Board's General Authority Clause, was non-mandatory.[216] Indeed, the board's authority could be limited or in theory even be excluded by the shareholders.[217] Not only that, but the Board's

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[208] HAJ Ford, RP Austin & IM Ramsay *Ford's Principles of Corporations Law* 12ed (2005) at 727; RP Austin (ed) et al *Australian Corporation Law* (1991) (revision service 193 - November 2014) at 32,211.

[209] John Farrar *Corporate Governance in Australia and New Zealand* (2001) at 57.

[210] See, for instance, *Mudaliar* supra note 162 at 53-54, *Inter-Continental Finance and Leasing Corporation (Pty) Ltd v Stands 56 and 57 Industria* Ltd 1979 3 SA 740 (W) at 748E, *Perpellief* supra note 3 at 14C. See further Jooste op cit note 9 at 464, Cilliers et al op cit note 2 para 12.01, JJ Du Plessis 'Maatskappygebondenheid vir die Optrede van Ongemagtigde Maatskappyfunksionarisse' (1991) 3 *SA Merc LJ* 281 at 281-2, JSA Fourie 'Verkoop Van Die Onderneming Van Die Maatskappy - Het Artikel 228 van Die Maatskappywet Nog Betekenis?' 1992 *TSAR* 1 at 2, SJ Naudé ''n Nuwe Benadering tot die Funksie van Maatskappydoelstellings' (1971) 88 *SALJ* 505 at 507-508, JS McLennan 'Contract and agency law and the 2008 Companies Bill' 30(1) 2009 *Obiter* 144 at 148 and 153, Henning op cit note 3 at 158 and MJ Oosthuizen 'Aanpassing van die verteenwoordigingsreg in maatskappyverband' 1979 *TSAR* 1 at 1.

[211] Stern op cit note 6 at 668, after surveying the approaches to corporate representation taken in English law, German Law and American law, observes as follows: 'The law governing the relationships between a corporation and other legal entities, therefore, has been agency law, and all corporate rights and duties have been molded to fit into the substance and rationale of that law.'

[212] See DuBois op cit note 43 at 118-9. Certainly this was the case in respect of unincorporated joint stock companies – see Griffiths op cit note 18 at 4.

[213] Supra para 2.5.5.2.

[214] See *Robinson* supra note 164 at 217-8.

[215] Commentators both in England and South Africa accept the premise that, at least until the end of the nineteenth century, the directors were regarded as agents of the company subject to the control of the general meeting. *Isle of Wright Railway v Tahourdin* (1883) 25 ChD 320 has in the past been cited as an example of this view, but the articles in that case expressly gave the shareholders the power to control and regulate the board. See Blackman et al op cit note 2 at 7-14-5, Paul L Davies and Sarah Worthington *Gower's Principles of Modern Company Law* 10ed (2016) para 14-6. See also Mayson, French & Ryan op cit note 90 at 625-6.

[216] Supra para 2.5.4. See also *Oakbank Oil v Crum* (1882) 8 App Cas 65 at 71 where the Earl of Selborne, referring to a company formed under the UK 1862 Act, said: 'It appears to me that directors and general meetings of companies of this sort can have no powers by implication except such as are incident to, or properly to be inferred from, the powers expressed in the memorandum and articles of association. Their powers are entirely created by the law and by the contract founded upon the law which enables such companies to be constituted.' Infra, however, note 994.

[217] The exception to the general rule that Board's General Authority Clauses be contained in the corporate constitution rather than legislation was the UK 1844 Act. The drafters of that Act appear to have accepted the authority of directors as a fact quite independent from the will of the shareholders. Not only did that Act contain a Board's General Authority Clause in its text, but section 27 expressly dictated that any restrictions on the board's authority should not have the effect of permitting shareholders to act on their own behalf in the ordinary

General Authority Clause itself also expressly allowed for the general meeting to prescribe regulations – apparently by ordinary resolution - for the board to follow.[218]

Meridian, too, confirms agency as the general framework for corporate representation. In this case, the principles of agency were referred to as the 'general rules of attribution' through which companies contract.[219] The court noted that while a company could have 'primary rules' in its constitution which deemed certain actions, like decisions of the board, to be decisions of the company itself, actions under those primary rules usually required a threshold of consent impractically high for everyday commerce.[220] It is simply not practically possible to trade if every contract required board approval – so companies need to appoint agents – and it is the principles of agency (including estoppel) which govern the company's liability in such circumstances.[221] The court also acknowledged 'special rules of attribution', which allow actions to be directly attributed to companies –[222] but these rules only apply *in exceptional circumstances* when liability cannot be attributed under the primary and general rules.[223]

3.2.3 The collective board: From agent to organ?

Another way to deal with corporate representation is to give credence to the notion that natural persons may act *as* the company and not merely as agents *on behalf of* the company. This notion is usually connected with the German *organtheorie*, in terms of which acts of

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management of the company 'otherwise than by means of directors'. Directors were also defined as 'persons having the direction, conduct, management or superintendence of the affairs of a company'. Critics of the agency approach point out that there exists no evidence that shareholders actually ever completely excluded the authority of the board and that companies have, at least since the 1920's, been expressly required to appoint directors. See section 139 of the UK 1929 Act, section 176 of the UK 1948 Act and sections 18(2) and 20 of the UK Companies Act. Section 7 of the UK 1844 Act also required companies to have three directors. See Watson op cit note 91 at 605.

[218] Infra para 3.2.3 regarding the evolution of the courts' approach to this issue.

[219] Supra note 4 at 945.

[220] See *Meridian* supra note 4 at 945 regarding other forms of primary rules. Presumably, the primary rules also refer to allocation of authority under board and shareholder resolutions - see Ferran op cit note 202 at 243.

[221] *Meridian* supra note 4 at 945.

[222] Ibid at 946. These special rules are invoked to give an answer to how a statutory provision which applies primarily to natural persons and requires some state of mind or knowledge on behalf of that person in order to attribute liability may be applied to the company. These provisions should not be confused with statutory provisions which are actually drafted with attributing liability to companies in mind such as the English Corporate Manslaughter and Corporate Homicide Act, 2007 (c 19). See Ferran op cit note 202 at 240.

[223] Ibid. See also *Northside Developments Pty Ltd v Registrar General* (1990) 170 CLR 161 (HC of A) at 201 (my emphasis): 'The organic theory … has been used to impose liability upon companies *beyond that* which could be imposed by the application of the principles of agency alone.'

certain corporate 'organs' are deemed to be those of the company without the need to invoke agency principles.[224] As noted above, English law traditionally followed the agency construction and the 'organic' idea of representation has not been widely recognised.[225] Indeed, Prentice commented as follows regarding the use of the term 'organ' in the First Directive:[226]

> '…the First Directive does not fit neatly into the framework of English company law because of the absence of the concept of "organ" as being generally accepted within that system.'[227]

Today, however, there appears to be more support for the concept.[228] It has, for instance, been pointed out that the agency-based view of corporate representation was never absolute. For example, it was accepted even in early cases that when a company's seal had been properly affixed to a document, that seal was tantamount to the company's signature (and not that of an agent of the company).[229]

Furthermore, other developments in corporate law undermined a strictly agency-based understanding of the board. Starting with *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame*,[230] the English courts developed the idea that once authority had been delegated to the board of a company through a standard Board's General Authority Clause, shareholders

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[224] Regarding the *organtheorie*, see SJ Naudé *Die Regsposisie van die Maatskappydirekteur* (1970) at 15. See also Farrar op cit note 209 at 58-59, Mayson, French & Ryan op cit note 90 at 152 et seq and Watson op cit note 39 at 130. This view has been of particular importance in German company law, which explains company liability for contracts concluded by a company's executive board (*Vorstand*) in terms of organic theory and not agency. See Vanessa Edwards *EC Company Law* (1999) at 34 et seq.

[225] See Edwards op cit note 207 at 203 (footnote 5): '… the *Organtheorie* has at best a tenuous foothold in English Company law'.

[226] As defined in para 7.2. DD Prentice 'Some Reflections on the Harmonisation of Company Law, an English Perspective' in Bruno de Witte and Caroline Forder (eds) *The Common Law of Europe and the future of legal education* (1992) at 350-1.

[227] This issue is covered in more detail infra para 7.3.2.

[228] See Davies & Worthington op cit note 215 para 7-1 and Watson op cit note 39 at 137. This does not mean that the meaning of the term is fixed. For instance, some commentators refer to organs meaning to imply application of the organic theory of representation, while other commentators use the term 'organ' more loosely, merely to refer to the the company's two decision-making bodies (the board and the shareholders). Griffiths op cit note 18 at 82 (footnote 51).

[229] See Watson op cit note 76 para 37. Griffiths op cit note 18 at 12 criticises this view for making the law of corporate representation unnecessarily complicated. See also *Houghton* (CA) supra note 162 at 267 where Sargant LJ dinstinguished between cases where companies were acting under seal and those where courts were considering the actions of single directors. Regarding the South African position, see *Potchefstroom Dairies* supra note 3 at 512-3 and *Northview Shopping Centre (Pty) Ltd v Revelas Properties Johannesburg CC* 2010 (3) SA 630 (SCA) para 7.

[230] [1906] 2 Ch 34 (CA) at 42-43. See also *Gramophone & Typewriter Ltd* v *Stanley* [1908] 2 KB 89 (CA) at 98, 105, *Salmon* v *Quin & Axtens Ltd* [1909] 1 Ch 311 (CA) at 318-320 (affirmed [1909] AC 442 (HL)) and *John Shaw & Sons (Salford) Ltd* v *Shaw* [1935] 2 KB 113 (CA) at 134.

could not, at least by ordinary majority, interfere with the exercise thereof, unless the articles expressly allowed the shareholders to do so.[231] The board was therefore, within the sphere allocated to it in a company's constitution, acting *as the company*.[232] In the terminology of *Meridian*, it may be said that a board acts as the company under the 'primary rules of attribution' in these circumstances. It should not be forgotten, however, that the underlying principle was still that the shareholders had the power to define the limits of the power and authority of a company's board.[233] These principles have been treated as applicable to South African companies by commentators[234] and have seen some acceptance by our courts.[235]

Another inroad made by the organic view was the development of the 'directing mind and will test' by Viscount Haldane in *Lennard's Carrying Company, Limited v Asiatic Petroleum Company Limited*, which allowed mental states to be equated with those of the company directly.[236] This approach, which was influence by German law,[237] proved to be especially useful in criminal law and tort/delict cases where it was necessary 'attribute' mental states to companies in order to found liability.[238] Lastly, legislative provisions which had been drafted

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[231] Although several of the more important cases did not deal with a standard Board's General Authority Clause, it seems as though this general proposition was also taken to apply to that standard clause, notwithstanding such clause apparently allowing shareholders to prescribe regulations (apart from the articles) to the board. That controversy is not addressed here. The point being made here is that the conception of a company gradually changed from seeing the board as mere agent of the shareholders, to seeing the board as an 'organ' of the company with its own sphere of operation, with which the general meeting could not interfere (unless the articles expressly allowed the general meeting to do so). See Davies & Worthington op cit note 215 para 14-6 and Blackman et al op cit note 2 at 7-21-6. See also *Ben-Tovim v Ben-Tovim* 2001 (3) SA 1074 (C) at 1086 regarding the position if the board is unwilling to act by virtue of being deadlocked.

[232] Both jurisdictions have moved to clarify this position. In the UK, the model articles, after granting the board general authority to manage a company's business, expressly allows shareholders by *special resolution* to direct the directors to take, or refrain from taking, specified action. Shareholders are, of course, also allowed to amend the articles by special resolution. In South Africa, the Board's General Authority clause has been placed in the Companies Act, thereby making the power original and not delegated, although shareholders may curtail these powers in a company's constitution (which may be amended by special resolution). The legal effects of this move are analysed in Chapter 8. For the moment, it is sufficient to say both jurisdictions have moved to a point where the shareholders can only directly interfere with board's authority through special resolution. See further Griffiths op cit note 18 at 74 et seq.

[233] Prentice op cit note 207 at 529.

[234] See Blackman et al op cit note 2 at 7-21-6.

[235] See *Van Tonder* v *Pienaar* 1982 (2) SA 336 (SE) at 341E and *Simon No v Mitsui and Co Ltd* 1997 (2) SA 475 (W) at 530E. See also *Cape United Sick Fund Society and others v Forrest and others* 1956 (4) SA 519 (A) at 540G.

[236] [1915] AC 705 at 713. See also *HL Bolton (Engineering) Co Ltd v. TJ Graham & Sons Ltd* [1957] 1 QB 159 at 172.

[237] *EI Ajou v Dollar Land Holdings plc & Anor* [1994] BCC 143 at 159.

[238] See Blackman et al op cit note 2 at 4-123 and Farrar op cit note 209 at 58.

with natural persons in mind, sometimes required interpretations which equated companies with natural persons.[239]

What do these examples of 'organic' theory mean for corporate contracting? The main result is that, although it is acknowledged that uncertainty regarding the concept of the board has endured,[240] commentators in both the UK[241] and South Africa[242] argue for the general position that when an act is performed by the board collectively, that act is performed by the company and not through agency.[243] For instance, the authors of *Gower's Principles of Modern Company Law* state as follows (original emphasis):[244]

> '… decisions can be taken by or on behalf of a company to enter into a contract or other transaction with a third party in two ways, either by the decision-making bodies established under the Companies Act by the company's articles of association (i.e. its board of directors or the shareholders acting collectively) or by persons (who may include individual directors) acting as agents. Where the board or shareholders collectively act, they constitute the company, i.e. they act *as* the company. They are not its agents.'

According to the authors, the contractual liability of a company when acting through one of its decision-making bodies, is based not on agency law but on 'organisational law'.[245] No authority is cited for this claim, but it clearly finds precedent in the 'primary rules' espoused in *Meridian*.[246]

Company boards, however, generally only act collectively in internal matters, meeting and passing resolutions approving transactions, group policies, financial statements etc. The entering into of contracts is largely left to single representatives, especially since the

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[239] For instance, South African courts have invoked attribution when dealing with section 2(1) of the Alienation of Land No 68 of 1981 - see *Northview Shopping Centre* supra note 229 paras 7-8.

[240] Farrar, JH 'Inquorate boards, organs and section 35A of the Companies Act 1985' [2003] 62 *Cambridge LJ* 45 at 47, *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) para 17 et seq.

[241] As stated by Sealy: 'the acts of corporate organs such as the board of directors are *ipso iure* deemed to be those of the company …' – see LS Sealy 'The corporate ego and agency untwined' [1995] 54 *Cambridge LJ* 507 at 508. See also Watson op cit note 76 paras 7 and 26. Ford et al op cit note 208 at 32,211 suggest the position is the same in Australian company law.

[242] Blackman et al op cit note 2 at 4-128.

[243] The same may be said of shareholders, but the focus here will be on the board, because the conclusion of contracts is something the shareholders rarely if ever get involved in these days. This was not always the case though, in the nineteenth century the conclusion of contracts through the shareholders was recognised. Questions of authority, however, did not arise in such circumstances, since the shareholders were regarded as having unlimited authority (except where they were acting ultra vires) – see Davies & Worthington op cit note 215 para 7-6.

[244] Davies & Worthington op cit note 215 para 7-4.

[245] Ibid para 7-1.

[246] See further Watson op cit note 76 para 51.

company seal has fallen into disuse. Commentators have therefore recognised that two sets of principles are applicable, depending on whether one is considering the internal acts of a collective organ or the external entering into of a contract – organic theory is applied to the former but not the latter.[247] Watson, an ardent proponent of a 'real entity' conceptualisation of the company, states as follows (my emphasis):[248]

> 'real entity theory is limited as it does not take account of the legal relationships that external "stakeholders" have with the company, including individual shareholders and individual directors. A director at the times that the board of directors meet is part of the collective internal "organ" that is the board. But at other times, *when the director acts externally on behalf of the company, the director is an agent of the company. Real entity theory and organic theory do not address that second legal relationship*.'[249]

Another reason why organic theory has not been used to explain corporate *contractual* liability is because it does not address the main point of contention in corporate contracting cases, namely 'who has authority to contract on behalf of a company?' Given that shareholders have always had the right to limit the authority of its corporate representatives through the corporate constitution (whether single or the board acting collectively), a third party contracting with a representative exceeding that authority will naturally be confronted with the argument that the company is not bound because of that fact.[250] Merely averring that the company is bound because it contracted through an organ is not enough. Indeed, one could question whether the action of a board contrary to the constitution is an act of an organ. After all, in *Meridian* a primary rule of attribution was described as a rule *which deems an act of an organ* to be an act of the company – an express exclusion of board power or authority could hardly qualify as such a rule. Managing directors are also sometimes classified as an organ of the company and there is no doubt that cases dealing with unauthorised contracts entered into by managing directors are decided on agency principles.[251]

The answer to the *question of authority* is therefore found in agency principles, even if a board collectively entered into a contract.[252] Where a board exceeds its actual authority,

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[247] Oosthuizen op cit note 210 at 1, Naudé op cit note 224 at 20 and Henning op cit note 3 at 158.

[248] Watson op cit note 39 at 137.

[249] See also Watson op cit note 39 at 139.

[250] This argument had added weight prior to the abolishment of the doctrine of constructive notice, given that, in terms of that doctrine, third parties were deemed to have notice of companies' constitutions. Infra para 6.2 regarding this doctrine.

[251] Blackman et al op cit note 2 at 7-13.

[252] See *Northside* supra note 223 at 201-2: 'But the organic theory merely extends the scope of an agent's capacity to bind a company and there must first be authority, actual or apparent. It is only then that a person may be regarded not only as the agent of a company, but also as the company itself — an organic part of it — so that

ostensible authority will adequately address the situation – especially since courts have made it clear that third parties may generally assume that boards usually have the power to make any contract within a company's business.[253] It should also be remembered that the organic view of the board (including the special rules of attribution in *Meridian*) were introduced to impose liability *in circumstances which agency principles would fall short*. There is no reason to suggest that agency principles would fall short if the question to be decided is merely whether a company should be bound to a contract concluded contra a company's constitution, even where that contract was entered into by the collective board.

Consider also the affixing of a seal to a contract. As noted above, there is authority for the view that a seal properly applied is tantamount to a signature of the company (and not that of its agent).[254] However, it is immediately apparent, when one considers that the persons who affixed the seal had to have authority to do so, that one cannot avoid applying the principles of agency even when a seal is used.[255] There is therefore no 'magic' in the seal – even if it is deemed to be an organic act of a company, its use is still dependent on the authority of the persons affixing it.[256] Dawson J stated, correctly it is submitted, as follows in the influential Australian case of *Northside Developments Pty Ltd v Registrar General*: [257]

> 'A body corporate can only act through agents, even in the affixation of a seal, and, if a person who is not authorized, or held out as being authorized, to enter into a transaction on behalf of a company purports to do so by affixing the company's seal to a document, the company will not be bound.'[258]

This approach, it is submitted, accords with that taken in *Wolpert v Uitzigt Properties (Pty) Ltd*.[259] In this case the court was dealing with promissory notes which had been stamped and signed on behalf of a company by a single director. The court rejected any notion that the

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"[t]he state of mind of [the agent] is the state of mind of the company" …. Thus the application of the theory depends in the first instance upon there being authority, that is to say, agency.'

[253] Infra paras 4.4.2 and 6.6.5 for a discussion in this regard.

[254] Supra note 229.

[255] Griffiths op cit note 18 at 6.

[256] Girvin, Frisby & Hudson op cit note 207 para 6-009.

[257] Supra note 223 at 202.

[258] See, however, Mason CJ at 160 et seq.

[259] Supra note 196.

use of the stamp added anything to the validity of the promissory notes – the key question was whether the director using the stamp was authorised or not.[260]

As we shall see in the following Chapters, both England and South Africa have moved, through both court decisions and legislative provisions, to suppress the effects of any constitutional limitations on third parties. Since the power and authority of a board is, unlike that of a single representative, usually directly conferred in the constitution, this means that, in effect, the conception of the board has moved closer to the 'organic' one, since a third party is now usually assured of holding a company bound to a contract entered into by its board (although there are exceptions to this).[261] The underlying legal construction, however, remains one of agency – the board's authority may be curtailed by shareholders and the effect of such curtailment needs to be dealt with. This thesis will, however, largely focus on the more likely scenario – a company contracting through a single representative, the authority of whom is disputed by the board or shareholders.

3.3 CONCLUSION

In sum, it may be said that agency principles are unavoidable in corporate contracting, regardless of whether a company is represented by a single representative or, less likely, contracting through its collective board or by seal. The next Chapter examines the principles of agency in closer detail.

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[260] *Wolpert* supra note 196 at 268B. See also *The Mine Workers' Union v JJ Prinsloo; The Mine Workers' Union v JP Prinsloo; The Mine Workers' Union v Greyling* 1948 (3) SA 831 (A) at 849, where the court noted that it was irrelevant that in casu a seal had not been used, while a seal was used in *Turquand*'s case.

[261] Infra para 8.6.

CHAPTER 4: THE PRINCIPLES OF AGENCY

4.1 INTRODUCTION

Having established that the principles of agency law are central to corporate contractual representation, it becomes necessary to examine those principles in more detail.

4.2 ENGLISH INFLUENCE ON THE SOUTH AFRICAN LAW OF AGENCY

The roots of South African agency law lie, not in English law, but in Roman-Dutch Law, which had already by the 17th century recognised that an agent could directly bind its principal.[262] Any suggestion that South African agency law is a mere copy of its English counterpart should therefore be dismissed out of hand and this Chapter should not be read as implying anything to that effect.[263]

During the 19th century, however, English law started exerting an ever stronger influence over South African agency law for the same reasons as in company law:[264] economic growth, British occupation, the apparent paucity of Roman-Dutch Law on the relevant subject and the influx of English-speaking jurists.[265] Prominent doctrines like estoppel and implied warranty of authority were taken over from English law during this period.[266]

In the field of corporate representation specifically, our courts have relied heavily, but not uncritically,[267] on English jurisprudence. Not only have our courts cited leading cases such as

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[262] David J Joubert 'Agency and Stipulatio Alteri' in R Zimmermann and D Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) at 335.

[263] Ibid at 341.

[264] Supra para 2.4.1. See also David Yuill 'Unauthorised agency in South African law' in Danny Busch and Laura J Macgregor (eds) *The Unauthorised Agent: Perspectives from European and Comparative Law* at 301.

[265] See Joubert op cit note 262 at 339.

[266] Ibid.

[267] See *Wolpert* supra note 196 at 265C: 'English Law is rich in precedent, but not so well off in principle.' Further, infra note 470.

Freeman[268] and, in particular, *Hely-Hutchinson v Brayhead Ltd*[269] with approval, but our courts have relied on English commentary through the years.[270]

Given this similarity, and in order to avoid tedious duplication, this Chapter will deal with the general principles of agency as applied in cases dealing with corporate representation in South Africa and England together, with differences being noted.

4.3 GENERAL PRINCIPLES OF AGENCY: A BRIEF INTRODUCTION

Agency principles recognise that one person (the principal) may authorise another person (the agent) to conclude a contract with a third party on the principal's behalf.[271] Notwithstanding the fact that it is the agent that negotiates and signs the contract, the legal obligations are created between the principal and the third party and the agent effectively steps out of the picture upon conclusion of the contract.[272] Key to this process is the authorisation of the agent – in order to bind the principal, the agent must be expressly or impliedly authorised to enter into that agreement, in which case that agent is said to be acting with actual authority.[273]

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[268] Supra note 10. Infra note 654 regarding acceptance of this judgment.

[269] Supra note 14. Regarding the acceptance by the SCA of Lord Denning's exposition of ostensible and actual authority in this case – infra note 347. See also *Forder, Ritch and Eriksson v Engar's Heirs* [1973] 2 All SA 119 (N) at 129 and *Kaine Stanley Charter v Butler's Port Alfred Properties (Pty) Ltd* 2017 JDR 0006 (ECG) para 34.

[270] In particular, *Bowstead & Reynolds on Agency* – see, for example, *Cape Produce Company (Pty) Ltd & others v NBS Bank Ltd (Assante & others as third parties)* [2012] JOL 28759 (W) at 45 and 47 and *Chappell v Gohl* 1928 CPD 47 at 52. Twenty-one editions have been published of this seminal work over a span of more than 100 years. See bibliography for details of the current edition.

[271] See Peter Watts and FMB Reynolds *Bowstead & Reynolds on Agency* (21ed) 2018 para 1-001, Cheng-Han Tan 'Unauthorised agency in English law' in Danny Busch and Laura J. Macgregor (eds) *The Unauthorised Agent: Perspectives from European and Comparative Law* at 186 and M Dendy (original text by JC de Wet) 'Agency and Representation' in WA Joubert (founding ed) *The Law of South Africa* vol 1 3ed (2014) para 126.

[272] See Cassim et al op cit note 11 at 188 and Walter D Geach and T Schoeman (consulting ed) *Guide to the Close Corporations Act and Regulations* (1984) [SI 20 - Jun 2013] at 562-1. This general statement is, however, subject to some caveats. First, it is assumed that the agent is not acting fraudulently. If the agent fradulently claims to have authority when he/she does not have such authority, the relevant third party may have a delictual claim for damages against the agent. Secondly, in English law the agent may be held liable on the contract at the option of the third party where the agent failed to disclose the fact of the agency to the third party. This is known as the doctrine of the undisclosed principal, which has been adopted in South Africa. See Davies & Worthington op cit note 215 para 7-16 (footnote 49). Furthermore, the principal at common law would be liable to indemnify the agent in respect of the performance of the obligations assumed by the agent under the contract. See *Freeman* supra note 10 at 503 and Jonathan M Silke (Original text by JE de Villiers and JC Macintosh) *The Law of Agency in South Africa* 3ed (1981) at 355. See further Dendy op cit note 271 paras 126, 163, 165 and 171.

[273] See Girvin, Frisby & Hudson op cit note 207 para 6-019. An agent's conduct may, of course, also be ratified afterwards by the principal but, as pointed out in para 1.3.4 supra, this thesis does not focus on ratification.

Actual authorisation occurs by consensual agreement[274] between the principal and agent,[275] a relationship into which a third party may not have any insight.[276] This is a very important point – although actual authorisation is legally necessary, the third party often (not always) does not conclusively know whether it has been granted, because it is ignorant of the relationship between principal and agent.[277] Indeed, most times a third party will rely, not on actual knowledge of the delegation of actual authority by principal to agent, but rather on representations made by the principal or persons authorised by it (potentially including, controversially, the agent)[278] as to the agent's authority. What then happens if it turns out the agent was in fact not actually authorised to conclude a specific contract but the representations of the principal (including the circumstances in which the principal allows its representatives to act on its behalf) reasonably made it seem that the agent had such authority? In those circumstances, the principal may still be held bound to that contract based on what is referred to as the 'ostensible authority' of the agent.[279] Despite initial uncertainty, by the end of the twentieth century such liability had come to be regarded as based on estoppel in both English and South African law, although this position in the latter has been placed in doubt.[280]

In sum, it may therefore be said that the relevant general principles of agency amount to no more than this: a principal may be held bound to a contract concluded by its agent where that agent had actual authority or ostensible authority.[281] To determine whether a company should be held bound to a contract purportedly entered into on its behalf by an agent, courts

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[274] *Freeman* supra note 10 at 502, *Cape Produce* (a quo) supra note 270 at 45-6. See also Tan op cit note 271 at 186.

[275] *Hudson Bay* supra note 282 para 47, *Freeman* supra note 10 at 502.

[276] Infra para 5.1.2, *Freeman* supra note 10 at 502 and *Makate* (CC) supra note 8 para 133. Of course, the third party's ignorance of the terms of the agreement between a principal and its agent does nothing to detract from the fact that that agent, when acting within his/her actual authority, will create binding obligations between the principal (ie the company) and the third party. See Mayson, French & Ryan op cit note 90 at 611.

[277] A common exception to this in practice is where the third party insists on receipt of the necessary shareholders' and/or board resolutions which are required for the implementation of a particular transaction.

[278] Infra para 4.5.3.

[279] See Mayson, French & Ryan op cit note 90 at 612.

[280] Infra paras 4.6 and 4.7.

[281] Infra quotation at note 633. The authors of *Bowstead & Reynolds on Agency* state as follows: 'On the current trend of English case law, it is clear that there is little support for any generalised form of liability of the principal beyond the agent's actual or apparent authority …. Recent judicial statements of the basic principles of agency are clearly based on the assumption that the principal is only bound where the agent had actual or apparent authority'. See Watts & Reynolds op cit note 271 para 3-005.

in both jurisdictions have devised a method whereby agency principles are applied in a linear way as a series of inquiries, first as to an agent's actual authority and then his/her ostensible authority.[282] This Chapter proceeds in the same order.

4.4 ACTUAL AUTHORITY OF AN AGENT

4.4.1 General

If actual authority is conferred by a principal on an agent by agreement between them, the scope of the rights and obligations created by that agreement must be determined not only by the expressed words used, but also with reference to tacit[283] and implied terms.[284] A company may therefore confer actual authority on a person to act on its behalf either in an express or an implied manner.[285]

Authority may be conferred in writing or verbally.[286] In the corporate context, resolutions are often passed expressly granting an agent specific or general authority.[287]

An implied conferral of authority occurs when authority is delegated to an agent not by express words, but such delegation may instead be inferred from the conduct of the persons

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[282] See, for instance, *Hudson Bay Apparel Brands LLC v Umbro International Ltd* [2011] 1 BCLC 259 para 46 et seq, *Criterion Properties plc v Stratford UK Properties LLC* [2004] 1 WLR 1846 at 1855, *Glofinco v ABSA Bank Ltd t/a United Bank* 2002 (6) SA 470 (SCA) paras 10-1 and *South African Broadcasting Corporation v Coop* 2006 (2) SA 217 (SCA) paras 62-3.

[283] Although it is accepted that the terms 'implied' and 'tacit' may in general be interchangeable, South African contract law usually distinguishes between implied and tacit terms, with the former referring to terms implied by law and the latter to silent terms which were agreed between the parties (See AJ Kerr *The Law of Agency* 4ed (2006) at 24-5). It may perhaps be argued that some instances of what is referred to as implied authority may, in fact, be more akin to tacit authority, such as where a principal tacitly acquiesces to the conduct of its agent. Our courts and commentators have, however, used the term 'implied authority' to cover all of the instances of actual authority which is not expressly granted. That usage is continued in this thesis. See, for example, *Perpellief* supra note 3 at 14H, FHI Cassim and MF Cassim 'The authority of company representatives and the Turquand rule revisited' 2017 SALJ 639 at 644 and Delport et al *Henochsberg on the Companies Act 71 of 2008* (2012) (service issue 23 – July 2020) at 95.

[284] *Hely-Hutchinson* (CA) supra note 14 at 583 and *Freeman* supra note 10 at 502.

[285] *Ukraine (Represented by the Minister of Finance of Ukraine acting upon the instructions of the Cabinet of Ministers of Ukraine) v The Law Debenture Trust Corporation PLC* [2019] 2WLR 655 para 79, *SMC Electronics Limited v Akhter Computers Limited* [2001] 1 BCLC 433 (CA) para 6, *Hely-Hutchinson* (CA) supra note 14 at 583, *LNOC Ltd v Watford Association Football Club Ltd* [2013] EWHC 3615 (Comm) para 61, *Cape Produce* (a quo) supra note 270 at 45, *Strachan v Blackbeard* 1910 AD 282 at 290 and *Coop* supra note 282 para 65.

[286] See Du Plessis op cit note 210 at 287.

[287]See *Hely-Hutchinson* (CA) supra note 14 at 583A, *Perpellief* supra note 3 at 14F and *Northern Metropolitan Local Council v Company Unique Finance (Pty) Ltd* 2012 (5) SA 323 (SCA) para 24.

who have actual authority and the relevant circumstances of the transaction.[288] An express manifestation of the conferral is therefore lacking in these circumstances, but it is still reasonable to infer from the circumstances (ie the conduct of the persons who have actual authority to conclude a contract on behalf of a company, usually the board) that authority has been delegated to the agent.[289] Implied authority is actual authority and is not contingent on representations made by the company to a third party.[290] Since implied authority is a form of actual authority, no implied authority can exist where authority has been expressly limited by the company.[291]

The test to determine implied actual authority is wide –[292] does the conduct of the company (ie the persons having actual authority to contract on behalf of the company) justify a conclusion that authority was indeed conferred upon an agent?[293] No single factor is conclusive.[294] The courts have, however, identified guidelines which point to whether an agent has implied actual authority to conclude a specific contract. The forms of implied authority most relevant to corporate representation are discussed in paragraphs 4.4.2 to 4.4.4 below.

4.4.2 Usual authority

Stated with almost vacuous simplicity, it may be said that, in general, an agent has implied authority to do the things which it is usual for an agent in its position to do.[295] In a corporate

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[288] *Hely-Hutchinson* (CA) supra note 14 at 583, *NBS Bank Ltd v Cape Produce Co* 2002 (1) SA 396 (SCA) para 24 and *Northern Metropolitan* (SCA) supra note 287 para 24. In *Ukraine s*upra note 285 para 79 implied authority was described as follows: 'Implied actual authority connotes circumstances, falling short of express words, in which the principal authorises the agent to enter into transactions of the type in question on the facts of the case'. See also *Majola Investments (Pty) Ltd v Uitzigt Properties (Pty) Ltd* 1961 (4) SA 705 (T) at 714A.

[289] See Silke op cit note 272 at 113.

[290] See *Mudaliar* supra note 162 at 54. See also Joubert op cit note 262 at 344.

[291] While this statement may seem obvious, it has not been without controversy – infra para 4.4.5.

[292] See *SMC Electronics s*upra note 285 paras 16-7.

[293] See *Hely-Hutchinson* (CA) supra note 14 at 583 and *Inter-Continental* supra note 210 at 748H and 749B.

[294] Du Plessis op cit note 210 at 288.

[295] A distinction is sometimes drawn between 'professional agents' and 'managerial agents'. In the case of a professional agent, authority is implied based on the profession which that agent holds. So, for instance, a court may investigate whether an attorney has usual authority to agree to settle litigation on behalf of its client by looking at what the norm is in the attorneys' profession (see, for example, *Waugh v HB Cifford & Sons Ltd* [1982] Ch 374 at 388E and *MEC for Economic Affairs, Environment and Tourism, Eastern Cape v Kruizenga* 2010 (4) SA 122 (SCA) para 8). The second sub-type of usual authority, which is by far the most prevalent in corporate representation cases, is usual authority arising from the appointment of a person to a managerial position. See Watts & Reynolds op cit note 271 paras 3-027-31, *SMC Electronics s*upra note 285 para 14 and Silke op cit note 272 at 146.

representation context, this type of implied authority translates to examining the usual authority of a corporate agent's position within the company and determining whether a specific contract fell within such usual authority.[296] In other words, if a company appoints a person to a particular position, the company is thereby said to have impliedly authorised the agent to do all such things as fall within the usual scope of that position.[297] In most (but not all) instances, the position to which an agent is appointed will be the single most important fact establishing implied authority.[298]

Over time, certain company positions have developed into 'recognised classes', with their own usual scope of authority.[299] For instance –

- Although the collective board does not act as an agent strictu sensu, we noted in previous Chapters that a third party dealing with a collective board would be justified in assuming that the board usually has the authority to make almost any decision in relation to a company's business.[300]
- An ordinary non-executive director does not, however, have any authority to bind a company in the usual course.[301] This also includes chairpersons, since they are only distinguished from other directors for internal purposes.[302] Obviously, the picture is different if a chairperson de facto performs the functions of a managing director.[303]

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[296] See *LNOC* supra note 285 para 61, *Ukraine s*upra note 285 para 79 and *Inter-Continental* supra note 210 at 749B.

[297] *Hely-Hutchinson* (CA) supra note 14 at 583B, *Freeman* supra note 10 at 488-489, *Northern Metropolitan* (SCA) supra note 287 para 24 and *Coop* supra note 282 para 65. See *Perpellief* supra note 3 at 14G, *Wolpert* supra note 196 at 266E.

[298] See *Nel v South African Railways and Harbours* 1924 AD 30 at 41-42.

[299] R Pennington *Pennington's Company Law* 8ed (2001) at 147 and JL Yeats (Managing Editor and co-author) et al *Commentary on the Companies Act of 2008* (2018) (Revision Service 1 - 2020) at 2-108.

[300] Supra para 3.2.3 and infra para 6.6.5. Although referring to ostensible authority, this sentiment was echoed by Slade J in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246 (CA) at 292B: '… as a general rule, a company incorporated under the Companies Acts holds out its directors as having ostensible authority to do on its behalf anything which its memorandum of association expressly or by implication gives the company the capacity to do.' See also at 295G and Obadina op cit note 207 at 46.

[301] See *Houghton* (CA) supra note 162 at 267, *Robinson* supra note 164 at 217-8, *Wolpert* supra note 196 at 267C-H, *Rosebank Television & Appliance Co (Pty) Ltd v Orbit Sales Corporation (Pty) Ltd* 1969 (1) SA 300 (T) at 303A, *R v Mall and Others* 1959 (4) SA 607 (N) at 622 – 623. For more recent affirmations of this principle, see *Kaimowitz* supra note 240 paras 19 and 21, *Zelpy 1780 (Proprietary) Limited v Mudaly* 2015 JDR 0187 (KZP) para 37 and *Brodsky Trading 224 CC v Nell* 2015 JDR 1328 (GP) para 84. See also Davies & Worthington op cit note 215 para 7-20 and Watts & Reynolds op cit note 271 para 3-029.

[302] *Wolpert* supra note 196 at 266C.

[303] Ibid, *British Thompson-Houston Co Ltd v Federated European Bank Ltd* [1932] 2 KB 176 (CA) and *Clay Hill Brick and Tile Co Ltd v Rawlings* [1938] 4 All ER 100.

- Managing directors generally have broad implied authority to conclude contracts for purpose of carrying on the business of the company in the usual way.[304]
- Executive employees who are not directors may also have usual authority according to their position.[305]
- Company secretaries were initially deemed to merely perform perfunctory administrative duties and to have no authority to bind a company to a contract at all.[306] In England, however, this position has changed and today it is recognised that company secretaries have wider usual authority, including to sign contracts connected with the administrative side of a company's affairs.[307] It is not entirely clear to what extent a more liberal view of the company secretary has been accepted in South Africa.[308]
- A shareholder does not, merely by virtue of its shareholding, have any usual authority to represent a company in its dealings.[309]

These categories should not be taken too seriously, however. First, the usual authority of a specific position does not automatically translate into actual authority. A board of a company may, for instance, preclude a managing director from concluding a type of contract which would fall within the usual authority of managing directors generally.[310] Secondly, the usual authority of company positions changes over time and is not fixed.[311] Thirdly, and most

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[304] *Wolpert* supra note 196 at 265H, *Machanick Steel & Fencing (Pty) Ltd v Wesrhodan (Pty) Ltd; Machanick Steel & Fencing (Pty) Ltd v Transvaal Cold Rolling (Pty) Ltd* 1979 (1) SA 265 (W) at 270A, Pennington op cit note 299 at 147 and Watts & Reynolds op cit note 271 para 3-029.

[305] See, for example, *SMC Electronics s*upra note 285, *Cape Produce* (SCA) supra note 288 para 32, *Cape Produce* (a quo) supra note 270 at 49, *Reed No v Sager's Motors (Pvt) Ltd* 1970 (1) SA 521 (RA), *Dicks v South African Mutual Fire and General Insurance Co Ltd* 1963 (4) SA 501 (N), *Kahn v Leslie and Son* 1928 EDL 416 at 419, *Hopkins v Dallas Group Limited* [2004] EWHC 1379 (Ch) para 90, *British Bank of the Middle East v Sun Life Assurance Co of Canada (UK) Ltd* [1983] 2 Lloyd's Rep 9 HL 16 and *Perpellief* supra note 3 at 17E.

[306] See *Barnett, Hoares & Co v The South London Tramways Co* (1887) 18 QBD 815 at 817, *George Whitechurch Ltd v Cavanagh* [1902] AC 117 at 124 and *Ruben v Great Fingall Consolidated* [1906] AC 439 at 443.

[307] *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711 (CA) at 717H. See further JG Collier 'Authority of a company's secretary to enter into contracts on its behalf' [1972] 30 *Cambridge LJ* 44 and JH Telfer 'The ostensible authority of company secretaries' (1973) 3 *Kingston LR* 65. See also *Kelly v Fraser* [2012] PENS LR 405 where it was noted, albeit obiter, that a company secretary has usual authority to communicate the decisions of the board.

[308] See *Perpellief* supra note 3 at 17-8 and *Powertech Industries Ltd v Mayberry* 1996 (2) SA 742 (W) at 750D. The authors of *Henochsberg on the Companies Act* are no doubt right in stating that each case will have to be judged on its own merits. See Delport et al op cit note 283 at 99-100.

[309] *Alexander v African Investment and Credit Company* (1917) 38 NPD 133 at 136-7.

[310] Infra para 4.4.5 regarding the effect of such a limitation. Conversely, a board may authorise a certain person to perform an action which does not fall within the usual authority of the position held by that person.

[311] Supra note 307.

importantly, establishing the authority of an agent *is always dependent on the facts of a particular case*.[312]

Crucially, it should be noted that usual authority plays an important role in determining the ostensible authority of an agent.[313] These two concepts are dealt with more fully in paragraph 4.5.1 below.

4.4.3 Incidental authority

An agent has implied authority to do what is incidental to the effective execution of his/her express authority in the usual way.[314] For example, an agent appointed to conclude a sale will have authority to do all that is incidental to completing the deal.[315] While this type of implied authority is certainly present whenever a company acts through an agent, the focus in corporate representation cases instead tends to be on the usual authority of the position held by a corporate agent. Furthermore, the value of distinguishing incidental authority from usual authority in such cases is not immediately apparent - it seems that these will often overlap, for the mere fact that, logically, acts falling within the usual authority of an agent's appointment will likely be incidental to that appointment.[316] Like usual authority, the question of which acts are incidental to an agent's authority is also relevant to determining an agent's ostensible authority.[317]

4.4.4 The acquiescence of the board and/or shareholders

Agency law in both South Africa and England recognises that an agent may have implied authority to act on behalf of a principal where that principal can be shown to have acquiesced

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[312] *South African Eagle Insurance Co Ltd v NBS Bank Ltd* 2002 (1) SA 560 (SCA) para 28, *Cape Produce* (a quo) supra note 270 at 48, *Glofinco v ABSA Bank Ltd (t/a United Bank)* 2001 (2) SA 1048 (W) at 1059F and *Engen Petroleum Limited v AAC Agri Foods CC* 2018 JDR 0793 (FB) para 17. See also Dendy op cit note 271 para 142, Davies & Worthington op cit note 215 para 7-20.

[313] See Watts & Reynolds op cit note 271 paras 3-028 and 3-031. Some of the cases cited above strictly dealt with ostensible authority and not implied actual authority.

[314] See *SMC Electronics s*upra note 285 para 14, Watts & Reynolds op cit note 271 para 3-021, *Broderick Motors Distributors (Pty) Ltd v Beyers* 1968 (2) SA 1 (O) at 4B, *Nel* supra note 298 at 42, *Clifford Harris (Rhodesia) Ltd and Another v Todd NO* 1955 (3) SA 302 (SR) at 304G and Silke op cit note 272 at 146.

[315] See Watts & Reynolds op cit note 271 para 3-023.

[316] See, for instance, how the English Court of Appeal treated incidental authority and usual authority (arising from profession) in conjunction with one another in *SMC Electronics s*upra note 285 para 14.

[317] See Watts & Reynolds op cit note 271 para 3-022.

to that agent acting on its behalf.[318] What this really amounts to, is simply taking into account the circumstances of the case and the conduct of the parties – if the principal acquiesces in the agent concluding a contract which exceeds his/her usual authority, then it is only proper to imply that the agent has actual authority to conclude such a contract.[319] Naturally, this implication is usually formed over time during a course of dealing,[320] but this is not strictly necessary, as one could conceive of a principal who is present at a meeting silently acquiescing to an act of his/her agent which the agent has not done before.

The classic example of this type of implied authority is to be found in the leading case of *Hely-Hutchinson*.[321] In this case, the chairperson of the board of directors of a company issued an indemnity and a guarantee on behalf of that company, neither of which would fall within the usual ambit of a chairperson's authority.[322] However the court held the company bound, based on the fact that the board of directors had over many months acquiesced to the chairperson acting as de facto managing director and making all final decisions relating to matters of finance.[323] It has been said that the acquiescence must be by the board and not separately by each member of the board – in other words the members of the board should have made known to each other that they acquiesced.[324]

In South Africa, too, there is ample example of companies being held bound based on the implied authority of a representative arising from acquiescence – particularly where that representative was the 'powerhouse' or 'dominating personality' of a group of companies, who acted with the full knowledge and acquiescence of the board of directors.[325]

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[318] *Ukraine s*upra note 285 para 79, *Hely-Hutchinson* (CA) supra note 14 at 584F, *Robinson* supra note 164 at 218 and *Perpellief* supra note 3 at 14H-15A, *Faure v Louw* (1880-1882) 1 SC 3 at 8, *Coetzer v Mosenthals Ltd* 1963 (4) SA 22 (A) at 23F and *Majola* supra note 288 at 714B.

[319] See Watts & Reynolds op cit note 271 para 3-042.

[320] *Robinson* supra note 164 at 181 and 217, respectively.

[321] Supra note 14. A South African example is to be found in *Majola* supra note 288, in which case a director who was in de facto control of a company had procured a short term loan on behalf of that company, which loan was paid into his personal bank account. The court held that he had implied authority to procure such a loan, inter alia, based on his previous dealings with the lender and the fact that the other director who co-managed the company in South Africa knew of, and acquiesced to, such dealings (including the use of the personal bank account).

[322] Supra note 14 at 584.

[323] Ibid at 587.

[324] See *Freeman* supra note 10 at 501. See further *Marshall Industrials Ltd v Khan* [1959] 4 All SA 369 (N) at 373.

[325] *Dickson v Acrow Engineers (Pty) Ltd* [1954] 1 All SA 308 (W); *Robinson* supra note 164, *De Villiers and Another NNO v BOE Bank Ltd* 2004 (3) SA 1 (SCA). See also, *Intramed (Pty) Ltd (in liquidation) v Standard*

Appointing a person to a specific position therefore does not create a straitjacket which strictly encompasses that person's implied authority – the test is wide and it is the facts of the case and the conduct of those with actual authority which must be considered.

4.4.5 Internal limitations and actual authority

If authority can be expressly given, it can also be expressly excluded or limited. If a principal places a limit on an agent's authority and the agent exceeds that limit, that agent cannot be said to be acting with actual authority.[326] This obvious point is entirely consonant with general contractual principles – it is trite that an implied term cannot overrule a conflicting express one.[327] Any suggestion that implied authority of an agent may exceed his/her actual authority can therefore not be maintained.[328]

Accordingly, if a principal limits his/her agent's authority without the third party knowing of such limitation, the third party will therefore have to rely on the ostensible authority of the agent.[329] This is, however, not tantamount to making those private limitations binding on a third party – indeed, it is a general principle of agency law that a principal cannot raise internal restrictions on authority against a third party who was unaware of such limitations.[330] All that is being said is that in such circumstances the third party will have to rely on the

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Bank of SA Ltd [2005] 1 All SA 460 (W) which was decided on substantially the same facts as *De Villiers*. In Intramed, however, the court held that the board had so clearly assented to the representative's actions, that his actions were expressly authorised, with no implication necessary.

[326] Watts & Reynolds op cit note 271 para 3-005.

[327] See *Mutual Aid Society v Cape Town Chamber of Commerce* 1962 (1) SA 598 (A) at 615D, *Transnet Ltd v Rubenstein* 2006 (1) SA 591 (SCA) para 18 and *Robin v Guarantee Life Assurance Co Ltd* 1984 (4) SA 558 (A) at 567C-F.

[328] In *Wolpert* supra note 196 at 266E it was said that: 'implied authority can be inferred, when the official acting on behalf of the company purports to exercise an authority which that type of official usually has *even though the official is exceeding his actual authority*'. See also *Perpellief* supra note 3 at 14G. It is, however, respectfully submitted that the statement that implied authority can exceed actual authority makes no sense, because implied authority *is* actual authority. It is ostensible authority, based on the usual authority of the position held by and/or the facts of the case, which may exceed actual authority in scope. See MJ Oosthuizen 'Note on *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 (2) SA 11 (T)' 1978 *TSAR* 172 at 173 and Du Plessis op cit note 210 at 287. Delport, however, appears to accept the abovementioned statement – see Delport op cit note 3 at 134. Another questionable statement regarding implied authority was made in *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2004 (2) SA 146 (C) para 7, where the court stated that the sole director had implied authority to sell the entire business of a company despite the sale not having been approved in terms of the Companies Act. With respect, a director cannot have implied authority to act contrary to a statutory limitation on his/her authority – although he may arguably have ostensible authority in the circumstances – infra para 8.6.

[329] See Silke op cit note 272 at 124, Watts & Reynolds op cit note 271 para 3-004, Yeats et al op cit note 299 at 2-108 and *Kruizenga* supra note 295 para 20.

[330] Infra para 6.6.9.

ostensible authority of the agent. It should be remembered that the same usual authority of an agent and course of dealing which may evidence implied authority may be relied on to establish ostensible authority.[331]

These principles are accepted in English law[332] and South Africa,[333] although not without criticism.[334]

4.4.6 Can an agent have actual authority to act against the wishes of his/her principal or for his/her own purposes?

What is the position where an agent concludes an agreement which falls within the type of agreements which he/she is (usually) authorised to conclude, but he/she does so for his/her own purposes and not those of his/her principal? For instance, if a bank manager is actually authorised to take deposits from clients – is he/she actually authorised to take deposits for his/her own fraudulent scheme?

The general principle, recognised in both England[335] and South Africa,[336] is that a principal will be bound by such acts performed by its agent, unless the third party with which that agent was dealing knew (or reasonably ought to have known) that the agent was acting against its principal's instructions. The policy behind this general rule is, at least in part, based on *Hern v Nichols* reasoning – the principal should bear the risk of its agent's fraud, because it was the principal which appointed the agent.[337]

That the principal's liability may be underpinned by the agent's ostensible authority is obvious. Whether the agent can be said to be acting with actual authority in such circumstances has, however, given rise to some controversy in both jurisdictions. On the one hand, it may be argued that an agent can have actual authority to act for his/her own purposes, provided he/she had actual authority to do the *type* of action performed. Motive is

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[331] See Watts & Reynolds op cit note 271 para 3-004.

[332] *Ukraine s*upra note 285 para 79.

[333] *Glofinco* (a quo) supra note 312 at 1059H. In partnership law it is accepted that reliance must be placed on ostensible authority where a third party deals with a partner in contravention of an internal limitation contained in the (unpublicised) partnership agreement – see Henning op cit note 3 at 163. See also *Makate* (CC) supra note 8 para 165.

[334] Dendy op cit note 271 para 144.

[335] Watts & Reynolds op cit note 271 paras 8-047 and 8-062.

[336] See *Randbank Bpk v Santam Versekeringsmaatskappy Bpk* 1965 (2) SA 456 (W) (confirmed on appeal in 1965 (4) SA 363 (A)) at 457F, *Chappell* supra note 270 at 52 and Kerr op cit note 283 at 237.

[337] See *Randbank* (AD) supra note 336 at 372E *Randbank* (a quo) supra note 336 at 457-8.

therefore seen as irrelevant when determining whether actual authority exists – as long as an agent can perform the type of act (ie take deposits), then there is actual authority. The agent is therefore not *exceeding* actual authority, but instead is *abusing* it.[338]

The second view is that an agent does not have actual authority, because it is implicit in the granting of actual authority that the agent must use the authority granted to it honestly and for the principal's benefit. Indeed, no principal would authorise its agent to act fraudulently.[339] Borrowing terminology from Worthington, the first approach will be referred to as the 'abuse of actual authority' approach, while the second will be referred to as the 'no actual authority' approach.[340]

Despite initial support for the 'abuse of actual authority' approach,[341] it is the 'no actual authority' approach which currently holds sway in English law,[342] although not without criticism.[343] South African law appears to remain equivocal on this point, there being authority for both approaches in our law reports.[344]

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[338] Sarah Worthington 'Corporate attribution and agency: back to basics' (2017) 133(Jan) *Law Quarterly Review* 118 at 132.

[339] Watts & Reynolds op cit note 271 para 3-010.

[340] Worthington op cit note 338 at 132.

[341] Earlier versions of *Bowstead on Agency* stated that (my emphasis): 'An act of an agent within the scope of his *actual or apparent* authority does not cease to bind his principal merely because the agent was acting fraudulently and in the furtherance of his own interests'. See FMB Reynolds *Bowstead on Agency* 15th ed (1985) at 279. In the current version, however, that statement is repeated, except that it no longer makes reference to actual authority - see Watts & Reynolds op cit note 271 paras 3-011 and 8-062.

[342] See *Hopkins* supra note 305 para 88, *Lysaght Bros & Co Ltd v Falk* (1905) 2 CLR 421 at 439, *Bass Jarrington Limited v The Royal Bank of Scotland plc, HQ Chester Limited* para 24, *Parti v Al Sabah* [2077] EWHC 1986 paras 44-50. See also *A L Underwood Ltd v Bank of Liverpool and Martins* [1924] 1 KB 775 (CA) at 791-792.

[343] For a detailed discussion, see Worthington op cit note 338 at 135-9 and Sarah Worthington 'Agents behaving badly?' (2017) 4 *Journal of International Banking and Financial Law* 202.

[344] A 'no actual authority' approach was followed in *African Life Assurance Co Ltd v NBS Bank* 2001 (1) SA 432 (W) at 451D-E. This approach appeared to also have been accepted by the court a quo in *Company Unique Finance (Pty) Ltd and another v Johannesburg Northern Metropolitan Local Council and another* 2011 (1) SA 440 (GSJ) para 7. This judgment was overturned on appeal in *Northern Metropolitan* (SCA) supra note 287, but the SCA did not directly address the court a quo's finding on this point and decided this case based on ostensible authority. For authority in favour of the 'abuse of actual authority' approach, see *Cape Produce* (a quo) supra note 270 at 39 and 51 and *Chappell* supra note 270 at 51. In both *Cape Produce* (a quo) and Chappell the court expressly relied on the abuse of actual authority' formulation set out in earlier versions of *Bowstead & Reynolds on Agency*. As noted in supra note 341, that formulation has been changed to reflect a no actual authority approach. See also Silke op cit note 272 at 508. It is also noteworthy that in both the *Cape Produce* appeal (supra note 288) and in *Glofinco* (SCA) supra note 282, another case which dealt with fraudulent dealings of a bank manager, the SCA confined its analysis strictly to ostensible authority (thereby lending implied support to the 'no actual authority' approach).

4.5 OSTENSIBLE AUTHORITY

4.5.1 General

In the absence of an agent having actual authority to conclude a contract on behalf of a company, the company may still be held bound to that contract based on the ostensible authority of the agent.[345] Diplock J, in *Freeman*, offered the following definition of ostensible authority:[346]

> 'An "apparent" or "ostensible" authority… is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the "apparent" authority, so as to render the principal liable to perform any obligations imposed upon him by such contract.'

Conceptually, ostensible authority does not denote authority actually conferred on an agent, but instead, an image of authority, created by the company (ie the persons within a company with actual authority to conclude the contract), to which a third party may hold a company bound. In a passage which has been repeatedly quoted with approval by South African courts,[347] Lord Denning described the nature of ostensible authority and its relationship to actual authority as follows:[348]

> 'Ostensible or apparent authority is the authority of an agent as it appears to others.[349] It often coincides with actual authority. Thus, when the board appoint one of their number to be managing director, they invest him not only with implied authority, but also with ostensible authority to do all such things as fall within the usual scope of that office. Other people who see him acting as managing director are entitled to assume that he has the usual authority of a managing director. But sometimes ostensible authority exceeds actual authority. For instance, when the board appoint the managing director, they may expressly limit his authority by saying he is not to order goods worth more than £500 without the sanction of the board. In that case his actual authority is subject to the £500 limitation, but his ostensible authority includes all the usual authority of a managing

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[345] See *Totterdell v The Fareham Blue Brick & Tile Co Ltd* (1866) LR 1 CP 674 at 677-8, *Hely-Hutchinson* (CA) supra note 14 at 583, *Cape Produce* (SCA) supra note 288 para 32, *Strachan* infra note 352, Dendy op cit note 271 para 160 and Girvin, Frisby & Hudson op cit note 207 para 6-021.

[346] Supra note 14 at 503. See further description of ostensible authority by Lord Keith in *Armagas* (HL) supra note 14 at 777A.

[347] *Makate* (CC) supra note 8 para 48, *Cape Produce* (SCA) supra note 288 para 24*, Coop* supra note 282 para 65 and *Northern Metropolitan* (SCA) supra note 287 para 27. It is curious that the Supreme Court of Appeal has focussed so heavily on the descriptions of actual and ostensible authority in *Hely-Hutchinson v Brayhead*, when Lord Denning in that case expressly deferred to the judgments in *Freeman* as authoritative in this regard - see *Hely-Hutchinson* (CA) supra note 14 at 583.

[348] *Hely-Hutchinson* (CA) supra note 14 at 583. See also *Ukraine s*upra note 285 para 80.

[349] This is presumably why the term 'apparent authority' is used interchangeably with 'ostensible authority' – while the former may be more descriptive, in this thesis the latter will be given preference because it was used by the House of Lords in *Armagas* (HL) supra note 14 and by the Constitutional Court in *Makate* (CC) supra note 8.

director. The company is bound by his ostensible authority in his dealings with those who do not know of the limitation.'

To speak of ostensible authority as being a type of authority is therefore technically incorrect – it is something completely different from actual authority.[350] As we have seen, the existence of actual authority, whether expressly or impliedly conferred, is determined by observing the relationship and conduct as between the company, as principal, and its representative, as agent.[351] The existence of ostensible authority, on the other hand, observes the principal-third party relationship, by examining the image of an agent's authority created by the principal as observed from the third party's point of view.[352] Here it is the agent (and not the third party) who is the 'stranger',[353] although that is not to say that the acts and the statements of the agents are necessarily completely irrelevant for purposes of this inquiry.[354] Because actual authority and ostensible authority have their genesis in different relationships, the question of ostensibly authority is therefore of an entirely different category from an inquiry regarding actual authority.[355] Indeed, the existence of actual and ostensible authority is not mutually exclusive and actual authority and ostensible authority usually co-exists.[356]

Lastly, the quotation above makes it clear that the concept of usual authority is important to establishing ostensible authority. This is dealt with below. However, it is important not to get confused between what usual authority means with respect to actual authority and what is means with respect to ostensible authority. In the case of the former, usual authority is an implied term of the contract of agency between the principal and the agent. In latter case it is a representation by a principal to a third party as to the authority of the agent. Therefore, although the usual authority accompanying one appointment may give rise to both actual and ostensible authority, those two concepts remain fundamentally different.[357]

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[350] This is why in *Inter-Continental* supra note 210 at 748C it was said that the phrase agency by estoppel was 'in itself, notionally, a misnomer'. In *Mudaliar* supra note 162 at 54-5 it was said: 'an apparent authority is one which a third person reasonably believes to exist but which in fact does not exist at all.' See also Tan op cit note 271 at 186 and Silke op cit note 272 at 114. Infra, however, para 4.7.

[351] Supra note 275.

[352] *Hudson Bay* supra note 282 para 53, Davies & Worthington op cit note 215 para 7-18 and *Strachan* supra note 289 at 290.

[353] *Freeman* supra note 10 at 503.

[354] Infra para 4.5.3.

[355] *Freeman* supra note 10 at 502, *Mudaliar* supra note 162 at 54 and Silke op cit note 272 at 441.

[356] *Hely-Hutchinson* (CA) supra note 14 at 583; Girvin, Frisby & Hudson op cit note 207 para 6-021.

[357] See *Mudaliar* supra note 162 at 62-3.

4.5.2 Requirements to establish ostensible authority in South Africa and England

In English law, the requirements for successful reliance by a third party on the ostensible authority of a company's agent were set out in *Freeman*:[358]

1. a representation that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced was made to the third party;
2. such representation was made by a person or persons who had actual authority to manage the business of the company either generally or in respect of those matters to which the contract relates;
3. the third party was induced by such representation to enter into the contract, that is, that he/she in fact relied upon it; and
4. under its memorandum or articles of association the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent.[359]

Freeman remains the *locus classicus* in English law relating to the representation of companies and has been affirmed by the House of Lords[360] and by the Court of Appeal[361] on several occasions.

Although South African courts have relied on the descriptions of the different types of authority by English courts, the *Freeman* test for relying on ostensible authority was never wholly taken over by our courts. Our courts have preferred to formulate the requirements for ostensible authority in their own words, although these requirements were not always clearly and consistently stated.[362] In *NBS Bank Ltd v Cape Produce Co (Pty) Ltd*,[363] however, the SCA clearly set out the requirements which a third party relying on a corporate

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[358] *Freeman* supra note 10 at 506.

[359] The only aspect of this requirement which will receive attention in this thesis is a company being precluded to delegate authority by its articles of association. As noted in Chapter 1, lack of capacity will not be addressed in this thesis.

[360] See *British Bank of the Middle East* supra note 305 and *Armagas* (HL) supra note 14 at 778B.

[361] See *Hely-Hutchinson* supra note 14 at 583A, *Acute Property Developments Ltd v Apostolou* [2013] EWHC 200 (Ch) para 23 and *Quinn v CC Automotive Group Ltd (t/a Carcraft)* [2010] EWCA Civ 1412 para 17.

[362] The exposition of the requirements for ostensible authority has changed and become more refined over time - see *Monzali v Smith* 1929 AD 382 at 385, *Strachan* supra note 289 at 296, *Big Dutchman (South Africa) (Pty) Ltd v Barclays National Bank Ltd* 1979 (3) SA 267 (W) at 282E, *Wolpert* supra note 196 at 266H-267A and Du Plessis op cit note 210 at 290.

[363] Supra note 288.

representative's ostensible authority had to prove.[364] These requirements, which were subsequently affirmed by several decisions,[365] were: [366]

1. a representation by words or conduct;
2. made by the principal and not merely by the agent, that the agent had the authority to act as it did;
3. a representation in a form such that the principal should reasonably have expected that outsiders would act on the strength of it;
4. reliance by the third party on the representation;
5. the reasonableness of such reliance; and
6. consequent prejudice to the third party.

It is immediately apparent that, although not identical, these tests overlap to a significant degree.[367] The substantive requirements of these tests are dealt with below, with differences between the jurisdictions highlighted.

4.5.3 A representation by the company

Both jurisdictions require a representation by 'the company' as principal, that the person with whom a third party is dealing has authority to conclude the relevant contract. But how does a company make a representation? After all, a person contracting with a company through its agent will usually only deal with the agent and not the board of the company. As we shall see, a third party may as a general rule not rely merely on representations made by an agent as to his/her authority – the representation has to be made by the persons with actual authority to conclude the contract. How is such representation made without direct communication between the board and the third party? The most common representation is made by the principal:[368]

> '… permitting the agent to act in some way in the conduct of the principal's business with other persons. By so doing the principal represents to anyone who becomes aware that the agent is so

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[364] It is noteworthy that the court in *Cape Produce* (SCA) supra note 288 para 24 expressly approved of the orthodox English descriptions of the concepts of actual authority (express or implied) and ostensible authority in *Hely-Hutchinson* (CA) supra note 14.

[365] *Glofinco* (SCA) supra note 282 para 12*, Coop* supra note 282 footnote 12, and *Northern Metropolitan* (SCA) supra note 287 para 28. See also *Cherry v Pick 'n Pay – Cleary Park* 2014 JDR 1079 (ECP) para 10.

[366] *Cape Produce* (SCA) supra note 288 para 26. For a substantially similar statement of the requirements see *African Life Assurance* supra note 344 at 451E-H; provided that prejudice was not referred to in that case.

[367] See Cassim & Cassim op cit note 283 at 648-650 for a comparison between the *Cape Produce* and *Freeman* tests.

[368] *Freeman* supra note 10 at 503 (see also at 505). See also Goff LJ in the Court of Appeal and Lord Keith in the House of Lords in *Armagas* supra note 14 at 731E and 777B, respectively.

acting that the agent has authority to enter on behalf of the principal into contracts with other persons of the kind which an agent so acting in the conduct of his principal's business has usually "actual" authority to enter into.'[369]

Accordingly, by appointing a person to a specific position, a company is deemed to be representing that such a person has the usual authority associated with that position.[370] Usual authority is therefore not only important to determine an agent's implied actual authority, but also that agent's ostensible authority. What was said regarding the usual authority of certain company positions in paragraph 4.4.2 is therefore also applicable here.[371] There is accordingly a very fine distinction to be drawn between implied actual authority and ostensible authority.

Although the appointment of a person is the most important representation on which a third party usually relies, it is not the only factor to be taken into account and, depending on the circumstances, it may not be enough.[372] Whether a representation was made is a question of fact, which has to be decided on a balance of probability.[373] In the words of the SCA 'it is in the totality of the appearances that the representation is to be found'.[374] Courts therefore have regard to ancillary factors such as the senior status of representatives, the trappings of their appointment, the course of dealing with the third party and the use of official documents and processes.

Going further, as with implied actual authority, the acquiescence of those with actual authority to certain actions by a director may also form the basis for the ostensible authority of an agent.[375] Indeed, there is no limit to the forms which a representation which creates ostensible authority may take and one must look at the entire conduct of the company in order

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[369] See also *Cape Produce* (a quo) supra note 270 at 47.

[370] *Cape Produce* (SCA) supra note 288 para 28-9 and *Kruizenga* supra note 295 para 16. Also see the example given by Wallis J in *Makate* (CC) supra note 8 para 139. In *South African Eagle Insurance Co Ltd v NBS Bank Ltd* case no 5142/97 (unreported) (W) (overturned on appeal in *South African Eagle Insurance* (SCA) supra note 312) Van Oosten J held that the appointment of a branch manager of a bank was in itself of no consequence. On appeal (paras 28-30), however, the SCA held that the bank held out the manager as having authority to accept deposits and his appointment played a pivotal part in this finding. See also the criticism of Van Oosten J's statement in *Cape Produce* (a quo) supra note 270 at 48-9.

[371] See *First Energy (UK) Ltd v Hungarian Intl Bank Ltd* [1993] BCC 533 at 540 and Watts & Reynolds op cit note 271 para 3-004.

[372] Yuill op cit note 264 at 307.

[373] *South African Eagle Insurance* (SCA) supra note 312. See also *Reed* supra note 305 at 525A.

[374] *Cape Produce* (SCA) supra note 288 para 33.

[375] Lord Keith in *Armagas* (HL) supra note 14 at 777C.

to evaluate the representation.[376] It is even theoretically possible for a company to create ostensible authority for only a specific transaction, although this will be exceedingly rare.[377] A representation may, of course, be withdrawn, but it remains valid until that time.[378]

As noted above, both jurisdictions accept the general rule that an agent cannot clothe himself/herself with authority (or 'self-authorise', to use the terminology used by the English Court of Appeal)[379] by merely making representations regarding his/her own authority, without more.[380] In order for reliance on the ostensible authority of a corporate representative to be successful a representation by the principal (or someone authorised by the principal) is required.[381]

So, for instance, in the leading English case on the matter namely *Armagas Ltd v Mundogas SA*,[382] the third party attempted to hold a company bound despite knowing that the relevant agent lacked the authority to conclude the relevant agreement. The third party argued that, although the agent was not authorised to conclude the contract, he was authorised to communicate the board's approval of the contract. The House of Lords (and the Court of Appeal) rejected this argument, however, by invoking the rule against self-authorisation.[383]

That agents cannot generally self-authorise, however, does not mean that their representations are *always* irrelevant. Indeed, it has been held that although a person may lack authority to enter into a transaction, that person may occupy a position in which he has ostensible authority to communicate to a third party that the proper person has authorised that

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[376] Goff *Armagas* (CA) supra note 14 at 731D and *First Energy* supra note 371 at 540.

[377] Imagine, for instance, that the board of a company informs a third party that a particular agent, who does not generally have authority to enter into the particular type of transaction envisaged between the parties, may be relied on in this specific instance. If that agent then enters into the relevant agreement without the company's consent, the company may be bound by that agent's 'specific' ostensible authority. See *Armagas* (HL) supra note 14 at 731E and 777D. See also judgment of Dunn LJ in the Court of Appeal - *Armagas* (CA) supra note 14 at 748.

[378] Mayson, French & Ryan op cit note 90 at 612.

[379] *First Energy* supra note 371 at 540.

[380] *Freeman* supra note 10 at 505, *Hudson Bay* supra note 282 para 55, *Thanakharn v Akai Holdings Limited* [2010] HKCFA 64 para 64, *Glofinco* (SCA) supra note 282 para 12 and *Kruizenga* supra note 295 para 16. See also Girvin, Frisby & Hudson op cit note 207 para 6-022.

[381] *Cape Produce* (SCA) supra note 288 para 25, *Freeman* supra note 10 at 504-5 and *Armagas* (HL) supra note 14 at 731E and 778B. See also JG Collier 'Actual and ostensible authority of an agent: A straightforward question and answer' [1984] 43 *Cambridge LJ* 26.

[382] Supra note 14.

[383] See Lord Keith in *Armagas* (HL) supra note 14 at 779 and Goff LJ in *Armagas* (CA) supra note 14 at 731B. See also Stephenson LJ at 758-759.

transaction.[384] In other words, although there is a general rule against self-authorising agents, there is nothing to stop a company from holding out a specific person as having authority to communicate decisions made within the company.[385] Again, it all depends on the facts of the case.[386]

Courts have therefore gradually sought to introduce more flexibility by inquiring whether an agent was in fact held out to be able to make representations regarding approvals from higher levels (such as the board), to better reflect the commercial reality of large complex organisations.[387] These inroads into the general rule are decidedly in favour of third parties. It is submitted that these inroads are necessary, since enforcing the general rule against self-authorisation too strictly simply does not take into account the fact that third parties often only deal with agents. The acceptance of a 'communication argument' should, however, remain an exception and not the general rule, lest companies be placed at the mercy of their agents.[388]

4.5.4 Reasonably expected to mislead

South African law requires that the representation of the principal must be of such a nature so that it could reasonably have been expected to mislead.[389] It is therefore not necessary to prove that the principal intended to mislead, but merely that the principal could have reasonably expected that its representation would have the effect of creating an impression of ostensible authority in the third party's mind.[390] The purpose behind this requirement is not to

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[384] *First Energy (UK) Ltd v Hungarian International Bank Ltd* supra note 371 at 540, 544 and 547, *Kelly* supra note 307 paras 12 to 15 and *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies Ltd* [1985] 2 Lloyd's Rep 36. See, however, Peter Watts 'Some Wear and Tear on Armagas v Mundogas: The Tension between Having and Wanting in the Law of Agency' [2015] *LMCLQ* 36 at 40 regarding the last-mentioned of these cases. See also *British Thompson-Houston* supra note 303 at 182 and *Freeman* supra note 10 at 499. For South African authority, see *Makate* (CC) supra note 8 para 161 and *Goode, Durrant and Murray Ltd v Hewitt and Cornell, NNO* [1961] 1 All SA 50 (N) at 53. In *Northern Metropolitan* (SCA) supra note 287 para 21-6 the SCA did appear to accept the idea that an agent could have authority to communicate approvals for agreements which he did not have authority to sign, although such an argument failed in that case.

[385] LTC Harms (original text by PJ Rabie) 'Estoppel' in WA Joubert (founding ed) *The Law of South Africa* vol 18 3ed (2015) para 82.

[386] *Kelly* supra supra note 307 para 15. See also *Galaxy Aviation v Sayegh Group Aviation* [2015] EWHC 3478 (Comm) para 102.

[387] Watts op cit note 384 at 39.

[388] See Davies & Worthington op cit note 215 para 7-23.

[389] *Strachan* supra note 289 at 289, *South African Eagle Insurance* (SCA) supra note 312 para 32 *Quinn & Co Ltd v Witwatersrand Military Institute* 1953 (1) SA 155 (T) at 159.

[390] *Cape Produce* (SCA) supra note 288 para 25.

hold a principal bound to consequences which it could not reasonably have expected and which are not the natural result of its conduct.[391] What this means is that, unlike in English law,[392] the reasonableness criterion is applied in South Africa not only to the estoppel-raiser (by testing reasonable reliance), but also to the estoppel denier.[393]

4.5.5 Reliance on representation

In order for a third party to hold a company bound based on the ostensible authority of one of its agents, the third party must have relied on the representation made as to the authority of that agent.[394] Obviously, if a third party is unaware of the representation, it can hardly be said to have relied on such a representation.[395] As we shall see, constructive notice of a particular fact is not enough – a third party must have had actual knowledge of a fact and relied on it.[396]

A third party can obviously not claim that a company is bound to a contract on the basis of the ostensible authority of an agent where that contractor knows that the agent does not have actual authority to enter into a contract of that type.[397] What is more difficult to determine is, absent an express disavowal of authority, in what circumstances a third party should be precluded from claiming reliance based on the circumstances prevailing at the time of the conclusion of a contract. This is a threshold issue – exactly how unusual must circumstances be or, rather, what level of notice must a third party have of an agent's lack of authority, for that third party to be precluded from relying on the ostensible authority of the company agent? What must the state of mind of the third party alleging apparent authority be?[398]

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[391] *Monzali* supra note 362, *Cape Produce* (SCA) supra note 288 para 25. For an example of how this requirement is applied, see *Cape Produce* (SCA) supra note 288 para 34.

[392] See, however, Cassim & Cassim op cit note 283 at 648-650, who argue that this requirement is substantially mirrored in the Freeman test.

[393] In *Connock's* supra note 266 the court distinguished the South African position form the English one, saying: 'to have regard only to the position of the representee in applying the objective test could in certain circumstances bear unjustly or unduly harshly on a representor, especially if he was innocent or blameless, and because the foundation of estoppel is still equity, our Courts have evolved a different approach in estoppel based on unintentional conduct in applying an objective test.' See also *Glofinco* (a quo) supra note 312 at 1060I.

[394] *Freeman* supra note 10 at 506. Infra South African sources at note 400.

[395] *Dicks* supra note 305 at 509F.

[396] Infra para 6.5 and 6.6.6.

[397] See *Criterion Properties* supra note 282 at 1856 and *Armagas* (HL) supra note 14 at 731E and 777C.

[398] *Thanakharn* supra note 380 para 49.

Traditionally, reliance was connected to a reasonableness criterion in that a third party was expected to make reasonable enquiries when dealing with a company.[399] This is still the position in South Africa – the third party must have acted reasonably in relying on a representation.[400] The objective reasonableness criterion means that a third party could not prove ostensible authority if it should reasonably have been suspicious of the agent's authority.[401]

The approach of the English courts, however, appears to have shifted on this question, unsurprisingly, to favour the third party contracting with the company. A line of cases have, although not without criticism, [402] accepted the proposition that a third party should only be precluded from relying on the ostensible authority of an agent if the third party's belief that the agent had authority would amount to being dishonest or irrational (which includes 'turning a blind eye' and being reckless).[403]

4.5.6 Prejudice

Unlike the *Freeman* test, the *Cape Produce* test requires a third party to have suffered prejudice in order to successfully rely on an agent's ostensible authority. This requirement has, however, been interpreted very widely[404] and has presented little difficulty in corporate representation cases. Indeed, the mere fact that the third party will lose the benefit of having a

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[399] See *Hopkins* supra note 305 para 94 and Infra para 6.3.3, *Glofinco* (SCA) supra note 282 para 35.

[400] *Cape Produce* (SCA) supra note 288 para 25 and *South African Eagle Insurance* (SCA) supra note 312 para 32.

[401] So, for instance, in *Weedon v Bawa* 1959 (4) SA 735 (D), the court held that the person dealing with an attorney's typist clerk regarding an investment could not set up agency by estoppel against that attorney, inter alia, on the basis of having failed to failed to observe 'ordinary business precautions.' At the same time, however, an estoppel-denier who made a false representation to a third party cannot later argue that the third party, if he/she had made further investigations, should not have believed the representation. See Harms op cit note 385 para 87.

[402] See Watts op cit note 384 at 48.

[403] *Thanakharn* supra note 380 para 49 and 52, court *a quo* in *Newcastle International Airport Ltd v Eversheds LLP* [2012] EWHC 2648 (Ch) para 108, *Quinn* supra note 268 para 20, *Gaydamak v Leviev* [2012] EWHC 1740 (Ch) para 249 and *Bass Jarrington* supra note 342 para 90.

[404] Prejudice includes refraining from taking an action which would have been beneficial - *In Re the Contributories of the Rosemount Gold Mining Syndicate in Liquidation* 1905 TH 169 at 205. Actual pecuniary loss is not required – the mere likelihood of such loss is sufficient - *Autolec Ltd v Du Plessis* 1965 (2) SA 243 (O) at 252H and JC Sonnekus (Original Text by the Hon PJ Rabie) *The Law of Estoppel in South Africa* 3ed (2012) at 199. This is not to say that this requirement does not impose any limits. In *IPF Nominees (Pty) Ltd v Nedcor Bank Ltd (Basfour 130 (Pty) Ltd. Third Party)* 2002 (5) SA 101 (W) at 122 H-J it was, for instance, held that the mere replacement of one creditor by another would not satisfy this criteria. See Harms op cit note 385 paras 88-9.

contract with the company if the company is entitled to deny the representation that its agent had authority may already suffice to meet this requirement. [405]

4.5.7 The company is precluded from delegating by its articles of association

Being decided at a time when constructive notice still applied, it was necessary in *Freeman* to note that a third party could not rely on an agent's ostensible authority if the articles of the company made it clear that authority could not have been delegated to that agent. Despite not being mentioned in *Cape Produce*, this was also the position in South African law.[406]

As we shall see, this requirement has been negated to a large degree by statutory amendments in both jurisdictions.[407] The extent to which this requirement has diminished in importance in English law may be gleaned from the fact that courts have recently started to omit this requirement from the quotation of the test for ostensible authority as set out in *Freeman.*[408] Indeed, one can hardly think of a more telling example of the dwindling relevance of a company's articles to third parties.

4.5.8 Negligence is not required

Although fault (in the form of intent or negligence) on the part of the estoppel-denier (ie the company) is a general requirement for estoppel,[409] courts have accepted that this is not a requirement for successful reliance upon the ostensible authority of a corporate agent.[410]

4.6 OSTENSIBLE AUTHORITY AND ESTOPPEL

In English law the position is firmly settled - ostensible authority is based on estoppel.[411]

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[405] Kerr op cit note 283 at 117, Yuill op cit note 264 at 313 and Sonnekus op cit note 404 at 206.

[406] Infra notes 538 and 539.

[407] Infra paras 7.3.5 and 8.4.

[408] See *Acute Property* supra note 268 para 24 and *Quinn* supra note 268 para 20.

[409] See *IPF* supra note 404 at 122H-J; *Big Dutchman* supra note 362 at 282E; Cilliers et al op cit note 2 para 12.33 and Du Plessis op cit note 210 at 290.

[410] Apart from negligence not being mentioned in either the *Freeman* or the *Cape Produce* test, see *Sonday v Surrey Estate Modern Meat Market (Pty) Ltd* 1983 (2) SA 521 (C) at 535F, *Glofinco* (a quo) supra note 312 at 1061G-J, Sonnekus op cit note 404 at 269 and Yuill op cit note 264 at 308. Harms (op cit note 385 para 96) argues that negligence is implied in the requirement that the person making the representation should reasonably have expected that such a misrepresentation would mislead. See, however, Sonnekus op cit note 404 at 274-5.

[411] *Freeman* supra note 10 at 498 and 503, *Armagas* (HL) supra note 14 at 777B (see also the judgments of Goff LJ and Dunn LJ in *Armagas* (CA) supra note 14 at 731D and 747E, respectively), *Quinn* supra note 268 para 20; *SMC Electronics s*upra note 285 para 22, *Acute Property* supra note 268 para 4 and *Newcastle International Airport supra* note 403 para 107. Regarding criticism of this view, see Tan op cit note 271 at 196 and Watts &

As noted earlier in this Chapter, estoppel was adopted into South African law from English law.[412] While important differences between estoppel in South African and English law exist,[413] the basic idea is the same in both jurisdictions - estoppel precludes a representor from denying the truth of a representation which it has made in circumstances where another person has relied on that representation to its prejudice.[414] Generally, this doctrine is based on equity, fairness and justice in that a person should not be allowed to make another believe in, and rely upon, a certain set of facts, and then later recant those facts.[415]

Estoppel is a wide-ranging concept that exists in many forms.[416] One of these forms is 'agency by estoppel', which has been recognised by South African courts for more than a century.[417] Agency by estoppel, naturally, refers to the situation where A has represented to B that C has authority to contract on A's behalf. If it turns out that B was not so authorised, A may, provided that the requirements for (agency by) estoppel have been proved, be estopped from denying B's lack of authority. The effect of such an estoppel would be that A would be bound by C's conduct as if C were A's authorised agent. This is not really agency at all, but the net effect, A being held bound to C's actions, remains the same – hence 'agency by estoppel'.

But is agency by estoppel the same as 'ostensible authority'? There can be little doubt, that by the turn of the millennium a clear distinction was made between actual (express or implied) and ostensible authority, with the latter term being accepted by both and courts[418] and commentators[419] as referring to agency by estoppel, just as in England. Given that the connection between ostensible authority and estoppel has become controversial in the wake of the Constitutional Court's judgment in *Makate*,[420] it is (unfortunately) necessary to

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Reynolds op cit note 271 para 8-028. See also *Northside Developments* supra note 223 at 211 and *Thanakharn* supra note 380 para 52.

[412] Supra note 266.

[413] The most substantial difference being that estoppel forms part of the substantive law of the former while it is regarded as a rule of evidence in the latter. See Harms op cit note 385 para 81. Regarding the acceptance of estoppel into South African law, see *Connock's (SA) Motor Co Ltd v Sentraal Westelike Ko-operatiewe Maatskappy Bpk* 1964 (2) SA 47 (T) at 49A-B and Sonnekus op cit note 404 at 51 et seq.

[414] See *Aris Enterprises (Finance) (Pty) Ltd v Protea Assurance Co Ltd* 1981 (3) SA 274 (A) at 291D, Harms op cit note 385 para 79 and Sonnekus op cit note 404 at 3 and 7.

[415] Sonnekus op cit note 404 at 3.

[416] *Makate* (CC) supra note 8 para 110.

[417] *Strachan* supra note 289 and *Monzali* supra note 362.

emphasise the point. For example, in *Big Dutchman (South Africa) (Pty) Ltd v Barclays National Bank Ltd* it was said that:[421]

> 'I turn now to the defence embodied in … the defendant's plea, namely that of the ostensible authority of Church …. In order to establish that defence, the defendant must prove all the requisites of an estoppel.'

In *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* the court stated:[422]

> 'To prove ostensible authority facts raising an estoppel against the company would have to be proved.'

Any doubt regarding such acceptance appeared to have been swept away in *Cape Produce*,[423] in which the SCA unanimously confirmed that '[w]here a principal is held liable because of the ostensible authority of an agent, agency by estoppel is said to arise'. This statement of the nature of ostensible authority was affirmed by the SCA on at least three occasions over the next decade.[424]

The position in South African law therefore appeared to be settled as in English law – ostensible authority is based on estoppel. That is, until the Constitutional Court weighed in on the issue in *Makate*, which is dealt with next.

4.7 *MAKATE*

4.7.1 Background

In *Makate*,[425] the topic of ostensible authority came before the Constitutional Court, the highest court in South Africa. In this case, Makate alleged that he had reached an agreement

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[418] Infra notes 421 and 422. See also *Mudaliar* supra note 162 at 58, *Clifford Harris (Rhodesia)* supra note 314 at 303G (my emphasis), *Glofinco* (a quo) supra note 312 at 1064A-B, *African Life Assurance* supra note 344 at 451E-H and *Inter-Continental* supra note 210 at 748 et seq. See also Wallis J's extensive arguments in this regard in *Makate* (CC) supra note 8 paras 140-157.

[419] MJ Oosthuizen *Die Turquand-Reël in die Suid-Afrikaanse Maatskapptyereg* (LLD Thesis, UNISA 1976) at 70, Silke op cit note 272 at 441, JC Sonnekus 'Estoppel en oënskynlike volmag van amptenare van owerheidstrukture' 2012 *TSAR* 593 at 596. See also Walter D Geach and T Schoeman (consulting ed) *Guide to the Close Corporations Act and Regulations* (1984) [SI 20 - Jun 2013] at 564-1, See, however, Kerr op cit note 283 at 26-31 and 94-126 as well as the criticism of Wallis J thereof in *Makate* (CC) supra note 8 para 154 (footnote 162).

[420] Infra para 4.7.3.

[421] Supra note 362 at 282E.

[422] Supra note 3 at 15A. See also *Hosken Employee Benefits (Pty) Ltd v Slabe* 1992 (4) SA 183 (W) at 190I.

[423] Supra note 288 para 25.

[424] *Glofinco* (SCA) supra note 282 paras 12-4, *Coop* supra note 282 para 66 and *Northern Metropolitan* (SCA) supra note 287 para 28.

[425] Supra note 13.

with his former employer, Vodacom, which was represented by one of its directors, Geissler. Makate had come up with an innovative idea for the 'please call me' messages which South Africans know so well. This idea was brought by Makate to the attention of Geissler, Vodacom's director of product development. Makate alleged that he had reached agreement with Geissler to the effect that he would be reasonably remunerated for his idea and that if such remuneration could not be agreed, then Vodacom's CEO (Knott-Craig) would determine such remuneration. Vodacom implemented Makate's idea and ultimately made billions of rands from it, but it denied that it was bound by such an agreement, inter alia,[426] on the basis that Geissler did not have any authority to conclude such an agreement on its behalf.[427] Makate, however, sought to hold Vodacom bound based on the ostensible authority of Geissler.[428]

The court a quo dismissed Makate's claims, inter alia, because the court found he had failed to allege the necessary facts to prove Geissler's ostensible authority. The court a quo and the SCA refused leave to appeal, which left only the Constitutional Court. All 11 judges of the Constitutional Court disagreed with the court a quo and held that Vodacom was bound to the agreement based on the ostensible authority of Geissler. The Court did not, however, agree on how to reach that conclusion, which led to differing approaches being taken in the respective majority and concurring minority judgments. These approaches are considered together with that of the court a quo below.

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[426] Vodacom's other main defence, which will not be canvassed here, was that the claim had prescribed. This argument was accepted by the Court a quo but rejected by the Constitutional Court. This finding by the Constitutional Court, too, has been criticised – see Sonnekus, JC 'Estoppel én Uitwissende verjaring – swak regswetenskap mag nie toegejubel word nie' 2016(3) *TSAR* 538.

[427] Not only did Vodacom deny that remuneration was due to Makate, but Geissler and Knott-Craig created a false narrative that it was in fact Knott-Craig who had come up with the idea. The conduct of these two men was described as 'dishonourable' and 'disgraceful' by the majority and minority judgments in the Constitutional Court - *Makate* (CC) supra note 8 paras 105, 117 and 160.

[428] Reliance on (express or implied) actual authority was abandoned – see *Makate v Vodacom (Pty) Limited* [2015] JOL 34657 (GJ) para 65 and *Makate* (CC) supra note 8 para 154.

4.7.2 The court a quo

It is perhaps apposite to start this discussion by quoting the particulars of claim of Makate. The entirety of the allegation pleaded in relation to Geissler's ostensible authority read as follows:[429]

> 'The defendant (respondent) was represented by Mr Muchenje [another employee of Vodacom ranking below Geissler] and Mr P Geissler (hereinafter referred to as the representatives) who were then occupying the positions of head of finance divisions and the director of product development respectively, in the employ of the defendant. The representatives were acting in the course and scope of employ with the defendant. *The representatives had ostensible authority to negotiate and to contract for and/or on behalf of the defendant*.'

In its plea, Vodacom denied the assertions made in the abovementioned paragraphs and the matter of authority was not further dealt with in Makate's replication.[430]

In argument, Vodacom raised two objections in relation to Makate's pleading. First, it submitted that in order to plead ostensible authority properly, Makate had to allege actual authority in its particulars of claim and, only once that was denied by Vodacom, should he have averred ostensible authority in his replication.[431] Secondly, Vodacom argued that in order to plead ostensible authority, the elements of estoppel must be alleged, including a representation by the alleged principal and the necessary causation.[432] Makate, on the other hand, argued that the mere allegation made in the particulars of claim was enough, but alternatively sought to amend his replication to plead an estoppel and the facts supporting it.[433] This request for amendment was made at a very late stage in the proceedings - after the close of the Vodacom's case, after Makate had led evidence and after the matter had been adjourned for final argument.

The court a quo accepted the law as set out in *Cape Produce* and therefore held that Makate did have to allege the allegations necessary to found an estoppel in order to rely on Geissler's ostensible authority.[434] This, Makate clearly did not do (my emphasis):[435]

> 'The mere allegation in the particulars of claim, that Mr Geissler had "ostensible authority", was not enough. The plaintiff had to plead an estoppel in the replication. *If the plaintiff was aware at*

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[429] *Makate* (a quo) supra note 428 para 130.

[430] Ibid para 132.

[431] Ibid para 136. This way of pleading has long been considered to be the correct way in which estoppel should be pleaded. See Harms op cit note 385 para 89, Silke op cit note 272 at 444-5 and Geach & Schoeman op cit note 419at 564-2.

[432] Ibid para 132.

[433] Ibid paras 138-9.

the outset of the true facts, namely, that there was no actual authority and that he was relying on ostensible authority, he should have pleaded the facts, as represented to him, to found such authority, in his particulars of claim. If he was not aware that Mr Geissler had no actual authority and had pleaded actual authority and the defendant had, in turn, pleaded the true facts (i.e. a denial of actual authority), the plaintiff may then have relied on estoppel in his replication. *But it was essential for the plaintiff to have pleaded the facts as represented to him*, if he was aware of those facts. The estoppel, which is not a cause of action, should then have been pleaded in a replication, in response to the defendant's plea.'

An amendment was therefore necessary to include the facts as represented to Makate. The court a quo, however, found that Makate's legal representatives, who had been aware of the need for such amendment, had *deliberately withheld* the amendments until right at the end of proceedings after both parties had led evidence and cross-examined witnesses.[436] Such deliberate action could simply not be condoned.[437] Consequently, Makate could not rely on the facts he sought to introduce by way of amendment, which meant that a case of ostensible authority had not been proved.[438]

The court a quo, however, went further and considered whether a case for ostensible authority would have had been made out, had Makate properly pleaded his case.[439] Here again, the court held that Makate's claim fell short. He had failed to prove that Vodacom had made a representation as to the authority of Geissler. According to the court, Makate's whole assertion boiled down to the appointment of Geissler as director of product development, which was not enough. Geissler was a mere director and not CEO (like Knott-Craig) and it could therefore not simply be assumed by Makate that he would have authority to bind Vodacom. What Makate had in fact relied on was Geissler's representations and not those of Vodacom.

4.7.3 Majority judgment of Jafta J in the Constitutional Court

The majority judgment of the Constitutional Court, written by Jafta J,[440] held that Vodacom was bound by the agreement concluded by Geissler on its behalf, as he had ostensible authority to represent Vodacom. How did Jafta J overcome Makate's deficient pleading of

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[434] Ibid para 156.

[435] Ibid para 157.

[436] Ibid para 158.

[437] Ibid para 163.

[438] Ibid para 164.

[439] Ibid para 165 et seq.

[440] With Mogoeng CJ, Moseneke DCJ, Khampepe J, Matojane AJ, Nkabinde J and Zondo J concurring.

estoppel? This was done, not by relaxing the rules regarding the pleading of estoppel, but by finding that the court a quo *had erred in assuming that ostensible authority was based on estoppel*.[441]

The main thrust of Jafta J's argument was as follows:[442] ostensible authority is (unlike estoppel) a type of actual authority which is conferred upon an agent by a representation by the principal to the relevant third party.[443] The same representation may give rise to ostensible authority or estoppel, but that does not mean that they are the same. The *only requirement* for proving ostensible authority is a representation by the principal that the agent has the power to act on its behalf.[444]

Jafta J appeared to put forward three main reasons for coming to this conclusion:[445]

1. in *Hely-Hutchinson*[446] Lord Denning stated that ostensible authority 'is the authority of an agent as it appears to others';[447]
2. there is not a single South African case prior to *Cape Produce* which held that ostensible authority is based on estoppel;[448]
3. ostensible authority only has one requirement, a representation, whereas estoppel has several requirements, including prejudice.[449]

Once estoppel and ostensible authority had been separated in this way, the issues regarding the proper pleading of estoppel were no longer relevant - the mere allegation of ostensible authority and denial thereof by Vodacom were enough.[450]

The court then considered whether Geissler had ostensible authority, applying not the 'incorrect' standard set in *Cape Produce* and other cases dealing with estoppel, but the correct standard relating to ostensible authority. Although the majority held that the only requirement to prove ostensible authority was a representation, it is clear that the notion of doing justice

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[441] *Makate* (CC) supra note 8 para 144.

[442] Ibid paras 45-6.

[443] Ibid para 46: 'While [ostensible authority] may not have been conferred by the principal, it is still taken to be the authority of the agent as it appears to others. It is distinguishable from estoppel which is not authority at all.'

[444] See para 47 (my emphasis): '... the presence of authority is established if it is shown that a principal by words or conduct has created an appearance that the agent has the power to act on its behalf. *Nothing more is required*.'

[445] These reasons will be scrutinised in more detail below – infra para 4.7.5.

[446] Supra note 14 at 583 – supra quotation in para 4.5.1.

[447] *Makate* (CC) supra note 8 para 49.

[448] Ibid para 70.

[449] Ibid para 46-7.

[450] Ibid para 59.

between the parties played an even more important role.[451] Taking this approach, the court held that Geissler had ostensible authority to bind Vodacom. This conclusion was based on not only his position and ostensible power within Vodacom, but plainly also on the unfairness of Vodacom making billions of rand while Makate was not paid 'even a cent'.[452] The personal circumstances of Makate appeared to also play a role.[453]

4.7.4 Concurring minority judgment of Wallis AJ in the Constitutional Court

The concurring minority judgment was penned by Wallis AJ,[454] who, while agreeing with Jafta J that Vodacom was liable based on the ostensible authority of Geissler, differed on the issue of whether ostensible authority is based on estoppel. Wallis AJ went to great lengths to show that it was settled law that ostensible authority was based on estoppel. He noted that Jafta J had not cited any authority prior to *Cape Produce* to support the notion that the SCA's approach in that case constituted a deviation from established principle.[455] The essence of his judgment was that it was not necessary to undermine the entire juristic nature of ostensible authority to solve the issues regarding the proper pleading of ostensible authority. Furthermore, apart from the issues relating to the interpretation of English and South African law on this point, Wallis AJ pointed out that the nature of ostensible authority was not even argued before the court and the majority had shown no constitutional imperative for developing the common law on this issue.[456]

Regarding the pleading of ostensible authority, Wallis AJ pointed out that it was already widespread practice to plead ostensible authority in particulars of claim where a plaintiff was not relying on the actual authority of an agent. The court a quo's strict approach to pleading amounted to 'pedantry'.[457] If a plaintiff was not relying on a purported representative's actual authority, that plaintiff should be able to raise ostensible authority from the outset.[458]

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[451] Ibid paras 65.

[452] Ibid para 64. See also paras 104-5, respectively: 'No smile was brought to [Makate's] face for his innovation.' and 'This leaves a sour taste in the mouth.'

[453] See at para 61 (my emphasis): 'Out of his *desperate situation*, the applicant formulated a brilliant idea'.

[454] With Cameron J, Madlanga J and Van der Westhuizen J concurring.

[455] Ibid para 140.

[456] Ibid para 109.

[457] Ibid para 119.

[458] Wallis stated that the proposition that estoppel may only be used as a shield and not a sword does not relate to the manner in which it is pleaded, but to the use to which it is put. In other words, a plaintiff pleading

The fact that Makate had not in his particulars even attempted to show that the requirements for ostensible authority had been met, also did not stop him from claiming. Although Wallis AJ admitted that 'the pleading was seriously deficient in detail and that the obligation to plead all the elements of estoppel was ignored',[459] this did not stop Makate's claim. This was because Vodacom had not compelled Makate to provide further particulars after he had failed to respond properly to Vodacom's initial request for particulars.[460] According to Wallis AJ, it had not been shown that Vodacom was prejudiced by the lack of particularity of Makate's pleadings.[461]

With the obstacle of improper pleading overcome, Wallis AJ proceeded to apply the orthodox principles of ostensible authority to the facts of the case. The main contentious issue was whether Vodacom had made a representation regarding Geissler's authority,[462] a question in respect of which the learned judge took a flexible approach.[463] Wallis JA started with Vodacom's board, which clearly had authority to conclude a remuneration agreement. The board, by appointing Knott-Craig as CEO, represented to the world that he had authority to conclude remuneration agreements on its behalf.[464] Knott-Craig had a close relationship with Geissler and was aware of Geissler's negotiations with Makate and could not reasonably have been unaware of the fact that Makate would have sought compensation for his idea.[465] Geissler was therefore invested with (ostensible) authority to bind Vodacom by Knott-Craig, who in turn was (ostensibly) authorised to do so by the board of Vodacom.[466] Vodacom was therefore bound to the remuneration agreement.

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estoppel from the outset would not be using it as a sword, but using it to remove an impediment to the successful prosecution of an action. Ibid para 122.

[459] Ibid para 124.

[460] Vodacom had also failed to ask for any further information regarding ostensible authority in its later request for particulars for trial. Ibid para 124.

[461] Ibid para 125.

[462] Confusingly, Wallis AJ held that causation ('reasonable reliance') had been established before establishing that a representation was made by Vodacom - Ibid para 158.

[463] Ibid para 161.

[464] Ibid paras 182-4. This authority, however, excluded entering into revenue sharing agreements – ibid para 179.

[465] Ibid.

[466] Ibid.

4.7.5 Analysis

The majority judgment in *Makate* as it relates to the issue of ostensible authority, with respect, falls short. Blanket dismissals of settled law require meticulous reasoning and thorough engagement of existing case law – it is respectfully submitted that the majority judgment fails on both those counts.

First, Jafta J's invocation of English case law to suggest that ostensible authority is not based on estoppel lacks substantiation.[467] English courts have not interpreted *Hely-Hutchinson* in general, or the statement relied on by Jafta J in particular, to mean that ostensible authority is some sort of actual authority.[468] As noted above, English courts have consistently accepted that ostensible authority is based on estoppel.

Confronted with these issues, the learned judge implied that English law is in a state of confusion regarding this issue. In support of this, he quoted a lament by Hathorn JP in the South African case of *Insurance Trust and Investments (Pty) Ltd v Mudaliar*[469] to that effect.[470] *Mudaliar* was, however, decided in 1942, when English law could justifiably have been said to be in a state of confusion regarding matters of corporate representation. As we shall see in Chapter 6, the confusion which existed in English law at that time was largely swept away by later judgments.[471]

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[467] Sharrock has referred to Jafta J's judgment as an 'obvious misinterpretation' of English law – see RD Sharrock 'Authority by Representation – A New Form of Authority?' PER / PELJ 2016(19) - DOI http://dx.doi.org/10.17159/1727-3781/2016/v19n0a1240 at 14. The authors of *Henochsberg* refer to the majority judgment as 'unfortunate' – see Delport et al op cit note 283 at 99. See also Lombard, Marianne and Christiaan Swart 'Vonnisbespreking: *Turquand* en estoppel: voëls van eenderse vere?' (2016) 13(2) *LitNet Akademies* 658 at 665 and Olivier op cit note 21 at 615 (footnote 6).

[468] Even if the position were not so clearly settled by later case law, *Hely-Hutchinson* can hardly be said to be authority for the claim that ostensible authority is not based on estoppel but a form of actual authority. Lord Denning specifically accepted the principles laid out in *Freeman*, in which ostensible authority was said to be based on estoppel, as binding. Indeed, the Court of Appeal declined to express any opinion the question of ostensible authority in *Hely-Hutchinson*, as that case was decided on the implied authority of the agent. See *Hely-Hutchinson* (CA) supra note 14 at 583A and 584G.

[469] Supra note 162.

[470] *Makate* (CC) supra note 8 para 76. Hathorn JP (*Mudaliar* supra note 162 at 61) said: 'The law in England seems to me to be in a state of confusion, especially as applied to companies. There are signs that the same confusion, borrowed from England, is finding its way into our law. Unless precision of thought and expression are insisted upon in South Africa in this branch of the law, principles which are simple and plain will become clouded.'

[471] Infra para 6.5.

Furthermore, consider the following cause of confusion in this area of law mentioned by the very same judge in the very same case (my emphasis):[472]

> 'The third cause of confusion is the use of the expressions "apparent authority" or "ostensible authority" in conjunction with actual authority, express or implied. *I venture to suggest that the first two phrases are apt to describe a conception which is confined to cases of estoppel*, that is, the conception of the authority of a supposed agent to act for a supposed principal, when in fact there is no actual authority or when the fact that there is actual authority is not a major issue. *But unfortunately the phrases are often used in cases of actual authority*.'

Far from being supportive of Jafta J's reasoning, it appears therefore that *Mudaliar* instead serves to indict the learned judge's position on ostensible authority.

Furthermore, Jafta J's criticism of Diplock J's seminal analysis in *Freeman* is hard to follow, apart from the repeated assertion that a representation may lead to a principal being held bound on the basis of ostensible authority *or* estoppel. The writer agrees with Wallis AJ that Jafta J's criticism of *Freeman* appears to be the result of reading that judgment 'through the filter of the view that apparent authority and estoppel are different concepts.'[473]

The second reason relied on by Jafta J for his finding was that there existed in South Africa no case law prior to the SCA's decision in *Cape Produce* which supported the conclusion that ostensible authority was based on estoppel. It is not entirely clear how the learned judge could have reached this conclusion, given the judgments referred to in paragraph 4.6 above. When Wallis AJ drew attention to the statements made in the earlier cases, in particular *Mudaliar*, Jafta J held that those statements cannot be reasonably construed to be authority for the proposition that apparent authority is estoppel. Wallis AJ retorted, correctly in the writer's view, that he was unable to read them as saying anything else.[474] This is not to say that the approach of the courts to ostensible authority is beyond

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[472] *Mudaliar* supra note 162 at 63.

[473] See para 135. Another issue which was raised by Jafta J, albeit briefly, was the question of consensus. Jafta J appeared to suggest that because our law distinguishes between the objective theory of contract and estoppel, a similar distinction should be made between apparent authority and estoppel. Any detailed consideration of this topic falls outside the scope of this thesis. See, however, Wallis AJ's criticism at para 157. It is broadly agreed with the learned judge that the issue of an agent's authority is not strictly one of consensus – the agent and the third party may actually reach consensus on the contents of the agreement, but that does not mean that the principal authorised the agent to enter into the contract. See *African Life Assurance* supra note 344 (at 451A), where the court noted that unexpressed mental reservations on the part of the agent are irrelevant to the conclusion of a contract, but this did not replace the court's inquiry into whether that agent had ostensible authority. This, it is submitted, is the correct approach. See, however, Tan op cit note 271 at 196.

[474] *Makate* (CC) supra note 8 para 147.

critique – it has been criticised in South Africa[475] and elsewhere -[476] but Jafta J's assertion that our courts had not come to this view prior to *Cape Produce* is simply incorrect.

The third argument put forward by the learned judge relates to the differences in the requirements to establish ostensible authority and estoppel. As has been pointed out, the requirements laid out in *Freeman* and *Cape Produce* are, although not identical, substantively similar. Furthermore, the conceptualisation of ostensible authority which Jafta J actually proposes is also not that different from the *Cape Produce* test. According to his judgment, only a representation by the principal is needed to found ostensible authority. But what about reliance? Surely a third party needs to rely on a representation and not be unreasonable or, at least, dishonest in doing so?[477]

If reasonable reliance is conceded, then, together with a representation by the principal, we already have effectively four out of the six requirements stated in *Cape Produce*. As noted above, prejudice really provides no obstacle in ostensible authority cases and negligence is not an express requirement for ostensible authority.[478] The only conceivable difference could then be the requirement that the principal should have should reasonably have expected that outsiders would act on the strength of its representation. As noted above, this requirement is not included in the *Freeman* test, and English courts have not had any qualms of equating ostensible authority and estoppel in that jurisdiction.

Finally, one cannot read Jafta J's judgment without detecting palpable outrage at the unfairness of Vodacom's conduct.[479] The law is not, however, based on a particular judge's sense of fairness. If it were, intolerable legal uncertainty would ensue and 'the criterion will no longer be the law but the judge.'[480] More specifically, while estoppel may be an equitable remedy, it is not a broad license to give effect to a person's vague sense of fairness.[481]

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[475] See DH Bester 'Scope of an Agent's Power of Representation' (1972) 89 *SALJ* 49.

[476] See Tan op cit note 271 at 196.

[477] See Sharrock op cit 467 at 16 and also Vela Madlela and Palollo Michael Lehloenya 'Representation of a company when contracting with another person under South African company law' 39(2) 2018 *Obiter* 547.

[478] Supra paras 4.5.6 and 4.5.8, respectively.

[479] See, in particular, *Makate* (CC) supra note 8 para 104.

[480] *Potgieter v Potgieter* 2012 (1) SA 637 (SCA) para 34, referring to *Preller v Jordaan* 1956 (1) SA 483 (A) at 500. See also *Trustees, Oregon Trust v Beadica 231 CC* 2019 (4) SA 517 (SCA) para 24.

[481] See Sonnekus op cit note 419 at 594.

Estoppel's goal is consistency – to keep persons to the representations they make – and its requirements must be systematically and rigorously handled.[482] As noted by Wallis AJ:[483]

> 'We cannot simply overthrow the existing law — which the Constitution explicitly preserved, subject to its being consistent with the Constitution — because a particular case evokes sympathy or because of the disgraceful conduct of a party.'

This, it is submitted, is exactly what the majority did. For all these reasons, Jafta J's judgment cannot be supported.[484]

Wallis AJ's judgment is to be lauded for setting the record straight regarding the nature of ostensible authority. However, this judgment, too, is not above scrutiny. The writer agrees with the learned judge that overly formalistic insistence on pleading ostensible authority only at replication may lead to unfair results for third parties dealing with companies.[485] However, relaxing the rules regarding *at what stage* something must be pleaded is completely different from relieving a party from pleading those facts/allegations at all. The Court a quo did not merely decide that Makate's pleading of ostensible authority was deficient because it was done at the wrong stage of the pleadings – indeed, the court expressly allowed for a claimant to plead the relevant facts if it knew that an agent did not have actual authority. Makate pleaded no facts to support his claim and the court a quo found that his legal counsel had *deliberately withheld* pleading the relevant facts. Wallis AJ did not deal with this issue, but rather laid the blame on Vodacom for not asking for further particulars. With respect, allowing a litigant to successfully rely on ostensible authority without pleading any facts is contrary to settled law[486] and may have undesirable consequences.

Quite apart from issues relating to pleading, however, it is submitted that Wallis AJ's application of the orthodox principles relating to ostensible authority is correct. Once it was accepted that Knott-Craig had knowledge of Makate's idea and acquiesced to the negotiations between him and Geissler, Makate should have been entitled to hold Vodacom to account.

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[482] Sonnekus op cit note 404 at 3.

[483] *Makate* (CC) supra note 8 para 140.

[484] Sharrock has gone so far as to question whether the majority judgment even constitutes a binding precedent, on the principle that a court is not bound by a decision of a superior court when that superior court arrived at its decision without due regard for the law. See Sharrock op cit 467 at 15.

[485] The relaxation of these rules have been applauded by some – see Madlela & Lehloenya op cit note 477 at 558.

[486] See *Union Government v Vianini Ferro-Concrete Pipes (Pty) Ltd* 1941 AD 43 at 49-50, Sonnekus op cit note 426 at 544 and op cit note 266 at 36-40.

4.7.6 Conclusion: an uncertain future

For the reasons set out above, it is submitted that the majority judgment in *Makate* ought not to be followed. Indeed, uncertainty in the wake of *Makate* has already become apparent. In *Engen Petroleum Limited v AAC Agri Foods CC*[487] the court, notwithstanding the fact that *Makate* was cited in argument, stated unequivocally that where reliance is placed on ostensible authority, the elements of estoppel have to be pleaded and proved. Furthermore, in *Bothma v Chalmar Beef (Pty) Ltd*[488] the court, after noting that *Makate* had 'definitively discussed' the 'inter-relatedness and difference' between ostensible authority and estoppel, proceeded to apply requirements to the facts which are indistinguishable from those set in *NBS*.[489] These cases provide some hope that the damage done by *Makate* may be limited, but only time will tell.

4.8 CONCLUSION

This Chapter has set out the general principles of agency which govern corporate contracting and sought to persuade the reader that the changes to such principles implied by the majority judgment in *Makate* ought not to be accepted. Next, we examine how these principles apply to companies in greater detail.

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[487] Supra note 312 para 18.

[488] 2019 JDR 0092 (FB) paras 26-9.

[489] At para 31. See also *SA Securitisation Programme (RF) Ltd v JW Auto CC* 2017 JDR 0787 (ECG) para 114 where the court appeared to take into account the reasonableness of the person seeking to rely on the ostensible authority of an agent, in attempting to apply the *Makate* test. See further *Princess Springs VW (Pty) Ltd v Roberts* 2018 JDR 2191 (GJ) and *Kaine Stanley Charter* supra note 269.

CHAPTER 5: THE DIFFERENT PERSPECTIVES OF CORPORATE CONTRACTING

5.1 INTRODUCTION

The aim of this Chapter is to illustrate that the principles of agency, interpreted in the context of corporations, manifest in two different pictures of corporate contracting – the 'Company Perspective' and the 'Third Party Perspective'. It is submitted that corporate representation can only be fully understood when the relationship between these different perspectives is understood.

5.1.1 The Company Perspective: (actual) authority flowing from the corporate constitution

From a company's perspective, actual authority is paramount.[490] This is true in both a positive and a negative sense. In a positive sense, actual authority lies at the very root of a company's ability to take part in commerce, since it is through authorised representatives that a company intends to contract with third parties. In a negative sense, limitations on actual authority represent attempts by the company to control what its representatives can and cannot do.

Taking into account the legislative framework detailed in Chapter 2, the traditional flow of actual authority from a company to one of its representatives looked as follows:[491]

1. The board of the company was given the power and authority to manage the company's business (via a Board's General Authority Clause).
2. The board was, however, only empowered to act in a collegiate way, which meant that authority had to be delegated to a single representative (via a Power-to-Delegate Clause).
3. The board's ability to delegate authority to a single representative (or act as a collective board) could, however, be circumscribed by other provisions in the corporate constitution, namely:

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[490] Supra para 4.4 and the cases referred to in that paragraph regarding the concept of 'actual authority'.

[491] While there is nothing in law preventing the granting of authority directly to a single representative under the articles, that is certainly not the way the legislative framework was set up. Such delegation would also undermine the board's collective power and it is also not evident from the case law that such clauses are prevalent. See, for instance, *LNOC* supra note 285 para 61 and *Makate* (a quo) supra note 428 para 166. Of course, a delegation may have multiple levels – for instance, a branch manager is granted authority by the CEO, who in turn, is granted authority from the board. The delegation of actual authority, however, has to ultimately be traceable up to the board acting collectively.

a. Reserved Matters Clauses, in terms of which certain actions could not be undertaken by the board without shareholder consent (which consent could be specified as unanimous or at a specified threshold). An example of such a clause would be a clause which requires the board to obtain the consent of shareholders before entering into a loan agreement above a certain monetary threshold; and

b. Exclusion Clauses, which placed an unqualified limitation the company's ability to enter into a particular agreement or, at least, on the ability of the company to enter into that agreement through a single representative. For example, suppose a company's constitution requires two directors to sign contracts exceeding certain monetary thresholds Exclusion Clauses are different from Reserved Matters Clauses in that a person could tell merely from reading the clause that a single representative could not have authority to enter into a specific contract, while in the case of Reserved Matters Clauses, a person reading the clause could only tell that a single representative's authority is subject to some other approval.

4. Lastly, a company's constitution also contained all manner of clauses regulating matters incidental to the flow of authority, like clauses relating to meetings (eg clauses relating to notices and quorums), resolutions and appointment of directors. It is tempting to call these clauses 'procedural' but that would perhaps be underestimating their importance. After all, a quorum clause is of fundamental importance – an inquorate meeting is no meeting at all.[492] In most cases, these clauses would be more relevant to the second delegation (ie from board to single representative), but these could also be relevant to the first delegation of authority by the shareholders to the board, if, for instance, shareholders had to hold a meeting to approve a Reserved Matter.

[492] Infra para 7.3.4.2.3.

This traditional ideal flow of authority may be illustrated as follows:

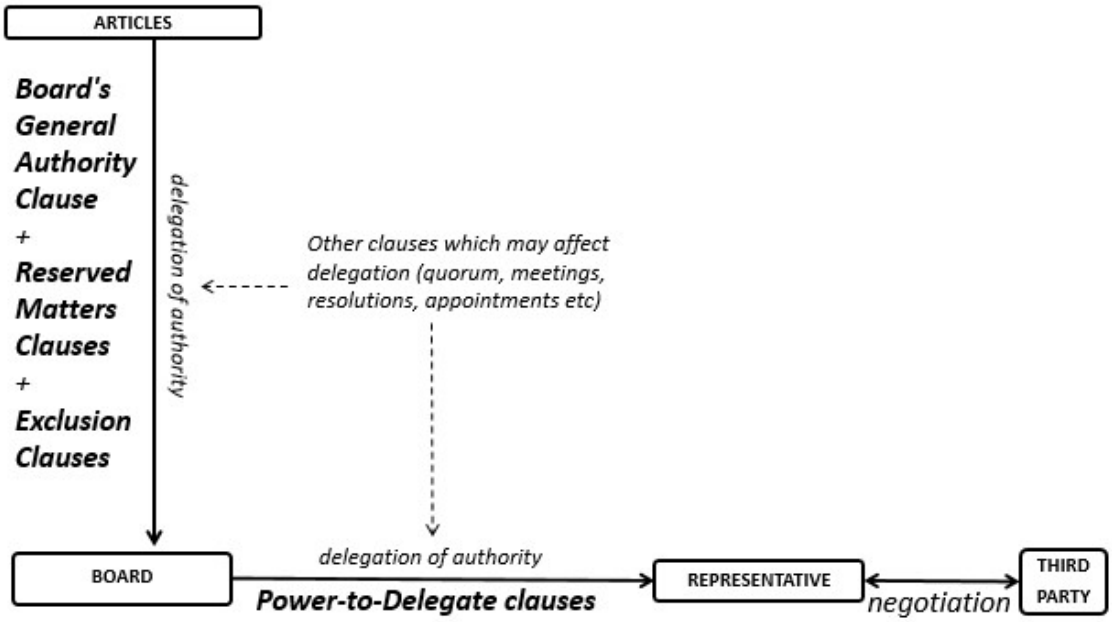

Figure 1: the Company Perspective

There are two fundamentally important points to make about the abovementioned perspective. First, the importance of the corporate constitution.[493] Ultimately all actual authority is tied to the constitution. Not only was the constitution traditionally regarded as the source of board authority, but the constitution also determined how the board's authority could flow elsewhere by virtue of all of the other clauses listed above. At the core of the Company Perspective is therefore the idea that a company's constitution is a legitimate and reasonable platform for shareholders, who have control over the contents thereof, to give, set limits to, or exclude the authority of corporate representatives.

Secondly, the delegation of authority to a single representative could not be determined merely by reading the company's constitution. All the articles could tell a reader was that the board could delegate authority to a representative and what the procedure and further internal requirements would be for such delegation. *Focusing merely on the constitution of a company could therefore never provide a complete picture when dealing with a single representative*. The only exception to this is if the constitution contained an Exclusion Clause (in which case a reader could deduce that a single representative could not have been authorised), but experience has shown that these clauses were rare.[494]

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[493] Griffiths op cit note 18 at 73.

[494] Infra note 539.

As we shall see in Chapter 6, due to the doctrine of constructive notice (and the *Turquand* rule), the Company Perspective was the focal point of early corporate representation cases.

5.1.2 The Third Party Perspective: ostensible authority

An outside[495] third party usually cannot see into the internal decision making processes of a company (unless facts about those processes have been revealed to the third party). However jarring to the corporate lawyer's ear, it is not commercial practice to read a company's articles before contracting with that company[496] and the corporate constitution is often 'forgotten in dusty filing cabinets'.[497] In any event, as pointed out above, in most circumstances merely reading a company's articles would not tell a third party enough to conclude that a single representative in fact has authority to deal on behalf of the company.

[495] Different considerations apply if the person contracting with a company is a so-called 'insider', which is not the focus of this thesis.

[496] Infra para 6.2.2.

[497] JS McLennan 'Contracting with Business Trusts' (2006) 18 *SA Merc LJ* 329 at 335.

So what does a third party rely on when contracting with a company? A third party relies on what 'the company' reveals to the world generally and what the company's representatives reveal to the third party specifically. This was recognised by Diplock J in *Freeman*:[498]

> 'In ordinary business dealings the contractor at the time of entering into the contract can in the nature of things hardly ever rely on the "actual" authority of the agent. His information as to the authority must be derived either from the principal or from the agent or from both, for they alone know what the agent's actual authority is. All that the contractor can know is what they tell him, which may or may not be true. In the ultimate analysis he relies either upon the representation of the principal, that is, apparent authority, or upon the representation of the agent, that is, warranty of authority.'[499]

This realisation is key, because it recognises that the Third Party Perspective is radically different from the Company Perspective. A third party is likely to rely on the following when dealing with a company:

1. The corporate shopfront: this may be described as facts which the company represents to the world, with no particular regard to the specific transaction which the third party wishes to enter into. These facts may include a corporate name, job-titles, the company's business, offices, advertisements, website, logo etc.
2. Internal Domain documents: A third party may be provided with copies of documents which evidence a company's internal authority hierarchy or actions taken pursuant thereto. Examples of such documents include, of course, the company's constitution, but may also include documents like signed written resolutions or minutes of meetings. What is crucial to note here, is that this category relates to documents of which the third party has actual knowledge and not merely constructive knowledge.[500]
3. Words and actions of persons within the company other than the representative, whether senior, subordinate or collegiate to the representative. For instance, the managing director of a company may tell the third party during a telephone conversation to deal with the particular representative in respect of the particular contract. This category also includes acquiescence by those other persons such as, for instance, if the managing director, instead of telling the third party anything over the phone, sits in the boardroom while a third party is dealing with the relevant representative.[501]

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[498] *Freeman* supra note 10 at 503 (Per Diplock LJ). See also *Seniors Service (PVT) Ltd v Nyoni* [1987] 4 All SA 196 (SC) at 201.

[499] See also *Freeman* supra note 10 at 502 per Diplock LJ: 'it is upon the apparent authority of the agent that the contractor normally relies in the ordinary course of business when entering into contract.' It was already recognised in *Totterdell* supra note 345 that the scope of an agent's ostensible authority is usually larger than the scope of his/her actual authority.

[500] Of course, it is impossible to objectively prove what exactly a person knew or did not know. What is intended here is knowledge which a person could reasonably be assumed to have actually had, such as for instance, an e-mail sent to and received by that person. Constructive notice of documents filed with the registrar would not, without more, be included.

[501] Supra Wallis AJ's reasoning in *Makate* regarding Geissler's authority in para 4.7.4.

4. Words and actions of the representative. Of course, during negotiations, a representative may make statements about his/her own authority.[502]

The Third Party Perspective may be illustrated as follows:

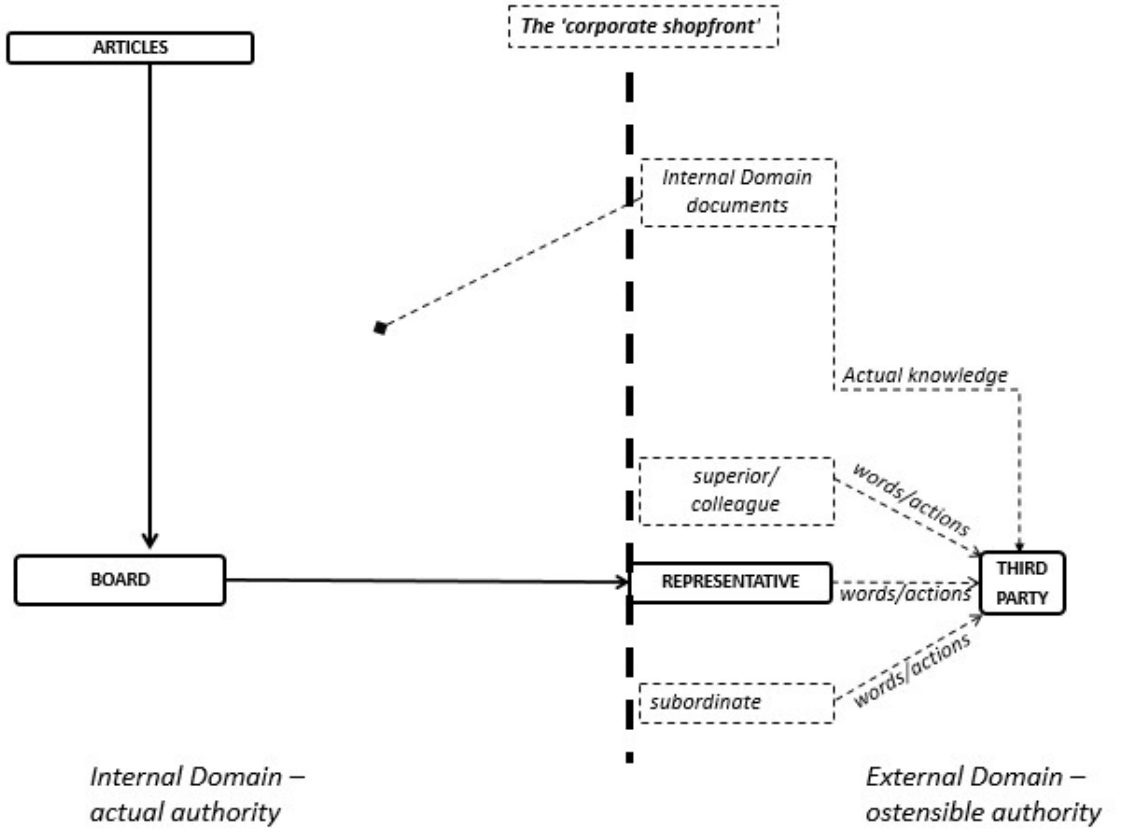

Figure 2: the Third Party Perspective

The illustration above distinguishes between a so-called Internal Domain and an External Domain. The former essentially includes the entire Company Perspective referred to in the previous paragraph, namely the corporate constitution and the flow of actual authority thereunder. Of course, any fact within the Internal Domain of which the third party has actual knowledge becomes part of the External Domain.

The External Domain, in turn, denotes facts 'outside the corporate shopfront', which the company tells the world at large or which have been revealed to the third party by its representatives.[503] Since the focus here is on what a third party sees and relies on without

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[502] Supra para 4.5.3 and the cases referred to in that paragraph regarding the potential for establishing 'ostensible authority' based on statements made by a company's agent.

[503] The weight given to these facts is not discussed here. Neither are the categories perfect – in a particular case a representation may fall in different categories. For instance, compared to a listed JSE company with large offices and a website listing its board of directors, a shelf company barely represents anything to the world. The point here is to draw attention to the fact that what a third party actually sees is very different from the picture seen by the company.

reference to the flow of actual authority under a company's constitution, it is clear that the Third Party Perspective is tied closely to the concept of ostensible authority.[504] It should be emphasised that External Domain only includes facts of which a third party has actual knowledge and relied on when contracting with a company and not facts of which a third party merely had constructive notice (which is dealt with in Chapter 6).[505]

The most important thing to realise about the third party perspective, is the unimportance of the corporate constitution to the third party. Unless brought out into the External Domain through actual knowledge, the corporate constitution does not feature at all – a third party relies on other representations when dealing with a company.[506]

5.2 THE GRADUAL SHIFT TO THE THIRD PARTY PERSPECTIVE

What the abovementioned pictures are intended to illustrate is that uncertainty lies at the heart of corporate representation. The company focuses on its perspective, which is rooted in its constitution (the Internal Domain), and the third party on its perspective (the External Domain), which is rooted in representations made to it. These domains may align in any given case, indeed they do in most transactions, but *there is no inherent reason why they should*.

It is not beyond reason to suggest that the law could by decree align these perspectives more closely. That could, for instance, be done by jettisoning the principle of collegiate management and decreeing that individual directors have authority to bind a company to contracts, as is the case with respect to partnerships[507] (and close corporations ('CCs')).[508] If this were to be the case, the perspectives would be much closer – both a company and a third party could rely on the fact that any single director is *ex lege* authorised to contract on behalf of the company (unless, obviously, the third party had knowledge to the contrary). This option is, however, also not free of issues and, in any event, collegiate management has

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[504] Supra para 4.5 and the cases referred to in that paragraph regarding the concept of 'ostensible authority'.

[505] The External Domain should therefore not be confused with the 'external position' of a company identified in *Mahony v East Holyford Mining Co* (1875) LR 7 HL 869 at 893, which would include all of the provisions of a company's constitutional documents, even if a third party did not have actual knowledge of them.

[506] As we shall see in Chapter 6, the injustice of the doctrine of constructive notice lay in its negation of this fact, in that this doctrine attributed 'knowledge' of a company's constitution to third parties which in reality they did not have.

[507] Supra note 165.

[508] Infra para 8.3.2.

always been and remains at the core of company law.[509] Another option is the German *procura*, in terms of which a publicly recorded agent is regarded as having the authority to bind the company.[510] As long as collegiate management forms the basis of corporate representation, however, we should be reasonable in our expectations as to the certainty which general legal principles can produce.

That does not, however, mean that there has been no change towards certainty in English and South African law – there has. This change has just not taken the form of attempting to align the two perspectives. Instead, the changes have sought to *diminish the importance of the Company Perspective* (ie the Internal Domain).

The driver of these changes has been the recognition that third parties are more worthy of protection in a corporate representation scenario than the company. Initially, far more attention was placed on the protection of the company in corporate representation cases, particularly as a result of the ultra vires doctrine. The basic idea was that companies should be entitled to place limits on what their representatives could do and these limits should be effectual against third parties in the real world.[511] Indeed, how else could company funds be secured?[512] Shareholder liability was also initially unlimited, adding another incentive to protect the company. Naturally, the focus was on the Company Perspective (Internal Domain) during this time, with courts focussing heavily on the corporate constitution.

Over time, however, there has been a definite shift from shareholder protection to third party protection.[513] Already in 1971, Naudé noted that the view that the third party was more worthy of protection 'accords not only with modern views on the Continent and elsewhere,

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[509] Ibid.

[510] Stern op cit note 6 at 659.

[511] Dwyer J in *JO Smith & Co v the Standard Bank of British South Africa (Limited)* (1868) 1 Buch 253 at at 268 summed-up this approach, when considering how strictly laws relating to the affixing of seals should be applied to companies: 'it would altogether destroy public confidence in trading companies if shareholders were to be at the mercy of unprincipled persons, who might swear to contracts having been entered into which were not even reduced to writing. I think we ought, therefore, to construe with the utmost strictness the provisions of any statute intended for the protection of shareholders in this respect.'

[512] Stern op cit note 6 at 652.

[513] See Davies & Worthington op cit note 215 para 7-6, Stern op cit note 6 at 655.

but also with regulations in other areas of our law.'[514] Indeed, EU law is staunchly pro-third party.[515]

The reasons for this shift are manifold. First, once limited liability of shareholders was introduced by the UK 1855 Act, the courts could much more easily protect third parties, since shareholders could only lose the money which they had freely invested.[516] Second, the reasonable expectations of honest businesspersons must be protected.[517] To not protect a bona fide third party would not only be unfair, but would substantially reduce the appetite to deal with companies, to the detriment of the economy. Thirdly, it may also be argued that there should be an equitable presumption to the effect that, in a situation where a company's agent has undertaken an unauthorised act, the liability should fall on the company rather than the third party, since it was the company who employed the agent. After all, the company vetted the agent and is in a better position to insure itself against harm caused by the agent.[518] This broad principle was already enunciated in 1700 in *Hern v Nichols*:[519]

> 'for seeing somebody must be a loser by this deceit, it is more reason that he that employs and puts a trust and confidence in the deceiver should be a loser, than a stranger …'

This dictum has been criticised in the context of corporate representation and it certainly falls far short of an absolute rule.[520] However, courts have wielded this principle when justice so demands.[521]

The effect of this shift on corporate contracting has, it is submitted, been two-fold. First, and most obviously, has been the introduction of pro-third party legislative provisions in both

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[514] Naudé op cit note 210 at 506. My translation - original text: '… strook nie alleen met moderne opvattings op die Vasteland nie, maar klop ook met reëlings op ander gebiede van ons reg'.

[515] Infra para 7.2.

[516] Supra para 2.3.1 and see Len Sealy and Sarah Worthington *Cases and Materials in Company Law* 8ed (2008) at 141.

[517] See *First Energy* supra note 371 at 533 and Davies & Worthington op cit note 215 para 7-17.

[518] Naudé op cit note 210 at 507, Stern op cit note 6 at 653-5.

[519] (1700) 1 Salk 289 at 289. See also *Lickbarrow v Mason* (1787) 2 TR 63 at 70: 'We may lay it down as a broad general principle, that, wherever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it.'

[520] See criticism of Lord Keith in *Armagas* (HL) supra note 14 at 780C and Watts op cit note 384 at 37. South African courts have regarded this rule as too widely stated, see *Grosvenor Motors (Potchefstroom) v Douglas* 1956 (3) SA 420 (AD) at 425G-H and *Trust Bank of Africa Ltd v Eksteen* 1964 (1) SA 74 (N) at 89H.

[521] See *Quinn* supra note 361 paras 18 and 29, *Randbank* (Appeal) supra note 336 at 370G and *Bothma* supra note 488 para 31. See also Sonnekus op cit note 419 at 600.

England and South Africa, which seek to directly diminish the importance the Internal Domain in corporate contracting. These sections are analysed in depth in Chapters 7 and 8.

There was, however, a second, more fundamental, change prior to the introduction of those sections. In terms of this shift, courts gradually de-emphasised constitutional authority (ie the Internal Domain) and began to focus more on viewing corporate representation from a the Third Party Perspective 'apart from the articles' (ie the External Domain).[522] This shift was, however, not expressly recognised, but rather played itself out in the answering of another question, namely what the nature of the *Turquand* rule was. This issue is discussed in the next Chapter.

[522] Obadina states, with reference to *First Energy* supra note 517 (my emphasis): 'In some recent cases, however, the courts have been prepared to give the principle of ostensible authority a wider and more flexible application on the ground that 'the reasonable expectations of honest men must be protected'. This shift in judicial policy has generated what can fairly be called a business-convenience model of ostensible authority whereby the outsider will be entitled to enforce a transaction undertaken by a functionary in the absence of actual authority whenever, in the light of the company's conduct considered as whole and trade practice, *it was reasonable for him to assume that the functionary possessed authority in the matter*.' Obadina op cit note 207 at 47.

CHAPTER 6: AN ANCILLARY RULE APPROACH TO THE *TURQUAND* RULE

6.1 INTRODUCTION

This Chapter examines the two nineteenth-century court-made doctrines which directly affected corporate contracting, namely the doctrine of constructive notice and the *Turquand* rule. In particular, this Chapter illustrates that the *Turquand* rule has come to be regarded in English law not as an independent authority giving rule, but as an ancillary rule within the greater inquiry into the (ostensible) authority of corporate representatives. It is submitted that good authority exists for adopting a similar view in South Africa. This 'Ancillary Rule Approach', it is further submitted, ultimately aligns better with the Third Party Perspective of corporate contracting.

6.2 THE DOCTRINE OF CONSTRUCTIVE NOTICE

6.2.1 Development of the doctrine and acceptance in South Africa

English law traditionally had a rather limited view of corporate personality. In fact, one could say that in the middle of the nineteenth century, a company *was only a company* for the purposes shareholders stipulated in its constitution. That, after all, was the effect of the infamous ultra vires doctrine - shareholders could not even ratify ultra vires acts.[523]

The ultra vires doctrine, however, could not properly function without a third party at least having access to the documents in which limitations on a company's capacity could be found. This is where the doctrine of constructive notice played its role.[524] This court-made[525] doctrine essentially held that, because (i) a company was required to file certain documents (including its articles)[526] and (ii) the public had access to those documents, any person

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[523] Contracts ultra vires were simply not binding on companies, regardless of a third party's protestations. See McLennan, JS 'The Ultra Vires doctrine and the Turquand rule in company law – A suggested solution' (1979) 96 *SALJ* 329 at 330 and Oosthuizen op cit note 210 at 2.

[524] See *Oranje Benefit Society v Central Merchant Bank Ltd* 1976 (4) SA 659 (A) at 673A. For a detailed account of the origins of this doctrine, see Oosthuizen op cit note 419 at 15-30.

[525] As noted in Chapter 2, legislation only went as far as requiring disclosure - no legislative provisions actually deemed third parties to have knowledge of the documents so disclosed. See *Oranje Benefit Society* supra note 524 at 672B.

[526] See *Irvine v Union Bank of Australia* (1877) 2 App Cas 366 PC and Davies & Worthington op cit note 215 para 7-8 footnote 20 regarding registration of special resolutions.

dealing with that company was deemed to have notice of those documents, even where they did not have any actual knowledge of the contents of such documents.[527] This did not mean that a third party actually had to read a company's articles, but simply that the third party was affected by the boundaries set in them.[528]

The origins of the doctrine are usually ascribed to the decision of the House of Lords in *Ernest v Nicholls*,[529] but it appears that the concept had already been established by then.[530] The doctrine also appears to have been accepted in South Africa from the very beginning of its corporate law history.[531] Together with the ultra vires doctrine, constructive notice had a devastating impact, but this doctrine also had an effect on intra vires contracts, which is examined in the following paragraph.

6.2.2 A highly artificial doctrine

The doctrine of constructive notice had the very artificial result of binding third parties to the provisions of a company's articles, even if those third parties did not actually know about those provisions. In the terminology of Chapter 5, the doctrine artificially bound third parties to the provisions of a company's constitution, despite those provisions usually being within the Internal Domain. Of course, some of the provisions of a company's articles may have been in the External Domain, by virtue of the third party having actually read those articles, but usually were not.

How can we know that third parties usually did not read company constitutions? First, in many influential corporate representation cases in both South Africa[532] and England,[533] the

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[527] *Ernest* supra note 168 at 419. See also *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) 486 (SCA) par 19, Davies & Worthington op cit note 526 para 7-6 and Cilliers et al op cit note 2 para 12.26.

[528] *Freeman* supra note 10 at 492, *Prinsloo* supra note 260 at 848 and *Wolpert* supra note 196 at 262B.

[529] Supra note 168. See, for instance, *Oranje Benefit Society* supra note 524 at 672B.

[530] See *Smith v The Hull Glass Co* (1852) 11 CB 897 at 927.

[531] See *JO Smith* supra note 511 at 268 and LOP Pyemont *Company Law of the Cape and other South African Colonies* (1906) at 31. See further *Prinsloo* supra note 260 at 848, *Wolpert* supra note 196 at 263H and *Abrahamse v Connock's Pension Fund* 1963 (2) SA 76 (W) at 79G.

[532] The third party did not have actual knowledge of the relevant compay's articles in *Prinsloo* supra note 260 (at 844 and 848), *Mahomed v Ravat Bombay House (Pty) Ltd* 1958 (4) SA 704 (T) (at 706A) or *Mudaliar* supra note 162 (at 60), the articles were not placed before the court in *Perpellief* supra note 3 at 16C and *Burstein v Yale* 1958 (1) SA 768 (W) at 772B and the constitution was not produced nor was there any proof that the third party had read them in *Neffensaan* supra note 29 (paras 26 and 44).

[533] *Kreditbank Cassel GmbH v Schenkers Ltd* (Court of Appeal) [1927] 1 KB 826 (CA) at 828, *Houghton* (CA) supra note 162 at 266, *Rama Corporation Ltd v Proved Tin and General Investments Ltd* [1952] 2 QB 147 at 149 and *Freeman* supra note 10 at 500. See also *Hely-Hutchinson* supra note 14 at 553.

court noted expressly that the third party did not have any actual knowledge of the company's articles. Secondly, the pronouncements of judges confirm this fact. For instance, Pearson LJ in *Freeman* remarked that 'It is true that the plaintiffs in this case did not look at the company's articles of association; *it would have been surprising if they had done so*.'[534] Wright J, in the court a quo in *Kreditbank Cassel GmbH v Schenkers Ltd*, on the question of whether a person dealing with a company would examine a company's articles, remarked: 'In business he would *seldom or never do so*, but take the risk.'[535]

The artificiality of this doctrine was aptly illustrated in *British Thompson-Houston Co Ltd v Federated European Bank Ltd*.[536] In this case the third party had presumably not seen the articles since these were not even placed before the court by either party.[537] The court then *mero motu and after the fact* called for the articles, in order to ascertain what effect the articles would have on the (intra vires) transaction. This strikes one as particularly out of touch – the articles were not relevant to the parties during negotiations, nor was it even relied upon initially in court proceedings, but the doctrine of constructive notice demanded that the articles be procured, as a provision hidden them in may be determinative of the third party's claim.

This doctrine had its most drastic effect (on intra vires transactions) if the articles contained an Exclusion Clause. In such circumstances, the third party, being affected by notice of that clause, could not be heard to say he/she unaware of it and a representative acting in contravention of that clause would not bind the company.[538] So, for instance, imagine a company's constitution expressly required a contract above a certain monetary threshold to be signed by two directors. In theory, a third party concluding such a contract with the company should not be entitled to hold the company bound if the relevant contract was only signed by one director, since it is clear to anyone reading the company's constitution that two signatures are required.

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[534] *Freeman* supra note 10 at 500.

[535] *Kreditbank Cassel GmbH v Schenkers Ltd* (court a quo) [1926] 2 KB 450 at 460.

[536] Supra note 303 at 177.

[537] Ibid and *Rama* supra note 533 at 166.

[538] See *Ernest* supra note 168 at 419, *Mahony* supra note 505 at 894, *County of Gloucester Bank v Rudry Merthyr Co* [1895] 1 Ch 629 (CA) at 633 and *Freeman* supra note 10 at 506. For South African affirmations of this principle, see *J.O. Smith & Co* (supra note 531) at 268, *Wolpert* supra note 196 at 264B, *Perpellief* supra note 3 at 15C, *Neffensaan* supra note 29 para 28.

Constructive notice of an Exclusion Clause precluded a third party from holding a company liable, regardless whether such liability was said to be based on ostensible authority of a representative or the *Turquand* rule.[539] In fact, this situation actually has nothing to do with the *Turquand* rule which, as we shall see, was developed to deal with the situation where a third party is deemed to have knowledge of a provision of a company's constitution which does not on its own disclose lack of authority, but requires further internal formalities to be observed in that regard.[540]

6.2.3 A negative doctrine

Over time, questions arose regarding the exact effect of the doctrine of constructive notice. What did it mean for a third party to be 'deemed to have notice'? Did that mean that a third party was deemed to actually have knowledge of the contents of a company's articles? After a period of uncertainty,[541] the English courts held that the true scope of the doctrine is strictly negative – it only 'operates against the person who has failed to inquire, but does not operate in his favour'.[542] This position has also found support in South Africa.[543]

The reasoning behind this conclusion has partly to do with the origins of the doctrine. The doctrine was intended as a shield to protect shareholders – allowing third parties to use it as a sword goes against the very basis for the doctrine.[544] Furthermore, allowing a third party to place reliance on articles of which he/she was unaware appears contrived, not to mention that it contravenes one of the basic requirements for setting up an estoppel against a company, namely that a person setting up an estoppel must have relied on representations made by the

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[539] See *Amalgamated Union of Building Trade Workers of SA v South African Operative Masons' Society* [1957] 1 All SA 451 (A) at 466. The application of this principle is, however, not as simple as it seems at first blush. In *Service Motor Supplies (1956) (Pty) Ltd v Hyper Investments* 1961 (4) SA 842 (A), for instance, a company was held bound by a lease signed on its behalf, notwithstanding the fact that the lease was not approved unanimously by all of its directors, as was required by the articles of the company. See also *British Houston-Thompson* supra note 536 at 180. Regarding the effect of the ultra vires doctrine on reliance on estoppel, see *Abrahamse* supra note 531. See also McLennan op cit note 523 at 349 and Olivier op cit note 21 at 617.

[540] See *Neffensaan* supra note 29 para 28 and Oosthuizen op cit note 210 at 5.

[541] See *Kreditbank* (a quo) supra note 535 at 460 and *Kreditbank* (Court of Appeal) supra note 533 at 837-8.

[542] *Rama* supra note 533 at 149. See also *Freeman* supra note 10 at 504, *Houghton* (CA) supra note 162 at 253 and the discussion of that case infra para 6.5.2.

[543] *Wolpert* supra note 196 at 263H. See further McLennan op cit note 523 at 343, SJ Naudé 'Company Contracts: The Effect of Section 36 of the New Act' (1974) 91 *SALJ* 315 at 317, Fourie op cit note 538 at 219, Jooste op cit note 9 at 468 and Olivier op cit note 21 at 618.

[544] Montrose 'The apparent authority of an agent of a company' (1934) 50 *Law Quarterly Review* 224 at 237.

estoppel-denier.[545] As we shall see, it was this issue which would prove to be the catalyst which ultimately led to the adoption of an agency-based approach towards the *Turquand* rule in England.[546]

6.2.4 The doctrine's gradual (but not yet total) demise

Unsurprisingly, opinion gradually turned against the artificial doctrine of constructive notice. Some argued for constructive notice to be downgraded to a rebuttable presumption,[547] while others argued for its complete abolishment.[548] Eventually, in the UK, the effect which this doctrine has on the conclusion of contracts has been effectively abolished for some decades.[549] South Africa, too, has now moved to a 'post-constructive notice' phase, although the doctrine has not been abolished in respect of all types of companies.[550] It is, however, still necessary to consider this doctrine and its initial impact on corporate representation, as it was at the centre of the law being developed on this point, and it was the *raison d'être* for the *Turquand* rule, to which we now turn.

6.3 AMELIORATING THE EFFECT OF CONSTRUCTIVE NOTICE: THE *TURQUAND* RULE

6.3.1 The board's conditional authority: the development of the *Turquand* rule

While the effect of the doctrine of constructive notice in respect of Exclusion Clauses may have been obvious enough, its effect in relation to other clauses was not so clear. Take for instance, a clause conferring authority on a board to contract on behalf of a company, but making such authority subject to shareholder approval (ie a Reserved Matters Clause). A person looking at a company's articles in such circumstances can only deduce that the board *may* have authority to act; provided its authority is perfected by the shareholder approval.

This issue was canvassed in the famous case of *Royal British Bank v Turquand*.[551] In this case two directors acting under the seal of the relevant company issued a bond for £2,000 on

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[545] Supra para 4.5.5.

[546] Infra para 6.5.2.

[547] Naudé op cit note 210 at 509, Oosthuizen op cit note 210 at 14.

[548] McLennan JS 'Time for the Final abolition of the Ultra Vires and Constructive Notice Doctrines in Company Law' (1997) 9 *SA Merc LJ* 333. See also Stern op cit note 6 at 657.

[549] Infra para 7.3.4.1.

[550] Supra para 1.3.3.

[551] [1855] 5 E&B 248 affirmed by Exchequer Chamber in *Royal British Bank v Turquand* [1856] 6 E&B 327.

behalf of that company to a bank. Article 50 of the registered deed of settlement of the company, of which the bank was deemed to have notice, conferred authority on the board to enter into loan agreements in the name of the company, but subject to authorisation by shareholders.[552] When the bank sued the company on the bond, the company averred that it was not liable, as the directors had not been authorised by a general resolution of the shareholders to issue the bond, as was required by article 50.[553]

The court a quo[554] held the company bound under the bond, but the matter went on appeal to the Exchequer Chamber, which unanimously affirmed the decision of the court a quo. Jervis CJ, in an approach which foreshadowed the agency-based approach which would become the staple in later judgments on corporate representation, sought to enquire whether the directors in casu did not have actual authority (although he did not use that term) to issue the bond.[555] The court, however, decided that the company should be held bound, not based on the actual authority of the directors, but on the basis that the bank was entitled to assume in the circumstances of the matter that the shareholders resolution required by the articles had been passed. The court's approach was summed-up in a passage which has become part of corporate law folklore:[556]

> 'We may now take for granted that the dealings with these companies are not like dealings with other partnerships, and that the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. And the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorizing that which on the face of the document appeared to be legitimately done.'[557]

At its core, this 'right to infer' represented a limitation of the doctrine of constructive notice – third parties were deemed to have knowledge of a company's constitution, but deemed knowledge of a clause granting conditional authority would not be interpreted against a third party, but in its favour.[558] This favourable interpretation entailed that, instead of

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[552] See *Turquand* (a quo) supra note 551 at 252.

[553] *Turquand* (EC) supra note 551 at 329.

[554] Regarding the court a quo's reasoning, see *Turquand* (a quo) supra note 551 at 261-2.

[555] *Turquand* (EC) supra note 551 at 332. A resolution passed at a general meeting of the company had been set forth in the replication, in terms of which the directors were authorised to borrow on bond such sums for such periods and at such rates of interest as they might deem expedient. The Judge expressed an opinion, without deciding, that such resolution may in and of itself have been enough to bind the company.

[556] Ibid.

[557] Compare this to the more limited dictum of the Court a quo (supra note 551) at 262.

[558] Davies & Worthington op cit note 215 para 7-7.

deemed knowledge of a conditional authority clause placing a third party on notice and requiring that third party to enquire whether the authority had been made unconditional, the third party would be entitled to assume that it had.

This rule – which was to become known as the *Turquand* rule or 'indoor management rule' -[559] was affirmed by the House of Lords in *Mahony v East Holyford Mining Company* (albeit in somewhat more general terms).[560] The rule was also accepted in South African law, at least from early in the twentieth century.[561] South African courts have also frequently referred to English cases when interpreting this rule.[562]

6.3.2 Extension to other types of internal formalities

While the *Turquand* rule may have been developed in the context of a board exceeding its conditional authority when concluding a contract, its application was not limited to such circumstances. In fact, the rule is usually stated as protecting third parties against any internal irregularities in respect of a company and not just the board exceeding its authority; provided that a third party may only rely on the rule if it was acting bona fide.[563] So for instance, the *Turquand* rule has been applied to hold a company bound where the relevant internal formality which was not complied with was the formal appointment of directors[564] or quorum for a board meeting.[565] In the terminology of Chapter 5, it may be said that the *Turquand* rule does not only apply to Reserved Matters Clauses, but also to other more 'procedural' clauses.

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[559] Infra note 560.

[560] Supra note 538 at 893-4.

[561] See *Paddon & Brock Ltd v Nathan* [1906] TS 158 at 163-4, *Legg & Co v Premier Tobacco Co* [1926] AD 132 at 143-4, *Prinsloo* supra note 260 at 845, *Silver Garbus & Co (Pty), Ltd v Teichert* [1954] 1 All SA 191 (N) at 197-8; *Potchefstroom se Stadsraad v Kotze* 1960 (3) SA 616 (A) at 621, *Wolpert* supra note 196 at 261A and *Perpellief* supra note 3 at 15D.

[562] See, for instance, *Prinsloo* supra note 260 at 848, *Neffensaan* supra note 29 paras 22 and 33 and *Roodepoort Settlement Committee v Retief* [1951] 1 All SA 247 (O) at 252-3.

[563] Infra note 765.

[564] See *Mahony* supra note 505, *Biggerstaff v Rowatt's Wharf Ltd* 1896 (2) Ch 93 (CA) at 94, *Duck v Tower Galvanising Co* [1901] 2 KB 314, *Re County Life Assurance* (1870) 5 Ch App 288 and *Roodepoort* supra note 562 at 252. See also Pennington op cit note 299 at 133.

[565] See *County of Gloucester Bank* supra note 538 and *Duck* supra note 564. See, however, *D'Arcy v The Tamar, Kit Hill, and Callington Railway Co* (1866) LR 2 Exch 158 and the comments thereon in *County of Gloucester Bank* at 632. See also *Roodepoort* supra note 562 at 253.

6.3.3 Limitations on the *Turquand* rule

Some limitations to the *Turquand* rule crystallised over time. First, a third party who actually has knowledge of an authority-related internal irregularity when contracting with a company will not be able to rely on the *Turquand* rule.[566] This limitation may actually amount to no more than an example of a third party not acting in good faith.[567] Secondly, if the circumstances are such that the third party has been put on notice or inquiry in relation to the board's lack of authority.[568] Of course, the necessity of these inquiries will depend on the circumstances – the more strange the conduct of the company's representatives, the greater need for inquiries to be made.[569]

It has also been held that the *Turquand* rule does not apply to forgeries –[570] it only applies to 'irregularities that otherwise might affect a genuine transaction'.[571] Finally, it has been held, at least in South Africa, that the *Turquand* rule cannot have the effect of allowing a transaction in contravention of a requirement for shareholder consent set by legislation (as opposed to an internal requirement in a company's articles), in particular in relation to the disposal of a company's business.[572]

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[566] *Prinsloo* supra note 260 at 845; *Burstein* supra note 532; *Wolpert* supra note 196 at 266F; *Levy v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (W) 487B-C and *Paddon* supra note 561 at 164. Pennington op cit note 299 at 130; Blackman et al op cit note 2 at 4-34-1; Cilliers et al op cit note 2 para 12.31; Oosthuizen op cit note 210 at 10 and Delport op cit note 3 at 135.

[567] See Oosthuizen op cit note 419 at 256.

[568] See *Mahony* supra note 505 at 895, *B Liggett (Liverpool) Ltd v Barclays Bank Ltd* [1928] 1 KB 48 at 56, *Morris v Kanssen* [1946] AC 459 at 475, *Big Dutchman* supra note 362 at 280B-C; *Wolpert* supra note 196 at 266G, *Quintessence Opportunities Ltd v BLRT Investments Ltd; BLRT Investments Ltd v Grand Parade Investments Ltd* 2007 (6) SA 523 (C) at 531G and *Dicks* supra note 305 at 509B.

[569] See *Liggett* supra note 568 discussed infra note 718. Another example is *A L Underwood Ltd* supra note 342. In that case it was held that a bank was put on enquiry by the fact that the director of a one-man company was depositing cheques for the company into his personal bank account.

[570] *Ruben* supra note 306.

[571] *Ruben* supra note 306 at 443. The real position is, however, far from simple. In particular, issues have arisen regarding what exactly constitutes a forgery See *Northside Developments* supra note 223 at 199 et seq, *Afrasia Special Opportunities Fund (Pty) Ltd v Royal Anthem Investments 130 (Pty) Ltd* 2016 JDR 1366 (WCC) para 41 and *Kreditbank* (CA) supra note 533 at 838-40.

[572] Infra paragraph 8.6.

6.4 THE NATURE OF THE *TURQUAND* RULE: TWO DIVERGENT APPROACHES

The juridical nature of the *Turquand* rule has been the subject of debate for over a century and its ambit has never really been conclusively settled.[573] Two dominant strains of thought have crystallised regarding the nature of the *Turquand* rule, namely the 'Ancillary Rule Approach' and the 'Independent Basis Approach'.[574] These two approaches are briefly sketched in this paragraph, with more detail to follow in the subsequent paragraphs.

6.4.1 The Ancillary Rule Approach

The Ancillary Rule Approach accepts that, since agency forms the basis of corporate representation, corporate liability for contracts needs to be governed by the 'first principles'[575] of agency (ie actual and ostensible authority).

The *Turquand* rule finds application in situations where a company can point to some internal formality not having been complied with, which means that in such circumstances, from an agency perspective, actual authority is usually lacking.[576] The Ancillary Rule Approach is therefore heavily focussed on company liability based on estoppel/ostensible authority, although it should be kept in mind that this approach leaves room for actual authority to be proven in any given case. In fact, because estoppel is not a cause of action in and of itself, the third party will usually assert actual authority in the first instance and thereafter meet a company's denials of actual authority with reliance on estoppel.[577]

The *Turquand* rule is therefore regarded, on the Ancillary Rule Approach, as playing an ancillary role in the greater (ostensible) authority inquiry. The function of the *Turquand* rule in this enquiry is negative and narrow: a company may not assail the ostensible authority of its corporate representative by pointing out that (i) the third party had constructive knowledge of an internal formality, contained in the company's constitution and (ii) such formality had not been complied with. McLennan describes this role succinctly: 'an estoppel set up against

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[573] Wright J in *Liggett* supra note 568 at 56 understated the issue when he described the *Turquand* rule as 'perhaps somewhat ambiguous'.

[574] See Jooste op cit note 9 at 465 and Van der Linde op cit note 28 at 833.

[575] See the quoted passage from *Mudaliar* infra 633. In *Freeman* (supra note 10 at 502) Diplock J endeavoured to restate the law 'upon a rational basis'.

[576] Supra para 4.4.5.

[577] Supra note 431. See also Oosthuizen op cit note 419 at 117.

a company is not defeasible merely because some internal formality has not been complied with.'[578]

The basis upon which the company is held bound, however, remains the ostensible authority of its agent and not the *Turquand* rule. Dawson J in *Northside Developments*[579] explained it thus:

> '… the indoor management rule only has scope for operation once it can be established independently that the person purporting to represent the company had actual or ostensible authority to enter into the transaction. The rule is thus dependent upon the operation of normal agency principles …'[580]

The *Turquand* rule therefore does not itself give any authority to a corporate representative – it only acts once the (ostensible) authority of a corporate representative has been established.

The extreme version of the 'Ancillary Rule Approach' suggests that the *Turquand* rule actually 'has no meaningful existence' and that '… there is nothing in the *Turquand* rule which cannot be arrived at by a sensible application of the agency concept of apparent authority.'[581] Generally, however, there is no reason not to grant the *Turquand* rule status as an independent rule under the Ancillary Rule Approach; provided that the operation of such rule is limited and does not constitute an independent basis of liability.

6.4.2 The Independent Basis Approach

The Independent Basis Approach regards the *Turquand* rule as an independent equity-based rule (selfstandige billikheidsreël) of company law, which constitutes a separate basis of liability to that of the 'first principles' of agency law.[582] So, if a third party invokes the *Turquand* rule and satisfies the requirements of that rule, the company may be held bound to that contract based on the *Turquand* rule alone – it is not necessary to make any reference to the authority of corporate representatives.[583]

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[578] McLennan op cit note 210 at 150.

[579] Supra note 223 at 198.

[580] Again, McLennan (op cit note 523 at 348) is worth quoting: 'The truth emerges that the *Turquand* rule is not a positive rule of law: it has purely negative operation and does not come into play unless the basic requirements of estoppel have been met …. The *Turquand* rule is not a substitute for the fundamental principles of the law of agency.'

[581] See Ben Pettet *Company Law* 2ed (2005) at 138 and 135, respectively.

[582] Lombard & Swart op cit note 467 and Oosthuizen op cit note 210 at 6.

[583] Du Plessis op cit note 210 at 283.

While no agency principles therefore have to be invoked in order to hold a company bound based on the *Turquand* rule, the rule's application does not preclude the application of those principles. In fact, the Independent Basis Approach freely acknowledges that agency principles set the general framework for corporate representation - what the *Turquand* rule represents is a company law-specific *adjustment*[584] to, or an offshoot from,[585] the underlying principles of agency. In whatever way it may be classified, it is clear that on this approach *Turquand* rule and agency principles are actually 'competing alternatives' – a company may be held bound under *either* the *Turquand* rule *or* ostensible authority.[586] Generally, however, it is said that estoppel has substantially more difficult requirements than the *Turquand* rule.[587] The fact that there are two competing bases for company liability is seen as a distinct advantage, since a third party gets to choose between two remedies when holding a company liable for the acts of an unauthorised representative.[588]

6.5 THE ADOPTION OF AN ANCILLARY RULE APPROACH IN ENGLISH LAW

6.5.1 General

There is little doubt that today English law primarily follows an Ancillary Rule Approach. The reason is, first and foremost, that the courts have followed the Ancillary Rule Approach set out by the Court of Appeal in *Freeman*.[589] Secondly, it is accepted that the statutory amendments in that country have supplanted the *Turquand* rule to a large degree.[590] The rule has, however, not been dealt any conclusive death blow and, perhaps, such a blow will never arrive. An Ancillary Rule Approach is also followed for the same reasons in Australia.[591] This paragraph seeks to explain how English law came to accept such a system.

6.5.2 Confusion in England? The *Turquand* rule and Power-to-Delegate Clauses

Gradually, corporate representation cases came to be dominated by cases dealing, not with actions of collective boards, but with actions of single corporate representatives, usually (de facto or de jure) managing directors.[592] How constructive notice and the *Turquand* rule would

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[584] Oosthuizen op cit note 210. See also *Simon* supra note 235 at 528E.

[585] Du Plessis op cit note 210 at 283.

[586] Cassim & Cassim op cit note 283 at 660, Oosthuizen op cit note 210 at 9, Du Plessis op cit note 210 at 291 and Lombard & Swart op cit note 467 at 667.

[587] Oosthuizen op cit note 210 at 9, Du Plessis op cit note 210 at 291, Lombard & Swart op cit note 467 at 667 and Cassim & Cassim op cit note 283 at 660.

[588] Du Plessis op cit note 210 at 291, Cassim & Cassim op cit note 283 at 660.

combine in these situations was far from clear, especially given the fact that a managing director is usually not directly given any powers under a company's articles. As noted earlier, articles would usually contain Power-to-Delegate Clauses, which meant that, unlike in the case of the board, power still had to be delegated to a managing director before he/she could bind the company.

This issue came to the fore in a series of cases in the English Court of Appeal between 1927 and 1932 (and two lower court decisions thereafter). In *Houghton & Co v Nothard, Lowe and Wills Ltd*,[593] *Kreditbank Cassel GmbH v Schenkers Ltd*[594] and, later in *Rama Corporation Ltd v Proved Tin and General Investments Ltd*[595] the court was faced with a similar argument from a plaintiff wishing to hold a company bound to a contract. In each case, the plaintiff had no actual knowledge of the company's articles, but averred that the company was bound based on the following logic: [596]

1. a third party is deemed to have knowledge of a Power-to-Delegate Clause;
2. the delegation of authority to a particular corporate representative is an internal formality;
3. based on the *Turquand* rule, a third party may, as long as it was acting in good faith, assume that internal formalities had been complied with; and

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[589] Supra note 14. Roskill J, for the court a quo in *Hely-Hutchinson* (supra note 14 at 562E) summed-up of the English judiciary post-*Freeman* adequately: 'The cases on this branch of the law are numerous, and until recently they were by no means easy to reconcile. They extended over more than a century and, until the recent decision of the Court of Appeal in [Freeman] were by no means easy to understand. But I am absolved from any detailed consideration of the earlier cases by the fact that in the *Freeman* case the Court of Appeal exhaustively reviewed and analysed those earlier cases, and laid down, in terms which are binding upon me, what the law applicable to this part of the case is.' As recently as 2018, the Court of Appeal stated that the law relating to the authority of agents is authoritatively set out in *Freeman* and *Hely-Hutchinson* – see *Ukraine s*upra note 285 para 78. See also Pettet op cit note 581 at 138, Cassim & Cassim op cit note 283 at 657 and Derek ADE Obadina 'Statutory reformations of the rule in Turquand in Commonwealth jurisdictions' *International Company and Commercial Law Review* (1997) 8(5) 158 at 159.

[590] Davies & Worthington op cit note 215 para 7-9.

[591] See *Northside Developments* supra note 223 at 159 and 199 and *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising & Addressing Co Pty Ltd* (1975) 133 CLR 72 at 78. See also Jooste op cit note 9 at 465.

[592] Infra para 6.6.5 in this regard.

[593] Supra note 162.

[594] Supra note 533. In this case a branch manager of a company had endorsed bills on behalf of that company in favour of a company in which he held an interest.

[595] Supra note 533.

[596] See *Houghton* (CA) supra note 162 at 252 and *Kreditbank* supra note 533 at 841 and 842 for further formulations of this argument.

4. the third party may therefore assume that power had been delegated to the relevant representative to conclude the contract and the company was therefore bound.

In each case, the court rejected this argument and held that the third party could not use its constructive notice to validate the transaction. In *Houghton* the Court of Appeal[597] per Sargant LJ said:[598]

> 'I cannot for myself see how they can subsequently make use of this unknown power so as to validate the transaction. They could rely on the fact of delegation, had it been a fact, whether known to them or not. They might rely on their knowledge of the power of delegation, had they known of it, as part of the circumstances entitling them to infer that there had been a delegation and to act on that inference, though it were in fact a mistaken one. But it is quite another thing to say that the plaintiffs are entitled now to rely on the supposed exercise of a power which was never in fact exercised and of the existence of which they were in ignorance at the date when they contracted. No case was cited to us in which a binding obligation has been constructed out of so curious a combination; and I cannot see any principle on which an obligation could be so constructed.'

In *Kreditbank* court regarded itself as being bound by *Houghton* to dismiss any argument on behalf of plaintiff bank that, because directors had the power to delegate the authority to the branch manager to endorse bills, the bank was entitled to assume that authority had been so delegated.[599] Atkin LJ, however, went further and commented on the 'true limits' of *Houghton*. The Lord Justice noted that a third party which has constructive notice of a Power-to-Delegate Clause is not, without making inquiries, in any position to tell whether authority had been delegated pursuant to that clause.[600] However, in certain circumstances such enquiries did not have to be made:[601]

> 'If you are dealing with a director in a matter in which normally a director would have power to act for the company you are not obliged to inquire whether or not the formalities required by the articles have been complied with before he exercises that power. Those are matters of internal management which an outsider is not obliged to investigate.'

In *British Thompson-Houston Co Ltd v Federated European Bank Ltd*,[602] however, the Court of Appeal appeared to allow a delegation argument. In this case, a guarantee had been signed on behalf of a company by its chairman. The articles of the company, naturally, contained a Power-to-Delegate Clause. The third party had not, however, had any actual

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[597] *Houghton* was affirmed by the House of Lords ([1928] AC 1 (HL)) entirely on agency principles.

[598] *Houghton* (CA) supra note 162 at 266.

[599] *Kreditbank* (CA) supra note 533 at 842-3.

[600] Ibid at 844.

[601] Ibid. Another example noted was where the articles conferred a power on the board do a certain act and there purports to be a resolution authorizing by the board authorising that act.

[602] Supra note 303.

knowledge of such a clause. All three judges held that the company was bound by the contract. Scrutton LJ expressly relied on the dictum of Atkin LJ quoted above and held that, on the facts of the case, the chairman was acting normally in the affairs of the company. No inquiry was therefore necessary and the third party could assume that the power had been delegated. To this may be added *Clay Hill Brick and Tile Co Ltd v Rawlings*[603] in which, based on *British Thompson-Houston*, it was held that a person dealing with a company could assume that its chairman (who was acting as managing director) had the authority delegated to him (pursuant to a Power-to-Delegate Clause) to receive money on behalf of the company.[604]

The earlier case of *Biggerstaff v Rowatt's Wharf Ltd*,[605] too, could be seen as supporting the delegation argument. In this case a company was held bound to a contract entered into by its (de facto) managing director, despite that managing director not having been formally appointed and no authority having actually been delegated to that director. Lindley LJ said (my emphasis):[606]

> 'Here the articles enabled the directors to give to the managing director all the powers of the directors except as to drawing, accepting, or indorsing bills of exchange and promissory notes. The persons dealing with him must look to the articles, and see that the managing director *might have* power to do what he purports to do, and that is enough for a person dealing with him bonâ fide.'

What was going on here? It seemed as though one line of cases (*British Houston-Thompson, Clay Hill and Biggerstaff*) allowed third parties to assume a delegation of authority without having actual notice of a company's articles, while the other (*Houghton, Kreditbank* and *Rama*) did not. Upon closer analysis, however, it becomes clear that whether the transaction was unusual, either in and of itself, or in respect of the position held by the relevant corporate representative was of fundamental importance in these cases.[607]

The position, however, remained uncertain. Slade J in *Rama* certainly thought that the decisions were conflicting and other judges,[608] also in South Africa,[609] agreed. What no doubt

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[603] Supra note 303.

[604] At 106.

[605] [1896] 2 Ch 93 (CA).

[606] *Biggerstaff* supra note 564 at 102. See also Kay LJ at 106.

[607] See, for example, *Houghton* (CA) supra note 162 at 267, *British Thompson-Houston* supra note 303 at 183 and *Kreditbank* supra note 533 at 844.

[608] Supra note 589.

[609] Infra note 631.

added to the difficulty was the practice of each judge giving a separate opinion, which led to a plethora of opinions on this matter.[610] Furthermore, certain judges approached the case from a stronger agency-based perspective, undermining the idea of an independent *Turquand* rule.[611] This is not to say that the abovementioned judgments were not correctly made on their facts, nor that these judgments did not already establish the principles which *Freeman* would be based on. What was needed was a systematic exposition of principles underlying corporate representation, which is what *Freeman* delivered.

6.5.3 *Freeman* and the triumph of the Ancillary Rule Approach in English Law

In *Freeman* the Court of Appeal applied the ordinary principles of agency and held a company bound to an instruction given by its (de facto) managing director, based on his ostensible authority. The real value of this seminal judgment, however, is threefold. First, it placed corporate representation in English law firmly within an agency paradigm, adopting in essence an Ancillary Rule Approach to the *Turquand* rule. Secondly, it reconciled the apparently conflicting decisions referred to in the previous paragraph with reference to agency principles. Thirdly, it authoritatively restated the agency principles applicable to corporate representation. What will be focused on here are the first two elements, as the third has already been dealt with in Chapter 4.

The court in *Freeman* first set about explaining the previous cases strictly with references to the principles of agency.[612] Once the previous cases were analysed through the lens of ostensible authority, the judges thought that the conflicts between the cases became more apparent than real.[613] The key to understanding the cases, according to the court, was to note that, where third parties were successful (ie *Biggerstaff*, *British Thomson-Houston* and *Clay Hill*), the relevant corporate representative was performing an act which fell within the usual

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[610] Between *Houghton*, *Kreditbank*, *British Thompson-Houston* and *Biggerstaff* there were 11 opinons, just in the Court of Appeal.

[611] See judgments of Bankes LJ in *Houghton* (CA) supra note 162 at 260, Lord Carson in *Houghton* (HL) supra note 597 at 33 and Greer LJ in *British Houston-Thompson* (supra note 536 at 182). See also *Wolpert* supra note 196 at 268H and *Mudaliar* supra note 162 at 56 in this regard.

[612] So, for instance, Wilmer LJ (*Freeman* supra note 10 at 494) stated that *Houghton* (CA) (supra note 162), *Kreditbank* (supra note 533) and *Rama* (supra note 533) as 'no more than illustrations of the well-established principle that a party who seeks to set up an estoppel must show that he in fact relied on the representation that he alleges.' Diplock LJ (at 506) thought that the confusion which had crept into the decisions were as a result of courts not properly distinguishing between the different requirements of ostensible authority (estoppel). See also at 509.

[613] *Freeman* supra note 10 at 493-4 and 508.

authority of his position, while in the cases where the third party failed (ie *Houghton*, *Kreditbank* and *Rama*), the corporate representative was not.[614]

In the cases where the companies were held bound to the relevant contracts, the third party was *not relying on the articles* but on the fact that the corporate representative was acting within his/her usual authority.[615] As discussed in Chapter 4, under agency law, when a principal appoints someone to a particular position (or de facto allows that person act in a certain position), that appointment (or acquiescence) amounts to a representation by the principal that the representative is authorised to do all the acts which fall within the usual authority of that position.[616] In these cases therefore, the third party was, by dealing with a corporate representative within his/her usual authority, actually relying on a representation by those who had actual authority to manage a company's business (usually the board).[617]

This point is of fundamental importance because it exposes the true limits of the *Turquand* rule. The parties in the successful cases (and in *Freeman*) were not holding a company bound because the *Turquand* rule allowed them to assume that the delegation had been made under the relevant Power-to-Delegate Clause. The companies were bound because the third party relied on the conduct of those with actual authority (usually the board) to represent a company in allowing a person to deal on behalf of that company, quite 'apart from the articles'.[618]

The only real influence of the articles in these circumstances on a third party's position would be if they contain an Exclusion Clause, in which case a third party would not be able to rely on the ostensible authority of the corporate representative, due to the operation of the doctrine of constructive notice.[619]

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[614] Ibid at 493 and 507.

[615] See *Freeman* supra note 10 at 493 and 507.

[616] Supra para 4.5.3.

[617] See *Freeman* supra note 10 at 506.

[618] See *Rama* supra note 533 at 165: 'It is possible to have ostensible or apparent authority, apart from the articles of association. You cannot have one inconsistent with the articles of association or beyond the articles of association, but a company can hold out by correspondence a person as holding authority which he does not, in fact, possess, to third persons dealing with him in good faith.' See also Montrose supra note 544 at 235: 'But one must distinguish between the apparent authority apart from the articles and the apparent authority in the articles; because, unless there is a positive doctrine of constructive notice of articles, a person who is unaware of the articles cannot set up the apparent authority in the articles.

[619] *Freeman* supra note 10 at 493 and 509.

The dictum in *Houghton* regarding the requirement of knowledge on the part of the third party dealing with a company is simply not applicable in these cases, because the third party is not relying on the articles of the company.[620] A company cannot therefore say that, based on *Houghton*, because a third party did not have actual knowledge of a Power-to-Delegate Clause that third party could not rely on a director's ostensible authority. In the words of Pearson LJ, such an argument would amount to 'legal pettifoggery'.[621]

In the failed cases the situation was very different. Since the relevant corporate representative was acting outside his/her usual authority, that third party could not, without more, be said to have relied on a representation by those within the company with actual authority.[622] Indeed, the third party 'had nothing to go on beyond the fact that in each case power to do the acts relied on might, under the articles of association, have been delegated to the person with whom they contracted.'[623] This meant that the contractor had to establish some other representation and reasonable reliance thereon. In each case, the third party merely sought to rely on constructive notice of Power-to-Delegate Clauses. However, since a party cannot rely on a representation of which it was ignorant, the third parties had to prove their knowledge of those articles.[624] This, the court held, was the proper scope of Sargant LJ's dictum in *Houghton* – when a party is attempting to establish a representation to found the ostensible authority of an agent, that party can only rely on representations of which he/she had actual knowledge. If a person seeks to establish that representation on the articles of the company, it must obviously have had actually known of those clauses. Where a person is dealing with an agent within his/her usual authority, however, the representation is established outside of the articles – the articles can only serve to destroy that representation in the very limited circumstances where they contain an Exclusion Clause.

This all places the *Turquand* rule into perspective. While it may sometimes have been said that a person may assume that authority had been delegated to an agent, the real basis for that assumption was the representations made by the company as to that agent's authority. Only once authority has been so established, may the *Turquand* rule have the effect of precluding

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[620] Ibid at 497 and 500.

[621] Pearson LJ (*Freeman* supra note 10 at 500) was specifically referring to *Rama*, but it is submitted this reference is also appropriate to *Houghton*, since *Rama* expressly followed *Houghton*.

[622] *Freeman* supra note 10 at 508.

[623] Ibid at 494.

[624] Ibid at 506.

the company from raising constructive notice of constitutional provisions against a third party.

6.6 LAYING THE GROUNDWORK FOR AN ANCILLARY RULE APPROACH IN SOUTH AFRICA

6.6.1 Introduction

With very few exceptions,[625] the preponderance of South African commentators have in the past supported,[626] and continue today to support,[627] an Independent Basis Approach. However, the writer believes that there are cogent reasons to question this view. The paragraphs which follow aim to make the case for an Ancillary Rule Approach to be followed in South Africa. This will be done, firstly, by noting the support which the Ancillary Rule Approach enjoys in case law. Thereafter, the reasons given for the Independent Basis Approach will be critically analysed.

Any endeavour like this is subject to an inevitable caveat. It would be wrong to suggest that the cases are always clear, or that there is no authority against an Ancillary Rule Approach. Nor is it suggested here that the agency principles advocated for are faultless in their application.[628] What the writer hopes to show is that there is good authority to support the Ancillary Rule Approach and that such approach is preferable on principle.

6.6.2 *Mudaliar*: South Africa's own *Freeman*?

Two decades before *Freeman*, a two judge bench in the Natal High Court gave judgment in *Insurance Trust and Investments (Pty) Ltd v Mudaliar*.[629] In this case, the court had to decide whether a company was liable for a promissory note executed in its name by its managing director. The two judges unanimously held that the company was not so bound, principally on

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[625] JS McLennan has steadfastly argued for an Ancillary Rule Approach for over four decades, see McLennan op cit note 210 and op cit note 523. More recently, the Ancillary Rule Approach has received support, see Natania Locke 'Neffensaan reg of verkeerd? Estoppel en die Turquand reël' (2017) *TSAR Lieber Amicorum* 150 at 161 and Olivier op cit note 9 at 26.

[626] Oosthuizen op cit note 210 at 7-10, Du Plessis op cit note 210 at 290-294, JJ Henning & Du Plessis JJ 'Kontraksluiting namens 'n vennootskap: 'n ondernemingsregtelike perspektief' (1993) 56 *THRHR* 339 at 345.

[627] See Cassim & Cassim op cit note 283 at 657 and 659; Cassim et al op cit note 11 at 184, Jooste op cit note 9 at 465 and Lombard & Swart op cit note 467 at 659.

[628] See *Northside Developments* supra note 223 at 211.

[629] Supra note 162.

the grounds that the transaction was for the director's personal benefit and that the third party had relied on representations by the director (and not the company).[630]

What is important for present purposes, however, is the exposition of legal principles offered by Broome J and, to a lesser extent Hathorne JP, in his concurring judgment. Broome J lamented the state of confusion which pervaded English law at the time – due in his words to the fact that the courts in England failed 'to recognise as a pure question of estoppel what is in essence nothing else'.[631] This confusion was, according to the judge, starting to seep into South African law.[632] It was therefore necessary to return to the 'self-evident' first principles governing agency (my emphasis):[633]

> 'I would have thought it to be clear on first principles that, apart from cases of ratification or enrichment, a person can *only* be held liable for the act of another professedly done on his behalf if he has *authorised* that other to do that act or if he is *estopped* from denying that other's authority.'

There were therefore only two bases for company liability – actual authority and estoppel. Broome J then proceeded to explain how the inquiries into the existence of actual authority or ostensible authority differed from one another.[634] In the second case, the enquiry is not into the existence of an agency which ex hypothesi does not exist at all, but into the 'representations of the defendant and the state of mind thereby induced in the plaintiff and the plaintiff's actions in consequence thereof.'[635] In other words, focus was shifted away from the question of whether actual authority existed under the articles, to what was represented to the third party 'apart from the articles' (that is, in the External Domain).

Broome J's invocation of orthodox agency principles left no room for the *Turquand* rule as an independent basis for liability. Indeed, the learned judge, foreshadowing *Freeman*,[636] was

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[630] The court found (at 59-60), first, that the relevant director had no actual authority to sign the promissory note, as a directors' resolution had been passed requiring two signatures for promissory notes. Neither, did the court find, had the director been held out by the company as authorised to issue the promissory note its behalf. Factors which supported this conclusion was the unusual circumstances related to the issuing of the promissory note: it was issued by the director at his house (not at the company's offices), the loan was paid in cash to the director (and not the company) and the promissory note was typed out by the director there and then, the third party had therefore merely relied on representations by the director and not by the company.

[631] *Mudaliar* supra note 162 at 54.

[632] Ibid at 54. See also Hathorn JP at 61.

[633] Ibid at 53-4. This approach was concurred in by Hathorn JP (at 61): 'My view is that the law relating to the branch of agency … is perfectly clear, whether it be applied to companies or natural persons. The principal is liable in two cases only. First, where there is an actual authority, express or implied. Second, where the principal is estopped from denying the authority of the agent.'

[634] Ibid at 54.

[635] Ibid. See also Hathorn JP (at 61-2).

of the opinion that all of the English cases where companies had been held liable for acts done without actual authority 'were all properly cases of estoppel'.[637] The court acknowledged that the earlier cases spoke of 'bona fides' and 'being put upon enquiry' instead of merely asking whether the third party was in fact misled by a representation made by the company. While these issues could, according to the court, be relevant, they were only relevant in a secondary way and did not did not affect the main inquiry, which was into whether a representative was actually or ostensibly authorised. The court stated:[638]

> 'If it appears that the plaintiff was not bona fide, it follows that he was not misled by the representation. If it appears that the plaintiff was put upon enquiry, that may have an important bearing upon the meaning and effect of the representation. But in either case the use of the phrases is misleading, because it tends to conceal the true enquiry which is as to the various elements of an estoppel.'

The court regarded it impossible (and undesirable) to try to approach corporate representation on a casuistic basis, by attempting to set out a series of propositions of law from the cases in which a company will be bound by an act done by one of its officers without actual authority.[639] Instead, all of this may be reduced to a single legal principle, namely estoppel which has to be applied in all the different circumstances. Once this principle is accepted, all difficulty in regard to the plaintiff's knowledge or want of knowledge of the contents of the articles disappears (my emphasis):[640]

> 'It is for the plaintiff to plead and prove the estoppel he relies on. If he relies on the contents of the articles as constituting a representation, he must prove that he knew the contents. *But he may rely on quite a different representation*, for instance, that the company held out a particular officer as having authority. In every case he must, of course, prove, not only the representation, but that he acted upon it to his prejudice.'[641]

On this approach, the focus is on the very basic question: was the third party misled by the company? If he relied on the articles, then those are relevant. If he did not, then they are not. Broome J therefore agreed with the approach taken by Sargant LJ in *Houghton*, to the effect that a third party could not rely on provisions of a company's articles of which he was unaware.

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[636] Supra note 612.

[637] *Mudaliar* supra note 162 at 57.

[638] Ibid at 58.

[639] Ibid at 54.

[640] Ibid at 57.

[641] This was echoed in *Wolpert* supra note 196 at 267A (my emphasis): '… the third party cannot rely on the registered documents of the company … in his favour, unless he knew about them and relied on them …. Such an estoppel could of course also be proved *without a knowledge of or a reliance on the articles*.'

It is tempting to read an 'extreme' Ancillary Rule Approach, which holds that the *Turquand* rule has no meaningful existence, into Broome J's judgment. It is, however, a temptation that should be resisted. It is submitted that the judge simply did not need to decide what remaining role there may be for the *Turquand* rule if it does not constitute an independent basis for liability because the facts of the case could not clear the first hurdle, namely the ostensible authority of the corporate representative. If the *Turquand* rule provides no authority of its own but relies on the ostensible authority of the agent, then there is not much to say about the *Turquand* rule in a case where the corporate representative has been found not to have had authority (actual or ostensible) at all.

While the principles enunciated in this case may not have been novel,[642] Broome J summed-up the situation with brilliant lucidity, at a time when the English courts were grappling with the very same questions. What *Mudaliar* shows is that there exists good authority in South Africa, pre-*Freeman*, of a principled Ancillary Rule Approach.

6.6.3 Other affirmations of the Ancillary Rule Approach

Even before *Mudaliar*, there were some indications of the acceptance of an Ancillary Rule Approach in South Africa.[643] In both *Acutt v Seta Prospecting and Developing Co Ltd*,[644] and *Welgedacht Exploration Co Ltd v Transvaal & Delgoa Bay Investment Co Ltd*,[645] Solomon J appeared to recognise only two bases for company liability, namely 'real authority' and ostensible authority.[646] In the former case, the learned judge even referred to *Mahony*, long considered a case foundational to the *Turquand* rule, as 'an example of the doctrine of estoppel'.[647]

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[642] See *Totterdell* supra note 345 at 677-8.

[643] See also the references to the *Turquand* rule in conjuction with estoppel in *Hoisain v Town Clerk, Wynberg* 1916 AD 236 at 240 and *Salisbury City Council v Donner* [1958] 2 All SA 360 (SR) at 364.

[644] 1907 TS 799.

[645] [1909] TH 90.

[646] In *Acutt* supra note 644 at 813 one of the prerequisites for liability for a contract into by a managing director was 'that the transaction in question falls within the *real or the ostensible authority of the managing director*'. See also at 814-5. See also *Welgedacht* supra note 645 at 103 (my emphasis): 'I cannot, therefore, think that the fact that he conducted the negotiations on behalf of the defendant company gave him any *real authority* to enter into such an agreement … nor can I see that *the directors can be said to have held him out to the plaintiff company* as having such authority.' See also *Mudaliar* supra note 162 at 58 regarding the latter case.

[647] Supta note 644 at 106. Regarding the basis for liability in *Mahony*, see further Watson op cit note 76 para 32 et seq and Locke op cit 625 at 154.

Broome J's approach in *Mudaliar* was substantially accepted in *Wolpert v Uitzigt Properties (Pty) Ltd*.[648] In *Inter-Continental Finance and Leasing Corporation (Pty) Ltd v Stands 56 and 57 Industria* Ltd, too, the court made no mention of the *Turquand* rule as a separate basis for company liability (my emphasis):[649]

> 'A is bound by an agreement purportedly entered into on his behalf by B with C if B had authority from A to enter into that agreement on A's behalf, or if A is precluded from denying such authority by virtue of the principles of estoppel. *Between actual authority and estoppel I can perceive no intermediate situation in which A is bound by B's agreement with C.*'

More recently, in *One Stop Financial Services (Pty) Ltd v Neffensaan Ontwikkelings (Pty) Ltd*, an Ancillary Rule Approach was expressly followed, with the court concluding:[650]

> '… the *Turquand* rule is simply an adjunct, in the context of companies and other entities with constitutions available to the public, of the law on ostensible authority, which is in turn a particular form of estoppel by representation.'

To the chagrin of proponents of the Independent Basis Approach,[651] the abovementioned conclusion was noted, without apparent disapproval, by Wallis AJ in his dissenting judgment in the Constitutional Court in *Makate*.[652]

Furthermore, the SCA (on multiple occasions) and Constitutional Court have accepted the law set out by the English Court of Appeal in *Hely-Hutchinson*, which case is itself expressly based on the Ancillary Rule Approach set out in *Freeman* above.[653] Our courts have also, to a lesser extent, directly accepted *Freeman*.[654] The more our courts pay heed to English

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[648] Supra note 528 at 264D and 269B. The court did, however, qualify its support (at 269B) by remarking that, in its opinion, Broome J should have pointed out that 'in the *Turquand* case the third party dealt with the board of directors and that that case may therefore not have been one of estoppel.' If the court merely meant to draw attention to the fact that the board of a company usually has wide-ranging powers and that a third party may be justified in dealing with it, then the comment is supported. However, if the court meant (see at 267G) that a board's authority can never be restricted and the board will always act with actual authority, then the qualification is not supported. It is clear that the articles can limit even the board's authority – after all the Board's General Authority Clause envisaged just that.

[649] Supra note 210 at 748F.

[650] Supra note 29 para 25. Other cases which have remarked on the connection between authority and the Turquand rule include *Sebenza Shipping & Forwarding (Pty) Ltd v Passenger Rail Agency of South Africa SOC Ltd* 2019 (2) SA 318 (GJ) para 16-17, *Milne NO v Fabric House (Pty) Ltd* [1957] 3 All SA 214 (N) at 217, *Hudson & Another v SA Airways SOC Ltd* (2015) 36 ILJ 2574 (LAC) para 8 and *Blue IQ Investment Holdings (Pty) Ltd v Southgate* (2014) 35 ILJ 3326 (LAC) para 32.

[651] Cassim & Cassim op cit note 283 at 659 referred to Wallis AJ's statement as 'most regrettable and disappointing'.

[652] *Makate* (CC) supra note 8 para 110.

[653] Supra note 347.

[654] See *Neffensaan* supra note 29 para 24, *Cape Produce* (a quo) supra note 270 at 47 (confirmed on appeal supra note 288) and *African Life Assurance* supra note 344 at 452. See further *S v Smith* 1985 (2) SA 70 (T) at 72E.

authority on corporate representation, the harder ignoring an Ancillary Rule Approach will become.[655]

The cases cited above show that the Ancillary Rule Approach has some considerable pedigree in South African case law. That is not to say that there aren't cases which conflict with the Ancillary Rule Approach.[656] Given the apparent incongruence between the cases, it is necessary to go deeper and consider the underlying principles at work, which is what the next paragraphs attempt.

6.6.4 The *Turquand* rule's dependence on usual authority in single representative cases vindicates the Ancillary Rule Approach

In paragraph 6.5.3 we noted that it was the recognition of the importance of 'usual authority' to determining whether a company should be held bound to an unauthorised contract, which ultimately led English courts to accept an Ancillary Rule Approach. This is not because usual authority is a ground of liability in and of itself[657] or even the only representation on which ostensible authority may be founded, but because it is a key ingredient of establishing ostensible authority in terms of agency law.[658] Once this is recognised, the real position becomes clear – the determining factor is the representation of authority made to the third party, of which usual authority is often (but not always) the most important, not the application of an 'independent' *Turquand* rule. It is only once (ostensible) authority has independently been established, that the *Turquand* rule then prevents the company from raising compliance with internal formalities to preclude liability.

Surveying South African case law, it is apparent that the *Turquand* rule has also been subject to usual authority throughout in this country. An excellent example of this is *Acutt*[659] in which a full bench of the Supreme Court of the Transvaal was seized with the question of whether a company was bound by the actions of its managing director. The managing director had entered into a contract with a third party whereby the third party would be paid a commission for finding a 'purchaser' (subscriber) for reserve shares of the company. The

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[655] Proponents of the Independent Basis Approach criticise our courts reliance on English precedent in this regard – see Lombard & Swart op cit note 467 at 659-60.

[656] Infra note 684.

[657] Oosthuizen's remarks in this regard are supported op cit note 210 at 7.

[658] Supra para 4.5.3.

[659] Supra note 644 at 819.

articles of the company contained a clause placing the issuing of the reserve shares under the powers of the board. Furthermore, the articles of the company contained a Power-to-Delegate Clause. Naturally, third party argued that, given that the articles empower the board to issue the reserve shares, and given further that the board may delegate such power to the managing director, the company was bound based on the *Turquand* rule.[660]

While the court did indeed decide that the company should be bound to the contract, it did so with express reference to the principles of agency[661] and, in particular, the ostensible authority of the managing director.[662] Regarding the application of the *Turquand* rule, the court's reasoning is illuminating. The court was distinctly uncomfortable applying the *Turquand* rule if the relevant contract was seen, as it was during counsel's argument on appeal, as a contract for the disposal of reserve shares of the company.[663] However, *once Solomon J characterised the contract as a commission agreement rather than a disposal agreement*, the rule could be applied, because, according to the judge, the power to remunerate any person for services rendered fell within the usual authority of a managing director.[664] This shows the real position with clarity – the articles allowed delegation to the managing director in both cases, but the *Turquand* rule *could only apply if the agreement was a remuneration agreement*, because only that agreement fell within the usual powers of a managing director, whereas a contract for the issuing of shares did not.[665]

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[660] *Acutt* supra note 644 at 815.

[661] Ibid.

[662] Ibid at 819.

[663] Ibid at 816.

[664] Ibid at 818-9.

[665] In *Welgedacht* supra note 645, too, the critical factor in the company's favour was the fact that the relevant agreement was an unusual one (see at 102). Any suggestion that the third party could merely rely on the *Turquand* rule because authority could have been delegated in terms of a Power-to-Delegate Clause was expressly denied. Solomon J stated (at 104): 'But though nearly fifty years have elapsed since the Companies Act of 1862 was passed, there is no decision in the English courts which goes the length of the contention which is now set up on behalf of the plaintiff company, or which decides that, in companies whose constitution contains such an article as the one in question, the company is bound by the acts of a single director, provided that the person dealing with such director has done so in good faith.' In *SA Securities v Nicholas* 1911 TPD 450 Wessels J (at 460), stated with reference to the English case of *Biggerstaff* supra note 564 that (my emphasis) 'anyone who deals with a managing director need only assume that whatever powers the directors *can* give to a managing director have been conferred upon him'. More preferable, it is submitted, is the statement of Bristowe J (at 462) in the same case, which includes a qualification with respect usual authority: 'a person dealing with the managing director is entitled to assume that he has all the powers which *his position as managing director would ostensibly give him*.' See also the learned judge's statement at 463. See also *Natal Land and Finance Corporation Ltd (In Liquidation) v Van Tonder* (1923) 44 NPD 286 at 293.

Gradually, the same usual authority fault line began to appear in South African cases. In two Appellate Division decisions, *National and Overseas Distributors Corporation Pty Ltd v Potato Board*[666] and *Potchefstroom se Stadsraad v Kotze*[667] corporate entities with public constitutions were held bound to unauthorised conduct, mainly because the unauthorised conduct fell within the usual authority of the relevant representative. Conversely, in *Dicks v South African Mutual Fire and General Insurance Co Ltd*,[668] *Wolpert*[669] and *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief*[670] companies were not held bound to contracts based on the fact that the relevant contracts fell outside of the usual authority of the relevant corporate representative. In *Dicks* the court plainly admitted usual authority as a prerequisite for the *Turquand* rule:[671]

> 'But where, as in this case, a person occupying a position which does not apparently qualify him to enter into contracts on behalf of the company, purports to do so, there is not, to my mind, room for the application of the principle enunciated in the *Turquand* case.'[672]

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[666] 1958 (2) SA 473 (A). This case has been cited as authority for the Independent Basis Approach (infra note 683 in this regard). In this case, the manager of the Potato Board, Rust, had mistakenly communicated its acceptance of a tender to a third party and the Board later argued, inter alia, that Rust was not authorised to conclude the relevant contract, because a resolution of the Board had not been passed approving the contract. The court disagreed and held that a contract had been concluded. It is submitted that this case is compatible with the Ancillary Rule Approach, because it is clear that the main issue in this judgment was establishing the ostensible scope of the authorty of Rust (at 478F). Indeed, only once the contract could be placed within his usual authority, was the *Turquand* rule applied (at 480D, my emphasis): 'The contract being one which the respondent could lawfully enter into and Mr. Rust *having been the proper person to make contracts* when an approving resolution by the Board had been passed, it seems to follow *that so far as the outside world was concerned he bound the respondent when he made a contract without such a resolution*. (cf. S.A.I.F. Cooperative Society v Webber, 1922 T.P.D. 49). The [Turquand rule] applies and any mistake that may have occurred and led to the appellant's tender being accepted without a supporting resolution by the Board could not prejudice the appellant. *So far as it was concerned* there was a properly made contract binding on the respondent.' It is moreover interesting to note that the court referenced *S.A.I.F. Cooperative Society*, which case was strictly based on ostensible authority and did not mention the *Turquand* rule.

[667] Supra note 561 at 622-3. In this case it was also clear that, apart from business convenience, the main reason why the city council was held bound to the cancellation of a contract on its behalf by the city clerk, was that the cancellation fell within the usual authority of the city clerk.

[668] Supra note 305 at 509E. In this case the court refused to hold an insurer bound to a policy issued by a clerk acting outside of her usual authority.

[669] In this case, promissory notes were stamped with a company's rubber stamp on behalf of a company by a single ordinary director (with his name appearing below the stamp). The court refused provisional sentence on those notes on the basis that the director did not have (express or implied) actual authority or ostensible authority to sign those promissory notes. See supra note 528 at 267H and 268D.

[670] Supra note 3. In this case, the court refused to hold a company bound to a submission to jurisdiction signed by the company accountant. See also *Hosken* supra note 422 at 190C et seq.

[671] Supra note 305 at 509A.

[672] See also *Nieuwoudt* supra note 527 paras 22-3, where Harms J acknowledged that the *Turquand* rule does not 'without more' allow third parties to assume that a delegation of authority had been made. The 'more' that was needed was the principles of agency. See McLennan op cit note 210 at 148.

In *Wolpert*[673] and *Perpellief* (the latter took general inspiration from the former),[674] the courts distinguished between the different types of corporate representatives, namely the board, the managing director an ordinary director and so on. The whole point of this distinction was, of course, to recognise that certain positions carry certain appearances with them. If a third party deals with someone within the usual authority of their position, then the third party may assume that internal formalities have been complied with, if not, then they cannot make that assumption.[675]

The inquiry regarding usual authority (which forms part of the wider agency inquiry enquiry), however, occurs independently from the *Turquand* rule.[676] So, for instance, in *Perpellief* the following was said, in respect of contracts entered into by representatives other than boards or managing directors (my emphasis):[677]

> '[The *Turquand* rule] only comes into operation once the third party has surmounted the initial hurdle not present in cases [where someone contracts with the board or the managing director] 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*.'

This is completely in line with the Ancillary Rule Approach except that, on first principles of agency, one cannot say that there is no first hurdle in the case of the board or managing director – there is always a hurdle of authority.[678] However, due to the nature of those positions, the first part of the enquiry is muted, because 'it is usual to confer the widest powers of management on those organs.'[679]

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[673] Supra note 528 at 265-6.

[674] *Perpellief* supra note 3 at 15H.

[675] *Wolpert* supra note 196 at 264B: 'If a company's official is acting within the usual authority of that type of agent the company is normally bound and the articles are only relevant if they make it clear that he had no actual authority. If any further formal act of internal management is required this can be assumed to have taken place by reason of the Turquand rule. If the act is outside the usual scope of authority mere knowledge that actual authority might have been conferred on the official is not sufficient to estop the company and the consequences of omnia praesumuntur rite ac solemniter esse acta do not help the third party.' See also *Perpellief* supra note 3 at 15.

[676] See *Wolpert* supra note 196 at 264B.

[677] Supra note 3 at 15F. See also at 18C.

[678] This is acknowledged when the judge in *Perpellief* supra note 3 at 15C said of contracts entered into by the board or managing director (my emphasis): '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.'

[679] *Wolpert* supra note 196 at 267G.

What these cases show is that there is reason to doubt the idea that the *Turquand* rule allows a third party, independently of the principles of agency, to hold a company bound to a contract by assuming that internal formalities have been complied with.[680] While this fact was hidden in cases dealing with collective acts of the board, it gradually became manifest in single representative cases, especially in cases where the single representative was acting outside of his/her usual authority.

The response by adherents to the Independent Basis Approach may be to assert that usual authority is merely yet another requirement for the application of the *Turquand* rule. This was the route taken by Oosthuizen,[681] who argued that usual authority be regarded as another limiting principle ('afbakeningskriterium') to the *Turquand* rule. With respect, the recognition of the importance of usual authority does not square up with the original definition of the *Turquand* rule. Secondly, merely adding usual authority to the list of requirements for the application of the *Turquand* rule fails to explain *why* the usual authority of the corporate representative has proven to be so important – it fails to see usual authority for what it really is. Usual authority, in the context of an ostensible authority inquiry,[682] is a representation made by those with actual authority to the outside world; an image, *an appearance*, which induces third parties to deal with the person appointed to the relevant position. It is that appearance, 'apart from the articles' which was determinative of liability in the cases referred to above, not an independent *Turquand* rule. Again, it is emphasised that usual authority is not the only representation which may found ostensible authority. However, just like in *Freeman*, recognising the importance which usual authority has played in our case law is the key which opens the door to the realisation that the Ancillary Rule Approach is the correct one.

6.6.5 Collective acts of a company's organs (*Prinsloo*)

The main case[683] on which the Independent Basis Approach is founded is *The Mine Workers' Union v JJ Prinsloo*.[684] There are two reasons averred as to why this case is conclusive

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[680] Ibid at 263A-C.

[681] Oosthuizen op cit note 210 at 12-3.

[682] Usual authority also has consequences for the implied authority inquiry - infra 4.4.2.

[683] The other case on which Oosthuizen (op cit note 419 at 114) places heavy reliance is *National and Overseas Distributors* supra note 666 at 480D, although the author does regard *Prinsloo* as 'much clearer'. As indicated supra note 666, the writer is of the view that this case is compatible with the Ancillary Rule Approach. Furthermore, it should be noted that one of the reasons Oosthuizen relied on this case is that negligence was

against the Ancillary Rule Approach. One is that the court did not refer to agency principles when determining the liability of the 'company' in this case. The second has to do with whether actual knowledge is required to rely on the *Turquand* rule versus estoppel. This paragraph only deals with the first of these two grounds – the second ground one is dealt with in paragraph 6.6.6 below.

In *Prinsloo*, the Appellate Division dealt with the validity of actions taken on behalf of a union which was a corporate body with a public constitution. The court had to decide whether the union was bound by an agreement approved by its 'Executive Committee' (akin to the board of a company),[685] despite the fact that the consent of its general council had not been obtained for the sale (as was required by the union's public constitution). The court found the union to be liable without express reference in its legal reasoning to agency principles, even though counsel clashed regarding the nature of the *Turquand* rule.[686] It is submitted that the fact that no agency principles were referred to in *Prinsloo* is, however, not as conclusive as it may first appear, for two reasons.

First, the court in *Prinsloo* was at pains to point out that the present matter was completely covered by *Turquand*'s case, because it was dealing with the *collective action of the 'active organ' of the union* (ie its Executive Committee), which was akin to the board of a company.[687] The court said (my emphasis):[688]

> '… the present case is *wholly covered by Turquand's case and does not depend on* the later extension or development of the rule, evidenced by Mahony's case (supra)[689] and the large number of cases which have since been decided in regard to the question of the due appointment or *authority of a director or directors* who have entered into a particular contract.'

The court was therefore well aware of the distinction between dealing with the collective board of a company and dealing with a single director and it restricted its pronouncements to

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argued before the court, but not considered by the court. Negligence is, however, not a requirement to prove ostensible authority – supra para 4.5.8.

[684] Supra note 260. See Oosthuizen op cit note 419 at 114, Cassim & Cassim op cit note 283 at 658. In *Mahomed* supra note 532 at 706G and 707B the court, referring to *Prinsloo*, stated that: 'It is implicit in the judgment of the Appellate Division that the [*Turquand*] rule is not based on estoppel' and 'the [*Turquand*] rule is not dependent on the requisites for estoppel'. It is however, agreed with the judge in *Wolpert* supra note 196 at 269A that *Mahomed* could be justified on the basis of ostensible authority. See, in particular, the reference to apparent authority in *Mahomed* at 706A.

[685] *Prinsloo* supra note 260 at 848.

[686] Ibid at 833 and 834.

[687] Ibid at 848. See further quotations infra note 698 and 699. See also 846.

[688] Ibid at 847-8.

[689] *Mahony* supra note 505.

the former case.[690] Therefore, even if *Prinsloo* could be read as conclusively supporting an Independent Basis Approach, its effect is limited strictly to collective acts of the board of a company.

Secondly, the fact that the court was dealing with the collective actions of the board, explains why agency principles were not referred to. As noted in Chapter 3, regardless of the jurisprudential approach one might take to the source of the authority of the board, it is accepted that the board is the organ of a company vested with authority to manage a company's affairs.[691] In agency terms,[692] this means that the representation as to the board's authority is so wide as to essentially cover any contract in a company's sphere of business. A court may therefore not even enquire regarding a board's 'usual' authority in such circumstances – the court can simply assume authority and apply the *Turquand* rule to quash any claims from the company that an internal formality had not been complied with. This was explained as follows in *Wolpert*:[693]

> 'The board is ordinarily the organ of a company vested with plenary authority on matters intra vires the company. There is therefore no difficulty in applying the Turquand rule in cases where the board has contracted.'[694]

And in *Neffensaan* (my emphasis): [695]

> 'Since a company's board usually has full authority to conduct its affairs and because the shareholders generally leave the conduct of the company's affairs to the board and thus hold the board out as the company's representative, X will ordinarily be acting reasonably by assuming that the board has authority. And since Turquand does not require X, unless he is put on notice, to investigate whether any condition to which the board's authority in a given instance may be subject has been fulfilled, *the case for ostensible authority is obvious, indeed so obvious that one would tend to explain the outcome solely with reference to the Turquand rule*.'

In *Prinsloo*, the court expressly drew an analogy between the board of directors of a company and the Executive Committee. It is reasonable to assume that, in doing so, the court regarded the Executive Committee, like a company's board, to be in charge of, or at least

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[690] In *Wolpert* supra note 196 at 267C the court lamented a failure to observe that in *Turquand*'s case and *Prinsloo* (supra note 260) the relevant actions were taken by the board and not single directors. See also at 262C and 265D.

[691] Supra para 4.4.2.

[692] Supra para 3.2.3 regarding the application of agency principles to contracts entered into by the collective board.

[693] Supra note 528 at 265G.

[694] See also *Amalgamated Union* supra note 539 at 464.

[695] *Neffensaan* supra note 29 para 29.

heavily involved in, the running of the business of the union.[696] Once this is acknowledged, the Ancillary Rule Approach provides a coherent explanation as to why court did not refer to agency principles – it would have been stating the obvious, given that it was dealing with the collective act of the 'board' of the union.

[696] Regarding the powers of the Executive Committee, see *Prinsloo* supra note 260 at 843.

6.6.6 Actual knowledge and ostensible authority

The court in *Prinsloo* was faced with the same argument which English courts faced post-*Houghton*, namely that, based on Sargant LJ's statement in *Houghton* that a party could not rely on a provision a company's articles sans actual knowledge of that article,[697] the third party in casu could not invoke the *Turquand* rule unless that party had actual knowledge of the company's constitution. The court doubted whether *Houghton* was applicable, because the case before the court fell completely within the ambit of *Turquand*'s case (ie a case where the relevant company acted collectively through its board) and in *Turquand*'s case no mention was made of the third party's knowledge.[698] The court concluded:[699]

> 'I do not think that the validity of a transaction such as the one in question in *Turquand*'s case is to be decided on a subjective basis, depending on whether the other party does or does not know of the constitution or whether - as would follow if the basis were subjective - even though he knew of the constitution, he did or did not apply his mind to the question whether the internal acts of management had been performed. It seems to me that the true position is that the necessary acts of internal management are presumed to have been performed and not that a particular person is entitled to assume that they have.'

Prinsloo has been argued to decisively show the difference between the *Turquand* rule and estoppel. Cassim and Cassim state (my emphasis):[700]

> '… the Appellate Division effectively decided that estoppel does not form the basis of the *Turquand* rule. *This is because the doctrine of estoppel clearly requires the third party to have had actual knowledge of the particular clause (constituting a representation) in the company's constitution*. But on the approach adopted in [*Prinsloo*] the outsider can rely on the *Turquand* rule even if he or she is not aware of the internal formality ….'

Furthermore, the authors contend that, due to South African law following an Independent Basis Approach, 'the third party in that case was protected despite his lack of knowledge of the relevant provision in the company's constitution.'[701]

The authors' statements appear to only leave room for ostensible authority to be rooted in a representation in the articles and not in representations 'apart from the articles'. The writer hopes to have illustrated in the previous paragraphs that, while estoppel would require a third

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[697] Supra note 598.

[698] At 848 (my emphasis): 'In the present case, the authority to purchase the farms was an act of the Executive Committee, which body, like a board of directors, is the active organ of the corporation, and I think that, *at any rate in a matter falling wholly within the limits of Turquand's case*, there is no justification for introducing the qualification propounded by Sargant, L.J.'

[699] Supra note 260 at 849.

[700] Cassim & Cassim op cit note 283 at 658. See also Oosthuizen op cit note 210 at 9.

[701] Ibid at 659.

party to have knowledge of a particular clause in a company's articles *if the third party relied on that clause*, third parties generally do not rely on clauses in articles, but on the ostensible authority of corporate representatives 'apart from the articles'. Holding a company bound based on estoppel is therefore *not* dependent on knowledge of a company's articles – it is based on facts revealed to the third party (ie facts in the External Domain), which may include the articles, *but usually do not*.[702] Estoppel therefore operates perfectly well to protect a third party 'despite his lack of knowledge of the relevant provision in the company's constitution.'

A more fundamental concern is raised by Oosthuizen, to the effect that the court's statement is incompatible with estoppel, because estoppel is based on the subjective knowledge of the third party.[703] This is, of course, true, but the answer to that is that the court was not describing estoppel, it was describing the *Turquand* rule. What the Ancillary Rule Approach argues is that ostensible authority has to be established *independently* from the *Turquand* rule and this may be based on the articles, but is usually based on other representations. Once that is established, constructive notice of internal authority requirements under the articles will not defeat the third party's claim (ie the *Turquand* rule) and this will be the case regardless of whether the third party's estoppel is based on the articles or established 'apart from the articles'.

The court's pronouncements must furthermore be seen in its historical context. The judgment was written in 1948, placing it at the height of the 'confusion' which reigned in English law at the time. The court clearly regarded the English cases to be conflicting, but steered clear of attempting to resolve any conflict, by limiting its pronouncements to cases which fall within the category of *Turquand*'s case (ie cases which dealt with the board acting collectively). As pointed out in *Freeman*, the dictum in *Houghton* (that a third party cannot rely on a provision in the articles of which it is unaware) is only in conflict with the later cases if it is regarded as authority for the 'broad proposition'[704] that reliance on the *Turquand* rule was always dependent on actual knowledge of a company's articles. As has been explained, previously, however, *Houghton* is not authority for that broad proposition – *Houghton* only applied where a corporate representative was acting outside of his/her usual

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[702] Supra paras 6.2.2, 6.5.3 and 6.6.2.

[703] Oosthuizen op cit note 419 at 115.

[704] *Freeman* supra note 10.

authority and a third party sought to establish company liability by *actually relying on the articles of a company*.[705] Had the court had the benefit of *Freeman* (or taken *Mudaliar* into account) the answer would have been much simpler – the third party was relying on the (usual) authority of the Executive Committee and not anything in the constitution of the union, therefore actual knowledge of the constitution was unnecessary and *Houghton* did not apply.

Another issue which requires attention under this heading, is criticism levelled at the following statement made in *Neffensaan* (a pro-Ancillary Rule Approach case) regarding knowledge and ostensible authority (my emphasis):[706]

> 'Without actual knowledge of the articles, [the third party] could not even begin to mount a case for ostensible knowledge *along the lines sketched by Diplock LJ at 647B–F of Freeman*…'

Commentators have interpreted this statement to imply that the judge was of the opinion that knowledge of a company's articles is a prerequisite for holding that company bound based on estoppel.[707] With respect, the words in italics make it clear that the court was not referring to mounting a case for ostensible authority[708] generally, but rather in a very particular situation, namely 'along the lines' sketched by Diplock J at a specific portion of his judgment in *Freeman*. This should already indicate that the judge could not hold the view that knowledge of a company's articles was always a prerequisite for ostensible authority, since *Freeman* goes to great length to distinguish between ostensible authority based on a company's articles (for which knowledge of the articles was required) and ostensible authority 'apart from the articles' (for which knowledge of the articles was required).[709] Indeed, when one turns to the specific reference given by the judge, one finds Diplock J explaining that *where a third party has to rely on the articles because the third party is unable to rely on the usual authority of a representative's position*, then that third party must have knowledge of the articles of the company. In other words, all the court was saying in

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[705] Supra para 6.5.3.

[706] *Neffensaan* supra note 29 para 44.

[707] Locke (who generally supports the Ancillary Rule Approach as set out in *Neffensaan* supra note 29) quotes this passage without including the italicised words and criticises the statement for failing to recognise that ostensible authority may be founded 'apart from the articles'. See Locke op cit 625 at 161. Lombard & Swart op cit note 467 at 666 appear to also take this meaning from the passage.

[708] The reference to 'ostensible knowledge' appears to be an error. The writer suspects that it may have been intended to be a reference to 'ostensible authority', as that was the subject matter of *Freeman* supra note 10 (the phrase 'ostensible knowledge' does not appear in that judgment).

[709] Supra para 6.5.3.

Neffensaan, was that, in casu, no case for ostensible authority *based on the articles* could be made sans knowledge of the articles.[710]

6.6.7 Actual knowledge and the *Turquand* rule

Another argument frequently made by commentators attempts to show the utility of an independent *Turquand* rule with reference to a situation where a third party has actual knowledge of an internal formality to which a corporate representative's authority is subject.[711] In these circumstances, it is argued that, since a third party has such actual knowledge, estoppel will be 'well-nigh impossible'[712] to prove, while reliance on the *Turquand* rule remains available, provided of course neither of the limitations to that rule apply.[713]

With respect, it is submitted that the conclusion that estoppel will not avail a third party in these circumstances is premature. While a third party with such actual knowledge would certainly need to make inquiries, an estoppel may be founded on the responses to those inquiries.[714] But surely that is the reasonable result? Why should a third party who *actually knows* that the authority of the person they are dealing with is subject to internal formality not make further inquiries?

Actual knowledge of internal formalities also seems like a very weak basis to justify an independent *Turquand* rule, given that, as we have seen, third parties usually do not have knowledge of such formalities, at least insofar as they are contained in a company's constitution.[715] Third parties deal based on representations made to them and any actual

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[710] Later in the paragraph (supra note 29 para 44), the court considered the potential for ostensible authority 'apart from the articles' and noted that the purported representatives had never been held out as managing directors, nor had it been established that the relevant business had been conducted with the consent of the third director.

[711] See the arguments of JJ Henning op cit note 117 para 308 and Henning & Du Plessis op cit note 626 at 345 et seq. Lombard and Swart (op cit note 467 at 667) argue that the *Turquand* rule will be applicable even where a third party (my emphasis) 'is conscious of a purported agent's *lack of authority* as a result of one or other internal requirement' (original text: 'bewus is van 'n beweerde agent se gebrek aan magtiging weens een of ander interne vereiste'). This cannot be correct, as knowledge of lack of authority is a recognised limitation to the *Turquand* rule. It is assumed that what was meant was actual knowledge of an internal formality (while not knowing whether the formality had been complied with). See also Delport op cit note 3 at 138 and Du Plessis op cit note 210 at 301.

[712] JJ Henning op cit note 117 para 308.

[713] Henning & Du Plessis op cit note 626 at 347.

[714] Infra note 725.

[715] Supra para 6.2.2.

knowledge of internal formalities merely form part of the 'totality of appearances' to be weighed up in any given case. This point is well illustrated by statements made in *Houghton* and *Mudaliar*, respectively. In the former case, Sargant LJ refused to accept that a third party could simply assume that authority had been delegated to a company representative even if the third party had actual knowledge of a Power-to-Delegate Clause. In the Lord Justices' opinion that would 'carry the doctrine of presumed power far beyond anything that has hitherto been decided'.[716] In *Mudaliar*, Broome J held that if a third party had read the articles he/she may very well have been able to assume that authority had been delegated to the relevant director *provided that the transaction was in the ordinary course of the company's business*.[717] These statements show that actual knowledge of a clause containing an internal formality was not determinative in and of itself. Instead, in these cases the 'usualness' of the transaction, whether in itself or in relation to the position of the corporate representative, which was determinative.[718]

6.6.8 The different requirements of estoppel and the *Turquand* rule

The Independent Basis Approach holds that estoppel (ostensible authority) has substantially more difficult requirements than the *Turquand* rule.[719] Given that, on this approach, estoppel and the *Turquand* rule are competing remedies at a third party's disposal for corporate liability this would constitute a big competitive advantage to the *Turquand* rule. This claim deserves further attention.

6.6.8.1 The Turquand rule's less onerous requirements?[720]

One would expect, given the above-mentioned claims, to find an overabundance of cases in which company liability is founded clearly on the *Turquand* rule as an independent rule. Instead what one finds is a raft of corporate representation cases in the SCA in the last two

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[716] *Houghton* (CA) supra note 162 at 266.

[717] *Mudaliar* supra note 162 at 56.

[718] Of course, there are circumstances in which actual knowledge of an internal authority restriction may prove determinative. For instance, in *Liggett* supra note 568 a director of a company who suspected fraud on the part of his co-director *actually told* a bank not to accept cheques on behalf of the company unless they also bore his signature. The court refused to hold the company bound based on the *Turquand* rule, because its actual knowledge of the director's instructions were deemed to place the bank on inquiry.

[719] Supra note 587. See also *Farren* supra note 328 para 18 and MJ Oosthuizen 'Die Turquand-reël as reel van die verenigingsreg' 1977 *TSAR* 210 at 215.

[720] Infra para 6.6.10 regarding the classic definition of the *Turquand* rule.

decades which simply proceed on the basis of agency and do not base liability on the *Turquand* rule.[721] Each of these cases dealt with the contractual liability of a corporate entity for the unauthorised conduct of their representative – fecund soil for the application of the *Turquand* rule, one would think. Yet all of them proceeded on a pure agency perspective. The Independent Basis Approach does not exclude agency, it is true, but the question remains - *why should this be the case*? Why were the *Turquand* rule's supposedly less onerous requirements not relied on in these cases?

6.6.8.2 Estoppel's substantially more onerous requirements?

Independent Basis Approach advocates have criticised estoppel's supposedly more onerous requirements. First, estoppel requires a representation made by the company (and not merely by the corporate agent). Cassim and Cassim criticise this requirement using the example of a company which has a clause in its constitution which authorises the chairman of the company to enter into a particular agreement, subject to shareholder approval.[722] According to the authors,[723] the third party would not be able to set up an estoppel in these circumstances because (i) the clause itself does not amount to a representation that authority has been granted and (ii) the third party is not entitled to rely on the mere appointment of the chairperson, given that limited authority is usually associated with that position.

While the writer does not take issue with these submissions, the conclusion regarding the inapplicability of estoppel is, with respect, premature. While a third party will not be able to rely on the chairman's usual authority, this does not mean that company liability is per se excluded. The company may still be liable in the event that the third party can prove other forms of representation on which he relied, such as perhaps previous dealings with the acquiescence of the board.[724] Without such representation, the third party has to make inquiries and the responses to those queries, such as for instance an assurance by, for

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[721] *South African Eagle Insurance* (SCA) supra note 312, *Cape Produce* supra note 288, *Glofinco* (SCA) supra note 282, *Kruizenga* supra note 295, *Coop* supra note 282, *Northern Metropolitan* (SCA) supra note 287. One may also mention *Service Motor Supplies* supra note 539 as well – see McLennan op cit note 210 at 148-9 in this regard.

[722] Cassim & Cassim op cit note 283 at 660-1.

[723] Ibid at 660-1.

[724] So, for instance, was the chairman of a board of directors held to have ostensible authority to bind a company in *Hely-Hutchinson* – supra para 4.4.4.

instance, the managing director that the chairman has authority, may found an estoppel against a company.[725] Surely, this is reasonable?

Moreover, the authors assert that, in their example, the 'third party may rely on the *Turquand* rule as an independent company-law rule to hold the company bound'. With respect, things are not that simple. As we have noted above, our case law (and even some leading Independent Basis Approach advocates)[726] support the conclusion that the *Turquand* rule depends on usual authority of corporate representatives. Given that the chairman is acting outside of his (very limited) usual authority, would inquiries then not be necessary even on the authors' Independent Rule Approach? The result would therefore be the same.

It should also be mentioned that the clause in the example is unrealistic – single directors are not generally directly empowered by the articles, as this undermines collective management by the board.[727] Far more likely would be a Power-to-Delegate Clause, and the authors accept that the *Turquand* rule cannot be applied in those circumstances without proving the (ostensible) authority of the corporate representative first.[728]

Another fact worth pointing out in relation to the representation requirement is that Oosthuizen advocated a second pre-requisite for the application of the *Turquand* rule, namely that there had to be a 'nexus' between the company and the relevant corporate representative.[729] The author realised that, without such a requirement, a third party would be able to rely on the *Turquand* rule even if a fraudster pretended to be, say managing director, and concluded a contract within the usual authority of a managing director. At least minimal involvement between the company and the representative in the form of some sort of appointment (even a defective appointment) was required. It is submitted that this requirement would, in many circumstances, amount to the same thing as the requirement for estoppel that the representation be made by the principal and not merely the agent. Seen in this light, the 'independent' *Turquand* rule creeps ever closer estoppel.

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[725] As was said in *Wolpert* (supra note 196 at 264D) of a third party dealing with a representative acting outside of his usual authority: 'He must enquire further and either ensure that the official has actual authority or elicit some further facts which estop the company from denying it. And these further facts would, probably, have estopped the company (unless the articles made it clear that the official could not have had actual authority) even if they had been elicited without any actual exploration of the articles, which therefore continued to be irrelevant.'

[726] Supra note 681.

[727] The authors cite another example in which this is done - see Cassim & Cassim op cit note 283 at 658.

[728] See Cassim & Cassim op cit note 283 at 662.

[729] Oosthuizen op cit note 210 at 11. See also Du Plessis op cit note 210 at 291.

Secondly, the requirement of reasonable reliance has also been criticised.[730] It is, however, submitted that when one keeps in mind that estoppel may be established based on the articles or 'apart from the articles', reliance poses no issue. Thirdly, commentators[731] in the past criticised the requirement of fault as onerous. It has, however, been settled that fault is not required to prove ostensible authority.[732] While the prejudice requirement under estoppel may be noted as a difference, it has been conceded that this requirement has not provided any practical problems.[733]

Taking the above into account it appears as though the requirements for estoppel are not as onerous as they have been made out to be.[734] Indeed, Lombard and Swart, who support an Independent Basis Approach, have acknowledged that, despite their criticism of estoppel's requirements, estoppel provides adequate protection to third parties in most instances.[735]

[730] See the discussion of the arguments made by Cassim and Cassim (op cit note 283 at 660) in paragraph 6.6.6.

[731] Oosthuizen op cit note 210 at 9-10, Du Plessis op cit note 210 at 290.

[732] Supra para 4.5.8.

[733] Oosthuizen op cit note 210 at 10. Supra para 4.5.6.

[734] Du Plessis op cit note 210 at 291.

[735] Lombard & Swart op cit note 467 at 667.

6.6.9 The *Turquand* rule should be confined to constructive notice cases

If the *Turquand* rule is an independent authority-giving rule of company law, then its existence is not necessarily tied to that of constructive notice. Adherents to the Independent Basis Approach, while acknowledging that one of the main purposes of the *Turquand* rule is (or at least was historically)[736] to ameliorate the effect of constructive notice,[737] have therefore sought to sever the *Turquand* rule from the doctrine of constructive notice. Oosthuizen sums-up this approach (my emphasis):[738]

> 'the Turquand rule should be seen as a general rule applicable to all societies whether endowed with legal personality or not and *irrespective of the applicability of the doctrine of constructive notice*; provided that the outsider has no access to the internal management of the association'[739]

There are, however, cogent reasons to question this approach. First, as a matter of historical development, the *Turquand* rule was expressly introduced to temper constructive notice.[740] It should not be forgotten that the *Turquand* rule as originally expressed in *Turquand*'s case had two parts: parties 'are bound to read the statute and the deed of settlement. *But* they are not bound to do more'.[741] Without a softening of constructive notice, a third party would have been placed in an impossible position by being 'deemed to have notice' of internal requirements, but having no means in which to see whether these have been complied with.[742]

Furthermore, it is submitted that, the judicial approach to the extension of the *Turquand* rule to other forms of business supports the contention that the rule is inextricably linked to constructive notice. In *Prinsloo*, the *Turquand* rule was applied to a union, but the court drew specific attention to the fact that the constitution of the union was open for public

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[736] Ibid.

[737] Oosthuizen op cit note 210 at 6, Henning & Du Plessis op cit note 626 at 346, Lombard & Swart op cit note 467 at 664-5 and 671.

[738] Oosthuizen op cit note 719 at 219.

[739] The last portion of the quotation is intended to indicate that the *Turquand* rule should not apply when a person has access to all of the company's internal documents. See Oosthuizen's criticism of *Potchefstroom* supra note 561 in which the Appellate Division applied the *Turquand* rule in circumstances where a third party dealing with a city council had all the means to discover the internal irregularity. See Oosthuizen op cit note 719 at 215.

[740] McLennan op cit note 210 at 146.

[741] Supra note 556. The same goes for the formulations in *Mahony* supra note 505 at 893-4, *Kreditbank* (CA) supra note 533 at 832 and 838, *County of Gloucester Bank* supra note 538 at 633 and *Freeman* supra note 10 at 491-2.

[742] Pennington op cit note 299 at 130.

inspection.[743] In *Potchefstroom se Stadsraad*, too, the constitution of the local council was public.[744]

In relation to trusts the judicial approach has been even more illuminating. If the *Turquand* rule did not depend on constructive notice, one would assume it would have been seamlessly transposed to trusts, which are, just like companies, entities subject to collegiate management.[745] This has, however, been far from the case. In *Man Truck & Bus (SA) Ltd v Victor*,[746] the *Turquand* rule was applied to a trust.[747] However, what is crucial to note is that the application of the *Turquand* rule was dependent on constructive notice – the court assumed that when a third party deals with a trust, that person is deemed to have notice of the contents of the trust deed.[748]

In *Nieuwoudt v Vrystaat Mielies (Edms) Bpk,* when this issue came before the SCA, Harms J admitted that it would be 'difficult' to apply the doctrine of constructive notice to trusts, because there was no central registry where trusts were collected and the Master had the discretion to refuse an application to see a trust deed.[749] This was relevant, because, according to the judge, the doctrine of constructive notice was an 'underlying principle' of the *Turquand* rule.[750] The same approach was taken in *Van der Merwe No v Hydraberg Hydraulics CC; Van der Merwe No v Bosman*,[751] where the court noted that it had it had some difficulty with the proposition of the applying the *Turquand* rule to trusts in the absence of evidence of actual or constructive knowledge by the third party of the provisions of the trust instrument.[752]

Lamentably the question still remains an open one and it is submitted that the sooner our courts dispel any notion of the *Turquand* rule applying to trusts, the better.[753] But this thesis

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[743] *Prinsloo* supra note 260 at 844A.

[744] And 631D. Supra note 739 regarding Oosthuizen's criticism of this case.

[745] *Thorpe* v *Trittenwein* 2007 (2) SA 172 (SCA) para 9; *Nieuwoudt* supra note 527 paras 16 and 23.

[746] 2001 (2) SA 562 (NC).

[747] See McLennan op cit note 497 at 330 in this regard.

[748] At 569G.

[749] *Nieuwoudt* supra note 527 para 16.

[750] Ibid.

[751] 2010 (5) SA 555 (WCC).

[752] At para 27.

[753] In *Land and Agricultural Bank of South Africa v Parker* 2005 (2) SA 77 (SCA) para 18 the question was again left open, with the court remarking that the *Turquand* rule 'may well in suitable cases have a useful role to

does not concern trusts – the point being made here is that in *Man Truck & Bus* the court applied the *Turquand* rule because it thought constructive notice applied to trusts, whereas in *Nieuwoudt* and *Hydraberg* the courts doubted the application of the *Turquand* rule because they doubted the application of constructive notice to trusts. In *all three cases* the operation of the *Turquand* rule was thought to be dependent on constructive notice.

Interestingly, Independent Basis Approach supporters have conceded that the *Turquand* rule should not apply in respect of partnerships, since a third party dealing with a partnership[754] is unaware of the terms of the relevant partnership agreement.[755] Although any analogy regarding partnerships and companies should be treated with caution, given their different models of representation,[756] such a concession certainly does not detract from the writer's submission that the *Turquand* rule is tethered to constructive notice.

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play in securing the position of outsiders who deal in good faith with trusts that conclude business transactions.' See, however, the doubts about the application of the *Turquand* rule to trusts in Edwin Cameron, Marius De Waal and Peter Solomon *Honoré's South African Law of Trusts* 6ed (2018) at 384-5.

[754] For clarity's sake, it should be noted that what is being discussed in this paragraph is the usual situation in which a third party is knowingly dealing with a partner of a partnership, but is unaware of the terms of the partnership agreement. Where a third party is dealing with a partner without knowledge that the partner is acting on behalf of a partnership, the doctrine of the undisclosed principal may apply – supra note 272 and JJ Henning op cit note 117 para 309.

[755] Henning & Du Plessis op cit note 626 at 346 and Oosthuizen op cit note 719 at 217-9. Those commentators do, however, suggest that the *Turquand* rule should apply in the situation where a third party has actual knowledge of the limitations on a partner's authority – supra para 6.6.7 in that regard.

[756] Supra note 165 regarding the implied right of a partner to represent his/her partnership.

There is another very good reason why the *Turquand* rule needs constructive notice to make sense – the law of agency already protects a third party dealing with an agent by rendering private instructions between an agent and his/her principal irrelevant to the third party. This was made plain by Nienaber JA in *Glofinco v ABSA Bank Ltd t/a United Bank*, which dealt with the actions of the branch manager of a bank:[757]

> 'Internal limitations of which outsiders who do business with the branch manager are unaware will not bind them. This is a principle as old as the law of agency itself.'[758]

Another example is *Cape Produce*,[759] where a bank attempted to avoid contractual liability based on non-compliance with internal procedures (which were not in the bank's constitution and therefore private). The court again emphasised the irrelevance of internal limitations, in a passage which accords with the Third Party Perspective (my emphasis):[760]

> 'When the enquiry becomes focused upon ostensible authority, evidence about the internal controls of the bank is largely irrelevant, despite the fact that the bureaucratic mind believes that things may not happen, do not happen, and finally, cannot happen, unless the regulations are complied with. *The outsider does not think that way*. Nor does the law.'[761]

These cases show that the law of agency already sufficiently protects a third party who is ignorant of a company's internal authority requirements and is not deemed to have constructive notice of those requirements.

What the above arguments show, it is hoped, is that the *Turquand* rule is limited to 'companies and other entities with constitutions available to the public'[762] – that is companies in respect of which the doctrine of constructive notice applies.[763] Accordingly, it is submitted that the *Turquand* rule is dependent on constructive notice and that should the doctrine of

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[757] Supra note 282 para 17. The learned judge dated this principle back to its Roman law origins. In *Wolfe v Liquidators, Smyth & Crawford* 1914 CPD 187, the court noted the principles laid down in the English company law case of *Biggerstaff* supra note 564, including that where the power to appoint an agent for a given purpose exists, irregularity in its exercise is immaterial to a person dealing with the agent *bona fide* and without notice of the irregularity in his appointment. That principle and and the others laid down in *Biggerstaff* supra note 564, the court noted, were 'quite consistent with those of the Roman Dutch law, and with our decisions thereon …'

[758] In this regard, it was noted in *Neffensaan* supra note 29 para 23: 'It may be that many of the cases decided in our law with reference to Turquand could as readily have been explained on the basis of this ancient principle.' See further *South African Eagle Insurance* (SCA) supra note 312 para 30, *Broderick Motors* supra note 314 at 3F and *Bothma* supra note 488 paras 27-8. See also JS McLennan 'Contracting with Close Corporations' (1985) 102 *SALJ* 322 at 323.

[759] Supra note 288.

[760] *Cape Produce* (SCA) supra note 288 (para 31).

[761] See also *Cape Produce* (a quo) supra note 270 at 50-1. See also Olivier op cit note 9 at 8 and 21.

[762] *Neffensaan* supra note 29 para 25. See also para 23.

[763] Supra para 6.2.1 regarding this doctrine and its application.

constructive notice be abolished, then the *Turquand* rule will have no meaningful existence.[764]

6.6.10 May a third party presume nothing at all?

If the prohibition on the raising of private instructions under agency law covers some of the negative operation attributed to the *Turquand* rule, what about the positive operation? Indeed, the classic definition of the *Turquand* rule is positive:[765]

> 'But 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 inquire whether acts of internal management have been regular.'

As we have seen, however, such a positive definition, which appears to require nothing more than good faith on the part of the third party, is 'inaccurate and misleading' –[766] it says nothing of the difference between actions of organs and single representatives, nor anything about the rule's dependence on usual authority, nor its connection to constructive notice.

Third parties are, however, able to generally presume that internal regularities have been fulfilled in accordance with the maxim omnia praesumuntur rite esse acta (all things are presumed to be done correctly), which is recognised in South African law.[767] In fact, the English House of Lords in *Morris v Kanssen*,[768] the South African High Court in *Wolpert*[769] and Brennan J writing for the Australian High Court in *Northside*[770] classified the *Turquand* rule as a species of that maxim. In *Prinsloo*, too, the Appellate Division seemed to imply that the *Turquand* rule was a presumption.[771]

To the extent that the *Turquand* rule has any positive effect, it is submitted that its extent goes no further than a presumption of regularity – it does not create any authority of itself. It is only once the (ostensible) authority of the relevant corporate representative has been

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[764] See McLennan op cit note 548 at 336.

[765] See *Morris* supra note 568 at 474, *Hely-Hutchinson* supra note 14 at 562C, *Nieuwoudt* supra note 527 at 491J, *Wolpert* supra note 196 at 261D and *Southgate v Blue IQ Investment Holdings* (2012) 33 ILJ 2681 (LC) para 59. See also the formulation by the Court of Appeal in *Biggerstaff* supra note 564 at 102.

[766] McLennan op cit note 523 at 346.

[767] *D Frenkel Ltd v Liquidators Susman Jacobs & Co Ltd* 1918-1923 GWLD 182 at 185; Lombard & Swart op cit note 467 at 665.

[768] Supra note 568 at 475.

[769] Supra quotation at note 675.

[770] Supra note 579 at 176. See also the judgment of Toohey J at 211.

[771] Supra quotation at note 699.

established, that the *Turquand* rule comes into full effect. This was recognised in *Afrasia Special Opportunities Fund (Pty) Ltd v Royal Anthem Investments 130 (Pty) Ltd*:[772]

> 'Suffice it to say that it is clear that the rule is of no assistance to a party seeking to enforce a transaction with a company who is not able to prove that the person with whom it transacted as the company's representative was authorised to represent the company'[773]

Independent Basis Approach adherents oppose the classification of the *Turquand* rule as a presumption of regularity on the basis that such a presumption is rebuttable, while the independent *Turquand* rule is not.[774] This is because, they argue, it will not help a company to prove that an internal requirement had not been complied with in order to defeat liability based on the *Turquand* rule. This objection is, however, not conclusive either way. First, there does not appear to be any reason why the *Turquand* rule could not be classified as a specific irrebuttable species of the maxim – which is the approach Wunsh took.[775] Secondly, this point does not distinguish the *Turquand* rule from estoppel - it also does not help an estoppel-denier to aver that the representation which he/she made was in fact untrue. Thirdly, there is no reason in principle to object to the *Turquand* rule being regarded as an irrebuttable presumption on an Ancillary Rule Approach, as long as it is applied as an ancillary rule to the greater (ostensible) authority enquiry.

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[772] Supra note 571 para 32.

[773] Compare with *Northside Developments* supra note 223 at 198 and 207.

[774] Oosthuizen op cit note 210 at 7, Lombard & Swart op cit note 467 at 665.

[775] See Basil Wunsh 'Section 228 of the Companies Act and the Turquand Rule' 1992 *TSAR* 545 at 545-546.

6.6.11 The unique origins of the *Turquand* rule?

The Ancillary Rule Approach connects the origin of the *Turquand* rule strictly to the doctrine of constructive notice and the injustice which would have arisen had this doctrine not been tempered somehow.[776] Exponents of the Independent Basis Approach, however, emphasise that the rule is founded in equity and business convenience.[777] Indeed, our courts have often emphasised the business convenience aspect of the *Turquand* rule.[778]

The writer does not take issue with these sentiments,[779] except to note that merely pointing out that the *Turquand* rule is based on equity and business convenience takes the Independent Basis Approach cause no further, because these concepts are also foundational to estoppel.[780] That estoppel is based on equity is obvious and well-known.[781] What is perhaps not so clear is that the concept of estoppel also serves business convenience – commerce could not function if persons were allowed to deny the truth of representations they have made (in circumstances where others have acted to their detriment on those representations). Equity and business convenience therefore serve as equally good motivators for the Ancillary Rule Approach, as they do for the Independent Basis Approach.

6.7 AN ANCILLARY RULE APPROACH TO THE *TURQUAND* RULE ALIGNS WITH THE THIRD PARTY PERSPECTIVE OF CORPORATE CONTRACTING

Regarding the *Turquand* rule as an independent authority-giving rule invariably results in setting up the corporate constitution as the focal point in corporate contracting cases. This is because the *Turquand* rule deals with what third parties can presume to have occurred under Reserved Matters Clauses or other procedural clauses in a company's constitution. Ultimately, this approach is based within the Company Perspective of corporate contracting, as its main focus is what the corporate constitution contains and what a hypothetical reader of that document could have assumed.

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[776] Supra note 742.

[777] Oosthuizen op cit note 419 at 122, Du Plessis op cit note 210 at 284 and Cassim & Cassim op cit note 283 at 657. See also Wunsh op cit note 775 at 546.

[778] *Prinsloo* supra note 260 at 845, *Wolpert* supra note 196 at 264H, *Potchefstroom* supra note 561 at 622E; *Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd v Göbel* NO 2011 (5) SA 1 (SCA) para 12.

[779] It should be remembered that the Ancillary Rule Approach does not deny that the *Turquand* rule exists at all, it merely posits that it has a very limited scope. Even that limited scope, however, is informed by considerations of equity and business convenience.

[780] See also Gaudron J in *Northside Developments* supra note 223 at 210.

[781] Supra para 4.6 and *Makate* (CC) supra note 8 para 110.

However, as the Third Party Perspective has become more dominant, that view has become increasingly untenable. This is because courts have recognised that a third party generally contracts with a company based on a range of fact-specific representations made by the persons in control of that company, which may include the corporate constitution, but usually do not. Thus, we saw English courts, starting in *Freeman*, de-emphasising the importance of the corporate constitution to a third party, except in the rare cases where the third party had actual knowledge of its terms or if constitution contained an Exclusion Clause (and the third party was deemed to have notice of such a clause). What mattered more was simply asking whether the third party was acting reasonably, based on the representations made to him/her, in trusting that the persons whom he/she was dealing with had authority to conclude the necessary contract. In this way, ostensible authority became the focal point of corporate contracting cases. Where a company raises non-compliance with an internal formality of which a third party has constructive notice, the *Turquand* rule may still have relevance, but it remains ancillary to the greater inquiry into the (ostensible) authority of corporate representatives.

CHAPTER 7: STATUTORY REFORM IN ENGLAND

7.1 INTRODUCTION

This Chapter will focus on the impact of legislation, in particular section 40 of the UK Companies Act and its predecessors, on corporate contracting in England. In short, this section renders constitutional limitations on the power of the directors of a company to conclude contracts on behalf of that company (or to delegate such power) ineffectual against bona fide third parties. This Chapter will investigate the genesis of section 40 as well as its effect on the common law. The ultimate aim of this Chapter is to illustrate the pro-third party approach taken in the UK and the EU and to draw lessons from English experience with section 40, in order to better interpret the provisions introduced by the South African Companies Act.

It is necessary to refer to Brexit. The UK's decision to leave the EU with effect from 31 January 2020 has introduced uncertainty regarding to what extent EU law will remain applicable to the UK. Even if EU law is no longer binding on the UK, it is uncertain to what extent the UK legislature will seek to undo changes brought about as a result of the UK's membership in the EU. The provisions introduced into English law as a result of the First Directive are more than 40 years old and no change to these has been touted yet.[782] This thesis proceeds on the only basis open to the writer – to assume that the relevant sections of the UK Companies Act will continue to be operational for some time yet.

7.2 EUROPEAN DIRECTIVES

Statutory intervention in relation to corporate contracting begins with the UK's accession to the European Economic Community ('EEC') in 1973.[783] The EEC came into existence

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[782] See, for instance, Neil Blundell & David Gent 'Brexit: Corporate law implications' available at https://www.twobirds.com/en/news/articles/2016/uk/brexit-english-corporate-law-and-transaction-implications, accessed on 23 October 2020.

[783] Previous corporate law commission reports had suggested changes to the common law principles regulating corporate contracting, but these were not implemented. See para 12 of the Report of the Committee on Company Law Amendment (1945) (the Cohen report) and paras 41-2 of the Report of the Company Law Committee (Cmd 1749, 1962) (the Jenkins Report). The Jenkins Report did, however, indirectly affect the drafting of the First Implementing Provision (as defined in para 7.3.1) – see JH Farrar & DG Powles 'The effect of section 9 of the European Communities Act 1972 on English Company Law Modern Law Review (1973) 36 270 at 271. See further JG Collier & LS Sealy 'The European Communities Act 1972 – company law' [1973] 32 *Cambridge LJ* 1 at 1.

in 1958 between West Germany, Belgium, France, Italy, Luxembourg and the Netherlands.[784] The treaty establishing the EEC empowered the Council of the European Communities to, inter alia, as far as necessary, co-ordinate safeguards required by member states of companies to protect the interests of both shareholders and third parties dealing with companies, to ensure that those safeguards are the same (throughout the member states).[785] The purpose of the equalisation of safeguards was to curb a so-called 'Delaware effect', in terms of which differences in company laws lead to new companies being disproportionately formed in the country with the laxest company laws.[786] The process of the harmonisation of European company law has continually developed and reached an advanced stage.[787] The provisions relevant to corporate representation were, however, already contained in the First Council Directive[788] issued on 9 March 1968 ('First Directive') and these remain applicable today (although the provisions are now contained in different directives).[789] Importantly, from an English law perspective, the First Directive was drafted and finalised before the UK's accession to the EEC, meaning that the UK had no input regarding its text.[790] This, as we

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[784] The EEC has its roots in the earlier European Coal and Steel Community, brought into existence by these six countries in 1951. See Pascal Fontaine 'Europe in 12 lessons' available at https://publications.europa.eu/en/publication-detail/-/publication/a5ba73c6-3c6a-11e8-b5fe-01aa75ed71a1, accessed on 23 October 2020 at 12.

[785] Article 53(3)(g) of the Treaty of Rome establishing the EEC, which was signed on 25 March 1957, but only came into force on 1 January 1958. See the fact sheet regarding the early European economic treaties at http://www.europarl.europa.eu/factsheets/en/sheet/1/the-first-treaties, accessed on 23 October 2020. The Treaty of Rome is available in its original languages, namely German, French, Italian and Dutch at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:11957E/TXT, accessed on 23 October 2020. Article 53(3)(g) of the Treaty of Rome establishing the EEC is now substantially contained in article 50(2)(g) of the Treaty on the Functioning of the European Union (Lisbon). See Edwards op cit note 224 at 5-14 regarding the initial controversy regarding the scope of article 53(3)(g). See also DD Prentice 'Section 9 of the European Communities Act' (1973) 89 *Law Quarterly Review* 518 at 518-22.

[786] Edwards op cit note 224 at 3.

[787] For instance, the recent consolidated Directive (EU) 2017/1132 runs to more than 80 pages, covering issues such as validity of company obligations, capital maintenance and mergers.

[788] 68/151/EEC. In addition to dealing with issues relating to the validity of company obligations, the First Directive also dealt with disclosure requirements and when a company may be deemed to be a nullity.

[789] The relevant articles and recitals of the First Directive have been retained in the same form in the more recent consolidated company law directives issued by the EU and therefore remain applicable to EU member states. The First Directive was replaced by Directive 2009/101/EC which, in turn, was replaced by Directive (EU) 2017/1132. The content of articles 9(1) and 9(2) of the First Directive are now contained in articles 9(1) and 9(2) of the 2017 Directive.

[790] See *Smith v Henniker-Major & Co (a Firm)* [2002] BCC 768 at 775 and *EIC Services Ltd v Phipps* [2004] EWCA Civ 1069 para 36. See also Mayson, French & Ryan op cit note 90 at 622.

shall see, has led to some issues because the text of the First Directive used terms unfamiliar to English lawyers.[791]

The First Directive expressly intended to favour third parties dealing with companies. Indeed, the fifth recital to the First Directive recorded that: 'the protection of third parties must be ensured by provisions which restrict to the greatest possible extent the grounds on which obligations entered into in the name of the company are not valid'.[792] To this end, the First Directive contained article 9(2), which specifically dealt with corporate representation:[793]

> 'The limits on the powers of the organs of the company, arising under the statutes or from a decision of the competent organs, may never be relied on as against third parties, even if they have been disclosed.'

This article has attracted little comment from English commentators, who have been far more content with discussions of the implementing legislation.[794] English courts have, however, been more willing to look at the First Directive when dealing with issues arising under the implementing legislation.[795] Two important features immediately stand out in article 9(2). First, the use of the word 'organ' raises questions, as this term was not historically recognised in English law.[796] In continental Europe, this term is used to refer to the bodies which exercise the functions and powers of a company.[797] Crucially, a distinction is made between 'organs of decision and deliberation' and 'organs of representation'.[798] The former refers to the organs acting in the internal management of a company, while the latter refers to

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[791] Supra quote at note 226 and see Edwards op cit note 224 at 16.

[792] The second recital also emphasises third party protection: 'Whereas the co-ordination of national provisions concerning disclosure, the validity of obligations entered into by, and the nullity of, such companies is of special importance, particularly for the purpose of protecting the interests of third parties'. These recitals are now recorded as the fifth and seventh recitals to Directive (EU) 2017/1132. The recitals were expressly taken into account in *International Sales & Agencies Limited v Sidney Marcus* [1982] 2 CMLR 46 at 57. See also the decision of the European Court of Justice in *Rabobank v Minderhoud* C-104/96 [1997] ECR I-7211 para 19.

[793] Article 9(1) of the First Directive dealt with the ultra vires doctrine. For a discussion of this provision and its interaction with article 9(2), see Edwards op cit note 207 at 202-3.

[794] Edwards op cit note 207 at 202. See, for instance, the limited attention paid to the wording of the First Directive in the latest versions of *Mayson, French & Ryan on Company Law* and *Gower's Principles of Modern Company Law* - see Mayson, French & Ryan op cit note 90 at 622 and Davies & Worthington op cit note 215 para 7-9, respectively.

[795] See, in particular, the opinion of Schiemann LJ in *Smith* supra note 790 at 793. See also *TCB Ltd v Gray* [1986] Ch 621 at 635 and *International Sales* supra note 792 at 57 in relation to the First Implementing Provision (as defined in para 7.3.1 below).

[796] Supra para 3.2.3. See also Edwards op cit note 207 at 202.

[797] Edwards op cit note 207 at 202.

[798] Ibid and Edwards op cit note 224 at 34.

the organs which are deemed capable, whether by generally applicable law or a company's constitution, of transacting on behalf (or as) the company with third parties.[799] In Article 9(2), the term 'organ' is used in both of these senses: the authority of a company's organ of representation must not be deemed to be limited by the company's statutes or by resolutions of its organs of decision and deliberation.[800]

So which bodies qualify as the different types of organs? In German terms, for instance, the supervisory board (*Aufsichtsrat*) would be an organ of deliberation and decision while the executive board (*Vorstand*) would qualify not only as an organ of deliberation and decision, but also as an organ of representation.[801] In English terms, the distinction is less clear. Shareholders and boards acting collectively are clearly 'organs of decision and deliberation',[802] but which body qualifies as the organ of representation? Certainly the board of directors does, but there has been uncertainty as to whether executive directors are covered by this wording.[803] It is submitted that Edwards is correct in arguing that this term should capture whoever is by generally applicable law, a company's constitution or the decisions of the organs of decision and deliberation allowed to contract on behalf of a company, which would include executive directors acting within the scope of their usual authority.[804] Read in this way, it may therefore be argued that not only entire boards acting on behalf of companies were intended to be covered by article 9(2) but also acts of executive directors.[805] This approach is, of course, quite logical, given that third parties rarely deal with entire boards. However, as we shall see, the English legislature has not always introduced wording which aligns with this purpose.[806]

The second noteworthy aspect is that the First Directive reflects a largely German organic approach to corporate representation.[807] Drafters of the First Directive were faced with two

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[799] Edwards op cit note 207 at 202.

[800] Ibid.

[801] Edwards op cit note 224 at 35.

[802] Mayson, French & Ryan op cit note 90 at 622.

[803] Farrar & Powles op cit note 783 at 202 acknowledged that the term 'organ' may include executive directors in the organic approach to representation, but doubted whether single directors were covered by the use of the word 'directors' in the First Implementing Provision. See para 7.3.4.2.3 below.

[804] Edwards op cit note 207 at 202. See also Claire Howell 'Companies Act 1985, s.35A and 322A: Smith v Henniker-Major and the proposed reforms' *Company Lawyer* (2003) 24(9) 264 at 268.

[805] Edwards op cit note 224 at 43.

[806] See para 7.3.4.2.3 below.

[807] Prentice op cit note 785 at 529.

incompatible theories of corporate representation.[808] According to the first approach, companies' liability for the acts of their representatives is explained with reference to the general principles of agency. This view, which has its roots in Roman Law, emphasises the fictional aspects of corporate legal personality, by portraying the company as a *persona ficta* which cannot act itself and which must be represented through agents.[809] Since the directors are merely agents, their authority to act on the behalf of the company may naturally be limited vis-à-vis third parties, who are bound by such limitations as have been disclosed in the company's public documents.[810] This approach was followed in all of the countries which were original members of the EEC, except Germany.[811] In German law, a company's executive board (*Vorstand*) is deemed to be acting *as* the company, in line with the organic theory of corporate representation. This means that it was not competent for third parties to be held bound by constitutional limitations of board authority (although such limitations may have internal effect between the board and the shareholders).[812] Article 9(2) is unequivocally in favour of the latter approach, favouring third parties dealing with companies even if constitutional limitations on the authority of the company's representative organs have been disclosed.

As we have seen, English law has historically favoured the agency-based approach, but this has slowly been eroded.[813] The adoption of provisions which implement article 9(2) of the First Directive, which underwrites an organic approach, represents further erosion of the agency-based approach in English Law.

Textual issues aside, article 9(2) represented a major shift away from the common law position in England in that it sought to render unqualified constitutional limitations on directors' authority ineffective. Furthermore, the doctrine of constructive notice was expressly

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[808] Edwards op cit note 207 at 202-3. See also Gianluca La Villa 'The Validity of Company Undertakings and the Limits of the EEC Harmonization' 3 *Anglo-American Law Review* (1974) 346 at 348 et seq.

[809] Ibid.

[810] Ibid.

[811] Ibid.

[812] Edwards op cit note 207 at 202, Prentice op cit note 785 at 529. See also section 37(2) of the German Limited Liability Company Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung, GmbHG*) and section 82(1) of the German Stock Corporation Act (*Aktiengesetz*). See further Gerhard Wirth, Michael Arnold and Mark Greene *Corporate Law in Germany* (2004) at 32 and 90.

[813] Supra para 3.2.2 and infra para 7.3.4.2.3.

undermined, because limits on directors' authority were futile, even if they were disclosed.[814] This consequently left the *Turquand* rule on uncertain ground, given its main purpose of softening the effect of the constructive notice doctrine. We now turn our focus to the implementation of the First Directive in the UK.

7.3 IMPLEMENTING THE FIRST DIRECTIVE

7.3.1 Legislative history

The English legislature has promulgated sections implementing the provisions of the First Directive relating to corporate representation on four occasions. In chronological order, the sections introduced were as follows:

1. Section 9(1) of the European Communities Act of 1972[815] ('European Communities Act'). The European Communities Act was promulgated in 1972 and became effective on 1 January 1973. The purpose of this legislation was the implementation in the UK of various obligations arising from EEC membership, including the First Directive;[816]
2. section 35 of the Companies Act of 1985[817] ('UK 1985 Act');
3. sections 35A and 35B of the Companies Act of 1989[818] ('UK 1989 Act');[819] and
4. section 40 of the UK Companies Act, which came into operation on 1 October 2009.[820]

In substance, however, these four sections only contain two different clauses. Section 9(1) of the European Communities Act and section 35 of the UK 1985 Act were close to identical. The UK 1989 Act then introduced more comprehensive provisions, which were substantially, though not identically,[821] reproduced in one section, namely section 40 of the UK Companies

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[814] There existed some controversy regarding the conflict of articles 9(1) and 9(2) of the First Directive with the disclosure requirements also contained in that Directive. See Prentice op cit note 785 at 538, Edwards op cit note 224 at 40-1 and Edwards op cit note 207 at 204-5 in this regard.

[815] (c 68).

[816] See Collier & Sealy op cit note 783 at 1.

[817] (c 6).

[818] (c 40).

[819] Section 35A dealt with the power of directors to bind a company and section 35B relieved third parties from making inquiries regarding limitations on directors' authority in a company's memorandum. Section 35B is now substantively contained in section 40(2)(b)(ii) of the UK Companies Act.

[820] Generally, regarding the UK Companies Act, see Paul Omar 'In the wake of the Companies Act 2006: an assessment of the potential impact of reforms to company law' *International Company and Commercial Law Review* 2009 20(2) 44 and Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' 5 ECFR 48 (2008).

[821] See para 7.3.4.2.3 below - obviously, attention will be drawn to the differences between the sections categorised within the Second Implementing Provision category.

Act. In this Chapter, where reference is made to the 'First Implementing Provision', this must therefore be understood to refer to section 9(1) of the European Communities Act and section 35 of the UK 1985 Act. Similarly, where reference is made to the 'Second Implementing Provision' this must therefore be understood to refer to sections 35A and 35B of the UK 1989 Act and section 40 of the UK Companies Act. Where reference is made merely to the 'Implementing Provisions', that reference should be read to refer to all of the abovementioned sections.

There are two reasons why it is important to make reference to the various predecessors of section 40 in order to fully understand this section. First, the First Implementing Provision and the Second Implementing Provision share the purpose of the First Directive, namely to protect persons contracting with companies from being bound by limits on the powers of directors contained in those companies' constitutions.[822] In fact, the Second Implementing Provision may even be loosely described as a 'fleshing-out' of the First Implementing Provision. There is therefore much similarity between these provisions, including as to their wording, and the jurisprudence developed in relation to the First Implementing Provision is relevant to the interpretation of the Second Implementing Provision. Secondly, some of the provisions of the Second Implementing Provision were introduced to deal with uncertainties in the text and/or judicial interpretation of the First Implementing Provision.

7.3.2 The First Implementing Provision

The First Implementing Provision, in the form of section 9(1) of the European Communities Act, read as follows:

> 'In favour of a person dealing with a company in good faith, any transaction decided on by the directors shall be deemed to be one which it is within the capacity of the company to enter into, and the power of the directors to bind the company shall be deemed to be free of any limitation under the memorandum or articles of association; and a party to a transaction so decided on shall not be bound to enquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and shall be presumed to have acted in good faith unless the contrary is proved.'[823]

Perhaps the biggest difference between article 9(2) of the First Directive and the First Implementing Provision, is that the latter is a deeming provision subject to certain conditions,

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[822] See, generally, regarding the purpose of these various sections *TCB* supra note 795 at 635, *EIC Services* supra note 790 para 37, Griffin op cit note 17 at 41 and Howell op cit note 804 at 268.

[823] Generally, regarding section 9(1) of the European Communities Act, see Collier & Sealy op cit note 783, Farrar & Powles op cit note 783 and Prentice op cit note 785.

while the former was an outright prohibition. Despite its unclear wording, article 9(2) of the First Directive is therefore much less complex at a conceptual level in that it simply prevents companies from raising internal arrangements vis-à-vis third parties. Conversely, the First Implementing Provision only applied in certain circumstances, namely when a person was *dealing with a company in good faith*. This requirement, which was repeated in the Second Implementing Provision, has given rise to much uncertainty.

There were other differences. The First Implementing Provision, unlike the First Directive (or the Second Implementing Provision), attempted to deal with both ultra vires acts and acts merely beyond the authority of directors in one subsection. This made the provision quite long and unwieldy, because these issues, although not entirely unrelated, are quite distinct from one another.[824] Furthermore, while the First Implementing Provision certainly did serve the First Directive's purpose of third party protection, the wording used was not well received and criticised as 'ill-translated'[825] and 'obscure'.[826] Less than two decades after its promulgation, the First Implementing Provision was replaced with the Second Implementing Provision in the form of sections 35A and 35B of the UK 1989 Act. The text of the First Implementing Provision will not be discussed any further here, but reference to it will be made in the analysis of the text of the Second Implementing Provision (ie section 40 of the UK Companies Act) in the following paragraphs.

7.3.3 The Second Implementing Provision

Although differences do exist between the two versions of the Second Implementing Provision, the text of the two sections is substantially the same. Courts and commentators have, with one exception,[827] been loath to dwell on the textual differences between the relevant sections of the UK 1989 Act, on the one hand, and section 40 of the UK Companies Act, on the other.[828] The version of the Second Implementing Provision which will be

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[824] See Prentice op cit note 785 at 527.

[825] Collier & Sealy op cit note 783 at 7.

[826] Farrar & Powles op cit note 783 at 271.

[827] That is, the change of the reference to limitations on the authority of 'the board of directors' in section 35A of the UK 1989 Act to just 'the directors' in section 40 of the UK Companies Act – infra para 7.3.4.4.

[828] For instance in *Ford v Polymer Vision Ltd* [2009] 2 BCLC 160, the court referred to section 40 of the UK Companies Act instead of section 35A of the UK 1989 Act, notwithstanding the fact that the former would only become effective six months later.

discussed in this thesis is obviously section 40 of the UK Companies Act, as this is the provision currently in force. Section 40 of the UK Companies Act, reads as follows:

> '40 Power of directors to bind the company
>
> (1) In favour of a person dealing with a company in good faith, the power of the directors[829] to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution.
>
> (2) For this purpose—
>
> (a) a person "deals with" a company if he is a party to any transaction or other act to which the company is a party,
>
> (b) a person dealing with a company—
>
> (i) is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so,
>
> (ii) is presumed to have acted in good faith unless the contrary is proved, and
>
> (iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution.
>
> (3) The references above to limitations on the directors' powers under the company's constitution include limitations deriving—
>
> (a) from a resolution of the company or of any class of shareholders, or
>
> (b) from any agreement between the members of the company or of any class of shareholders.
>
> (4) This section does not affect any right of a member of the company to bring proceedings to restrain the doing of an action that is beyond the powers of the directors. But no such proceedings lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.
>
> (5) This section does not affect any liability incurred by the directors, or any other person, by reason of the directors' exceeding their powers.
>
> (6) This section has effect subject to—
>
> section 41 (transactions with directors or their associates), and
>
> section 42 (companies that are charities).'

Notwithstanding their shared substance, a few differences stand out at first glance between the Second Implementing Provision and the First Implementing Provision. First, the Second Implementing Provision does not deal with the issue of corporate capacity and ultra vires – a welcome improvement.[830] Secondly, the Second Implementing Provision is far longer and more detailed. Thirdly, the Second Implementing Provision introduced special regimes which

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[829] Supra note 827.

[830] Corporate capacity is dealt with in section 39 of the UK Companies Act and was previously dealt with in section 35 of the UK 1989 Act. The difference in the subject matter of these provisions and the Second Implementing Provision was noted *obiter* in *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579 where it was said that section 40 of the UK Companies Act and article 9(2) of the First Directive 'do not validate acts of directors which are outside the capacity of the company. They are concerned with the validation of acts outside the authority of the directors, but within the capacity of the company itself.'

apply in the case of contracts by companies that are charities and contracts by companies with directors and/or their associates, neither of which are dealt with in this thesis.

Before the text of section 40 is discussed, it is apposite to make a few remarks regarding companies' constitutions under the UK Companies Act and, specifically, section 40. In terms of section 17, the term 'constitution' has a wider meaning than merely the articles of association, as it also includes resolutions which have to be filed with the Companies House (such as special resolutions and resolutions amending a company's articles).[831] The memorandum of association is now treated as part of a company's articles and is only relevant when a company is formed – it is only the articles which remain continually relevant.[832] Model articles have been prescribed, which companies are free to adopt either in whole or in part.[833]

For the purposes of section 40, however, the term 'constitution' is defined even wider.[834] A person dealing with a company is not protected merely against limitations on directors' authority contained in a company's constitution as defined above, but also any limitations deriving from (i) a resolution of the company or of any class of shareholders or (ii) any agreement between the members of the company or of any class of shareholders.[835] Accordingly, not only special resolutions are included for the purposes of section 40 of the UK Companies Act, but also ordinary shareholders resolutions. The intention appears to be to include 'any formal rules laid down by the shareholders generally (or any class of them) for the conduct of the company's affairs, whether taking the form of the adoption of the alteration of the company's articles or not'.[836]

The range of documents included in section 40 is therefore much wider than the First Implementing Provision, which only referred to limitations on authority arising under a company's memorandum and articles. Any uncertainty as to whether persons dealing with a company would be protected against limitations contained in registered special resolutions

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[831] See sections 17 and 29 of the UK Companies Act.

[832] See sections 8 and 28 of the UK Companies Act.

[833] See footnote 175.

[834] Davies & Worthington op cit note 215 para 3-17 and 3-33.

[835] Section 40(3) of the UK Companies Act.

[836] Davies & Worthington op cit note 215 para 7-14.

has therefore been settled in favour of the person dealing with the company.[837] Section 40 does, however, not appear to go as far as the First Directive. The First Directive referred to limitations of authority not only under a company's statutes (interpreted as articles),[838] but also limitations contained in resolutions of 'competent organs'. This has been interpreted as including not only shareholders resolutions, but directors' resolutions as well.[839] The effect of such omission is, however, doubtful since, as with shareholders agreements, persons dealing with companies were never deemed to have notice of the contents of board resolutions anyway.

7.3.4 Analysis of section 40 of the UK Companies Act

7.3.4.1 Section 40 abrogates the constructive notice doctrine

The First Directive sought to neutralise the doctrine of constructive notice, by determining that internal limits on the authority of a company's organs of representation were ineffective against third parties, even if they were disclosed.[840] To this end, all of the Implementing Provisions contained a provision absolving a person dealing with a company from examining that company's constitutional documents or making enquiries regarding the powers of the directors of that company.[841] The widest formulation of this provision is to be found in Section 40(2)(b)(i) of the UK Companies Act, which states that a person dealing with a company is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so.

This provision represents a radical departure from the common law position in that third parties are not required to make inquiries regarding constitutional limitations on directors' authority. Constructive notice of unqualified exclusions of directors' authority contained in a company's constitution therefore no longer affects third parties.[842] It is, however, important to keep in mind that the effective abolition of the constructive notice doctrine in section 40 only

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[837] See Farrar & Powles op cit note 783 at 276 and Collier & Sealy op cit note 783 at 5 regarding this initial uncertainty.

[838] See Mayson, French & Ryan op cit note 90 at 622.

[839] Edwards op cit note 224 at 43.

[840] Edwards op cit note 207 at 204.

[841] See section 9(1) of the European Communities Act, section 35 of the UK 1985 Act and section 35B of the UK 1989 Act.

[842] Collier & Sealy op cit note 783 at 5. See also Pennington op cit note 299 at 130 and *Thanakharn* supra note 380 para 58.

applies when the other requirements for the application of that section are met, that is, when a person is 'dealing with a company'.[843] A person dealing with a company is also only relieved from inquiring regarding certain matters (ie limitations on the powers of directors), not the constitution of a company as a whole. Section 40 should therefore not be mistaken for a general and unequivocal repeal of the constructive notice doctrine, which surely would have been preferable.[844]

On the wording of section 40, it is arguable that absolution from making enquiries applies to all persons dealing with companies, even those doing so in bad faith. Such absolution will, of course, be cold comfort to persons dealing in bad faith, since those persons do not have the benefit of the deeming provision contained in section 40(1). Furthermore, while lack of making enquiries will by itself not disqualify a person dealing with a company, it may still potentially be a contributing factor in proving that persons was acting *mala fide* where the facts of the matter showed that person intentionally turned a blind eye.[845]

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[843] See Davies & Worthington op cit note 215 para 7-9. The meaning of this phrase is dissected below. See, however, Prentice op cit note 785 at 527, who appears to have read the First Implementing provision as a general abolition of the doctrine of constructive notice.

[844] The UK 1989 Act sought to introduce a general abolishment of the constructive notice doctrine into English company law, but the relevant section was never brought into force – see Davies & Worthington op cit note 215 para 7-26. See, however, Griffin op cit note 17 at 41-2.

[845] Infra para 7.3.4.3 and Eilis Ferran 'The reform of the law on corporate capacity and directors' and officers' authority: part 2' *Company Lawyer* (1992) 13(9) 177 at 177-8.

7.3.4.2 Who is 'a person dealing with a company'?

As alluded to above, perhaps the most difficult issue presented by section 40, as well as the other Implementing Provisions, is determining when an individual or entity will qualify as 'a person dealing with a company'. The answer to this question determines whether section 40 is applicable at all and is therefore of fundamental importance. The phrase may be broken into three parts, viz 'a person', 'dealing' and 'with a company', each of which raises questions and has attracted judicial comment.[846] These phrases are discussed below in turn.

7.3.4.2.1 'a person'

The First Directive only applied where a 'third party' dealt with a company, which has been interpreted by the English courts to exclude both directors[847] and shareholders.[848] Section 40 (and all of the other Implementing Provisions), however, uses the wider term 'person', which is clearly wide enough to include insiders and outsiders in relation to a company on a literal interpretation.[849] Despite section 40's wide wording, however, the courts appear to be reluctant to offer protection to insiders on the back thereof, especially where those insiders are charged with complying with the company's constitution (as in the case of directors)[850] or are dealing with the company as insiders (such as shareholders receiving bonus shares).[851]

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[846] The approach of breaking–up the phrase into parts should not be taken too far, as courts have also interpreted the phrase holistically. See, for instance, *EIC Services* supra note 790 para 35.

[847] At least a director who took part in breaching the constitutional limitations on directors' authority – see *Smith* supra note 790 at 793.

[848] *EIC Services* supra note 790 para 37.

[849] Christian Twigg-Flesner 'Sections 35A and 322 revisited: who is a "person dealing with a company"?' (2005) 26(7) *Company Lawyer* 195 at 196. See, in relation to the First Implementing Provision, Collier & Sealy op cit note 783 at 3 and 5.

[850] See *Smith* supra note 790. See, however, *Re Torvale Group Ltd* [2000] BCC 626 at 639. Regarding whether directors are covered by section 40 see, in general, Howell op cit note 804 at 266, Adrian Walters 'Section 35A and quorum requirements: confusion reigns' (2002) 23(11) *Company Lawyer* 325 at 325, Twigg-Flesner op cit note 849 at 196 and 199; Farrar & Powles op cit note 783 at 272, Farrar op cit note 240 at 46 and 47, Davies & Worthington op cit note 215 para 7-12 and Mayson, French & Ryan op cit note 90 at 624.

[851] See *EIC Services Ltd v Phipps* supra note 790 para 37, Twigg-Flesner op cit note 849 at 199 and Davies & Worthington op cit note 215 para 7-12.

7.3.4.2.2 'dealing'

The word 'dealing' also requires interpretation. When the First Implementing Provision was introduced, there was some uncertainty as to whether this term included a unilateral gratuity from a company.[852]

The Second Implementing Provision, however, sought to clarify this position by providing that a person 'deals' with a company if he is a party to any transaction *or other act* to which the company is a party.[853] The reference to 'other act' is indeed very wide and includes acts such as the issuing of options and debentures.[854] It has been argued that this clarification means that acts of gratuity on the part of the company are included within the ambit of the Second Implementing Provision.[855] However, in *EIC Services Ltd v Phipps*[856] it was held by the Court of Appeal that a bonus issue of shares was not 'dealing' for the purposes of section 35A of the UK 1989 Act.[857] The court said that section 35A contemplates a bilateral transaction between the company and the person dealing with the company or an act to which both are parties.[858] A bonus issue of shares therefore did not qualify, inter alia, because such an issue was an 'internal arrangement with no diminution or increase in the assets or liabilities of the company, with no change in the proportionate shareholdings and with no action

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[852] Farrar & Powles op cit note 783 at 272. *International Sales* supra note 792 at 58 could be argued to lend some support for the view that such gratuities did not fall within the ambit of the section. In that case, a director of a company had used the funds of that company to repay loans made by one of his acquaintances to another director of the company, who passed away insolvent. It was held that the recipient of the 'handouts' purportedly paid by the company on that occasion was not 'dealing' with that company, but instead with the director facilitating the repayments. This finding was, however, principally based not on the meaning of the word dealing, but the fact that the dealings were regarded as those personal to the director. Collier & Sealy op cit note 783 at 2 appeared to suggest that the term 'dealing' was wider than 'contracting'. Prentice op cit note 785 at 525 argued that gratuities should be included within the purview of 'dealing'.

[853] Section 35A(2)(a) of the UK 1989 Act and section 40(2)(a) of the UK Companies Act.

[854] *Ford* supra note 828 para 74.

[855] In relation to section 35A of the UK 1989 Act, see Poole op cit note 17 at 47, Claire Howell 'Section 35A of the Companies Act 1985 and an inquorate board: one won't do' *Company Lawyer* (2002) 23(3) 96 at 96 and Twigg-Flesner op cit note 849 at 199. See also Girvin, Frisby & Hudson op cit note 207 para 6-014.

[856] Supra note 792.

[857] Compare Collier & Sealy op cit note 783 at 3, who appear to have contemplated that an issue of bonus shares would have been 'dealing' under the First Implementing Provision.

[858] *EIC Services* supra note 790 para 35. See also *re Hampton Capital Limited* [2015] EWHC 1905 (Ch) paras 57-58 where it was held that section 40 was not intended to enable a person who received money from a company to answer a claim by that company of unjust enrichment by merely averring that the money was received in good faith.

required from any shareholders'.[859] A shareholder who pays for his/her shares, for example pursuant to a rights offer, would, however, be dealing with a company.[860] A *quid pro quo* approach should, however, not be pressed too far, as section 40 was surely intended to cover the granting of guarantees.[861] In *Cottrell v King*,[862] it was doubted, albeit *obiter*, whether a person receiving already issued shares from another shareholder would be dealing with the company which issued those shares, given that the company's role in such a transaction is limited to registering transfer. In other words, the purchaser in a sale of shares transaction will presumably not be dealing with the company in which shares are being purchased for purposes of section 40 when relying on representations by the representatives of that company as to whether the transfer of the shares has been registered.

In summary, the position appears therefore to be that, again, notwithstanding the apparent wide wording of the Second Implementing Provision, courts are hesitant to include within the purview of 'dealing' anything other than a transaction which is bilateral in a meaningful sense.[863]

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[859] Having such a one-sided act be subject to section 35A would also have been practically unworkable, as it would have resulted in the bonus issue being void in respect of some shareholders and valid in respect of others, depending on their circumstances - *EIC Services* supra note 790 para 35.

[860] *EIC Services* supra note 790 para 35.

[861] Twigg-Flesner op cit note 849 at 199.

[862] [2004] EWHC 397 (Ch) para 29.

[863] Davies & Worthington op cit note 215 para 7-12.

7.3.4.2.3 'with a company'

At the heart of each of the Implementing Provisions lies an apparent circularity:[864]

1. an Implementing Provision will only be invoked by a person dealing with a company where a board has exceeded its powers;
2. but to invoke the Implementing Provision, that person must have been dealing with that company;
3. strictly speaking, a person cannot be dealing 'with a company' if the board did not have authority to deal with that person.

Courts have justifiably been reluctant to indulge such overly literal reasoning, because it would render the Implementing Provisions ineffective.[865] This has meant that judicial interpretation has usually focussed on the purpose of the Implementing Provisions, namely to aid bona fide third parties contracting with companies by preventing those companies from raising constitutional limits on board authority against them.[866]

Such a purposive approach was taken in *TCB Ltd v Gray*.[867] This case dealt with a claim by a bank against one Gray based on a personal guarantee signed by him. The personal guarantee was granted in respect of any amounts which one of Gray's companies, namely Link, failed to pay pursuant to a debenture granted by Link to a bank as security for a loan by that bank to Link. Gray's debenture was therefore ancillary to the debenture issued by Link. When Link went into liquidation, the bank claimed on the personal guarantee against Gray, who opposed the action. Gray averred that the debenture had been invalidly granted by Link, which meant that the personal guarantee was also not valid, as it was ancillary to the debenture. The reason why the debenture was invalid, the court heard, was that it had been executed contrary to Link's articles of association. Link's articles required that a debenture must be sealed and signed by two directors or one director and the company secretary. In

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[864] Carnwath LJ in *Smith* supra note 790 at 791 eschewed a literal interpretation of section 35A of the UK 1989 Act, describing the circularity in this section in different terms: 'On its face, the section is about the "power of the board of directors" to bind the company, in favour of a person who is party to "any transaction … to which the company is a party". This begs two questions to which the section provides no direct answer: how does the "board of directors" exercise its power; and in what circumstances is a transaction to be treated as one to which the company is a "party"? Both questions can only be answered, under the ordinary law, by looking at the company's constitution. Yet that is the very inquiry which the section seeks to avoid.' See also Ferran op cit note 845 at 177 and Walters op cit note 850 at 325.

[865] *TCB* supra note 795 at 636 and *Smith* supra note 790 at 791.

[866] *Smith* supra note 790 at 777, *TCB* supra note 795 at 635. Academic opinion has also favoured a purposive approach – see Farrar op cit note 240 at 46.

[867] Supra note 795 (appeal dismissed (1987) 3 BCC 503 - the Court of Appeal dismissed Gray's appeal without considering the applicability of the First Implementing Provision).

casu the debenture had, however, been signed not by a director, but by Gray's attorney on the back of a power of attorney granted by Gray. Counsel for Gray therefore argued that, based on the literal interpretation of the First Implementing Provision, the debenture was not a 'transaction' to speak of, since the debenture had not been validly sealed and signed. This argument was accordingly based on the circularity referred to above – there was no transaction, so the First Implementing Provision was not triggered.

The court, however, dismissed this argument on purposive grounds, noting that such a literal interpretation would 'drive a coach and horses' through the First Implementing provision.[868] The learned judge stated:[869]

> 'It being the obvious purpose of the section to obviate the commercial inconvenience and frequent injustice caused by the old law, I approach the construction of the section with a great reluctance to construe it in such a way as to reintroduce, through the back door, any requirement that a third party acting in good faith must still investigate the regulating documents of a company.'

The circularity described above does, however, give rise to an important question, what level of 'unauthorised' engagement on behalf of a company should trigger section 40? For instance, can a third party dealing with a single non-executive director (or low ranking employee) rely on section 40? The intention of section 40 could hardly have been to place companies at the mercy of their agents. On the other hand, is section 40 only applicable where a third party deals with the whole board? That would render section 40 inapplicable in most scenarios where contracts are concluded. It is therefore necessary to determine what the 'irreducible minimum'[870] is which is required to be met in order for section 40 to be triggered.

The leading case on this point is the decision of the Court of Appeal in *Smith v Henniker-Major & Co (a Firm)*.[871] This case concerned a situation where a director and chairman of a company, one Smith, approved a cession by that company to himself of an action against a firm of attorneys. When Smith instituted proceedings against the firm, his claim was attacked on various grounds, including that the cession of the claim by the company to him was invalid. This was so, the firm argued, because the cession had been approved at an inquorate board 'meeting' where only Smith was present. The company had two directors at the relevant time and its articles required a minimum quorum of two directors for board meetings. Smith,

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[868] *TCB* supra note 795 at 636.

[869] Ibid.

[870] *Smith* supra note 790 at 777-8.

[871] Supra note 790.

however, argued that he was protected by section 35A of the UK 1989 Act. The relevant question in this instance was therefore whether a director and chairman of a company (Smith) could be said to have dealt with that company at all, given that the decision by the company's 'board' to sign a cession of a claim in favour of that director was taken at an inquorate meeting. Rimer J in the court a quo[872] held that inquorate board decisions should not trigger protection under section 35A of the UK 1989 Act. Walker LJ disagreed and held that section 35A was available to Smith, but Carwath LJ questioned Walker LJ's approach. Schiemann LJ did not directly address this point and, together with Carnwath LJ, dismissed the appeal. The various approaches of the judges are discussed below.

Rimer J held the view that the reference to the power of the 'board'[873] of directors to bind the company' in section 35A presupposed at least a valid exercise of power by the board.[874] An inquorate decision is a nullity – there has not been any exercise of powers by the board in such an instance and the application of section 35A was thus not triggered. Section 35A dealt with limitations on the powers of directors akin to the constitutional limits on authority to borrow money as in the *Turquand* case. A quorum requirement, however, does not meet the description of a 'limitation', since a quorum has absolutely no effect on the ambit of directors' powers. This conclusion was contrary to the wide interpretation of the word 'limitation' which was given in *TCB*[875] in respect of the First Implementing Provision. In that case it was argued that the constitutional requirements for the signing of a debenture did not constitute 'limitations' on the powers of directors. The court, however, differed and stated that:[876]

> 'Any provision in the articles as to the manner in which the directors can act as agents for the company is a limitation on their power to bind the company and as such falls within the first part of [the First Implementing Provision].'

Rimer J, however, did not accept such a wide approach. The learned judge pondered what the practical effect would be of classifying a quorum provision as a limitation. Would this mean that in substance a company would no longer have a quorum requirement in its constitution?[877] *TCB* could be distinguished from the current matter, the learned judge held, because in that case a board minute approving the relevant debenture had been put forward

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[872] *Smith v. Henniker-Major & Co (a Firm)* [2002] BCC 544.

[873] This wording is discussed in more detail in para 7.3.4.4 below.

[874] *Smith* supra note 790 at 780.

[875] Supra note 795.

[876] Supra note 795 at 636.

[877] *Smith* a quo supra note 872 at 549.

by the company and the individual directors had all favoured the transaction (even though no valid board meeting was actually held).[878] What was therefore necessary to show to engage section 35A was a transaction decided on by the board, and that threshold had not been met in casu.[879]

In the Court of Appeal, Walker LJ (in his dissenting opinion) thought that Rimer J had placed the bar for the application of section 35A too high. Walker was of the opinion that the word 'limitation' could cover quorum requirements. Crucial, in his mind, was the distinction between a nullity (or non-event) and a decision which was merely procedurally flawed. Section 35A should obviously not validate the former, but should be used to validate the latter, even if the irregularity was a quorum requirement.[880] What was needed to trigger section 35A was a 'genuine decision taken by a person or persons who can on substantial grounds claim to be the board of directors acting as such (even if the proceedings of the board are marred by procedural irregularities of a more or less serious character)'.[881] This distinction led the Lord Justice to eschew hard and fast rules for a flexible and imprecise test, which would have to be applied in an ad hoc way. In this case, Smith's meeting, although flawed would have met this threshold.

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[878] Ibid at 549-550.

[879] Ibid at 550-1.

[880] Walker LJ appear to agree with the wide definition of 'limitation'. For support of the wide view, prior to Henniker-Major, see Ferran op cit note 845 at 178.

[881] This approach appeared to receive implicit support in *Ford* supra note 828 paras 77-8. The approach of Collier & Sealy to the First Implementing Provision seems to also align with this approach – those authors required a board to have met or considered a transaction to trigger third party protection under that provision. See Collier & Sealy op cit note 783 at 5.

Carnwath LJ, in turn, disagreed with Walker LJ. In his view, the distinction between procedural and substantive irregularities didn't increase certainty. Under the company's constitution, Smith's one-man board meeting was a nullity.[882] Why should this non-event therefore be characterised as a mere procedural irregularity? What matters is what has been put forward by the persons with apparent authority to represent the company. In Carwath LJ's words, the policy introduced by the First Directive could be summed-up as follows:[883]

> '… if a document is put forward as a decision of the board by someone appearing to act on behalf of the company, in circumstances where there is no reason to doubt its authenticity, a person dealing with the company in good faith should be able to take it at face value …. In principle, where the person in question is a third party in the ordinary sense, a wide interpretation is wholly appropriate.'

This explains, the Lord Justice held, why in *TCB* the court accepted that a minute of a meeting of directors which had, in fact, not been held, could trigger the application of the relevant Implementing Provision. The point is that the minute was represented as a decision by 'someone having apparent authority so to represent it, and in circumstances in which the other party was entitled to rely on the representation'.[884] The Lord Justice did, however, caution that he was not attempting to set a general test.

Commentators appear to be divided on which of the abovementioned approaches should be followed.[885] Hard cases make bad law and the facts of *Smith* were quite far removed from the situation of a bona fide outsider attempting to contract with a company - so general conclusions should only be drawn cautiously from this judgment. Rimer J's approach probably does set the bar too high – requiring a quorate board decision in order to trigger section 40 would undo much of the good this section is designed to do.[886] This approach loses sight of the fact that, from a third party's point of view, there is no way to tell whether a board decision was quorate, especially given the fact that no knowledge of the company's

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[882] *Smith* supra note 790 at 791.

[883] At 792. Carnwath LJ's comments were technically made in relation to the First Directive, but the courts have interpreted this statement as accurately reflecting the policy behind the Second Implementing Provision – see *Cottrell* op cit note 862 para 27 and *EIC Services* op cit note 790 para 34 and 38. See Girvin, Frisby & Hudson op cit note 207 para 6-013.

[884] *Smith* supra note 790 at 791-2.

[885] For instance, Davies & Worthington op cit note 215 para 7-12 support Walker LJ's approach, whereas Mayson, French & Ryan op cit note 90 at 624 support Carwath LJ's approach. For support of Rimer J's approach, see Walters op cit note 850 at 325.

[886] See Ferran op cit note 845 at 178.

constitution is attributed to that third party.[887] It has been suggested[888] that on this approach the third party would have to rely on the *Turquand* rule where the board was inquorate.[889] This suggestion, however, loses sight of the fact that the third party would not have constructive notice of the company's constitution, which would make the application of the *Turquand* rule tenuous at best.

The answer lies somewhere between the view of Carnwath LJ and Walker LJ. Walker LJ's distinction between nullities and procedural irregularities can only take one so far. It may be helpful where 'true' procedural irregularities exist, such as, for instance, defects as to the notice or location of a meeting.[890] Generally, its usefulness is doubtful, because the line between procedural irregularity and nullity can be thin and blurry. Carnwath LJ's approach has found judicial support,[891] and, it is submitted, is the most practically workable, because, like the common law of principles of ostensible authority, it determines whether a third party should be protected based on what was represented to that third party.[892] Indeed, from a third party's perspective, the difference between procedural and substantive irregularities in board decisions is non-existent. The risk of this approach is third party over-protection, but this could hopefully be curtailed by the good faith requirement[893] and the requirements of proving the ostensible authority of single company agents.[894] In sum, Carnwath J's approach should be accepted, as it is the most in line with a Third Party Perspective of corporate contracting.

7.3.4.3 The good faith requirement

Article 9(2) of the First Directive, being an outright prohibition, did not require good faith on the part of the third party dealing with a company to enable protection under that article. The

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[887] Howell op cit note 855 at 98. Perhaps the example given by counsel in the court a quo illustrates this point even better. Imagine one company's constitution requires shareholders' consent to borrow above Rx, whilst another company's constitution instead requires a higher board quorum to borrow above Rx. Surely, from a third party's point of view, it seems unreasonable to be protected in the first instance but not in the second. Rimer J, however, did not budge. See court a quo in Smith a quo supra note 124 at 549.

[888] Howell op cit note 855 at 97-8.

[889] Supra note 565.

[890] *Ford* supra note 828 para 78.

[891] *Cottrell* op cit note 862 para 27, *EIC Services* op cit note 790 para 34. See also the judgment of Neuberger J in the court a quo in *EIC Services Ltd v Phipps* [2003] EWHC 1507 (Ch) para 205.

[892] Farrar op cit note 240 at 47.

[893] This will not necessarily be an easy task, given the statutory presumptions in favour of good faith - see Howell op cit note 804 at 268-9 and para 7.3.4.3 below.

[894] Infra para 7.3.5.

drafters of the First Directive were not blind to this issue, the term good faith was in fact specifically omitted from the final draft of the First Directive, as it was thought to be too ambiguous to apply across the whole continent.[895] It was envisaged that each member state would introduce their own measure which would protect companies from unscrupulous third parties using that article to validate their transactions.[896] Although no criterion was expressly included, there is some indication that the drafters of the First Directive agreed that article 9(2) should not apply in instances of fraud by a third party.[897]

The English legislature decided to include the good faith standard in the First Implementing Provision and it has been a feature of all of the Implementing Provisions. This requirement is therefore a pre-requisite for the application of section 40, as a person dealing with a company other than in good faith cannot rely on that section.[898] Crucially, the Implementing Provisions presumed good faith on the part of the person dealing with the company, thereby placing the onus to prove lack of good faith on the company against which those provisions are wielded.[899]

The important question, then, is what will constitute a lack of good faith on the part of the person dealing with a company? Does knowledge of the constitutional limitations which were being exceeded by the directors acting on behalf of the company constitute bad faith? The position was quite uncertain under the First Implementing Provision. Collier and Sealy argued that if a third party had actually read and understood[900] a company's memorandum and articles and it was clear from those documents that the directors could not bind the company to a transaction, then that third party would be lacking good faith.[901] Farrar and Powles, on the other hand, argued that mere knowledge of a company's public documentation could not show a lack of good faith – in their words – it was 'difficult to see what is involved

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[895] Farrar & Powles op cit note 783 at 273. Surveying the uncertainty among English commentators regarding the ambit of the term as used in all of the Implementing Provisions, one has to say that this suspicion was well-founded.

[896] Edwards op cit note 224 at 39 and Edwards op cit note 207 at 204.

[897] Ibid.

[898] In *Ford* supra note 828 para 73 the good faith requirement was referred to as the 'touchstone' of section 40.

[899] Poole op cit note 17 at 47, Davies & Worthington op cit note 215 para 7-10. See *Sargespace Limited v Eustace* [2013] EWHC 2944 (QB) para 35. See, in relation to the First Implementing Provision, *International Sales* supra note 792 at 58.

[900] This scenario was to be distinguished from a scenario where a third party had read and not understood those documents, which commentators argued should not constitute bad faith. See Collier & Sealy op cit note 783 at 3. See also Prentice op cit note 785 at 524-5.

[901] Collier & Sealy op cit note 783 at 2.

short of fraud'.[902] What was immediately apparent, however, was that the mere lack of making enquiries regarding constitutional limitations on directors' authority would not constitute bad faith, as the First Implementing Provision (and, subsequently, the Second Implementing Provision) relieved a third party from making such enquiries.[903]

The Second Implementing Provision, however, answered the knowledge question decisively in favour of the third party by providing that a person dealing with a company is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution.[904] Uncoupling knowledge from good faith can be said to be broadly in line with article 9(2) of the First Directive, which applied regardless of the knowledge or bona fides of a person dealing with a company.[905] Actual knowledge on the part of a person dealing with a company of that company's constitution therefore does not constitute bad faith, whether that person understood the significance of its provisions or not.[906] Conversely, lack of knowledge also does not establish good faith.[907] This does not, of course, mean that knowledge of lack of authority is completely irrelevant – it must just not be equated with a lack of good faith.[908] Knowledge of lack of authority may therefore constitute an 'ingredient' of proving bad faith, but what else is required?

In *International Sales & Agencies Limited v Sidney Marcus*[909] it was held that, under the First Implementing Provision, a person dealing with a company lacked good faith where that person knew that the transaction entered into was ultra vires and in breach of duty and trust, or could not have been unaware of that fact. The court's determination that a person dealing with a company would not be protected where that person actually knew (or could not have been unaware) that a transaction was ultra vires is not directly relevant to this thesis.[910] What

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[902] Farrar & Powles op cit note 783 at 273.

[903] See *TCB* supra note 795 at 636 and para 7.3.4.1 above.

[904] See section 40(2)(iii) of the UK Companies Act and section 35A(2)(b) of the UK 1989 Act.

[905] Poole op cit note 17 at 48.

[906] Ibid.

[907] Ferran op cit note 845 at 177-8.

[908] See *Ford* supra note 828 para 73, Davies & Worthington op cit note 215 para 7-10.

[909] Supra note 792 at 57 and 59.

[910] This statement was not as controversial as it sounds, given that the First Directive specifically gave national legislatures the option to qualify its implementation of article 9(1) of the First Directive in that way - supra note 793.

needs more careful consideration, was the statement that lack of good faith on the part of the person dealing with the company could be shown from the fact that they had actual knowledge (or could not have been unaware) that the director in question was making the relevant payments to them in breach of their fiduciary duties to the company. Such an approach was perhaps warranted in that case, as the payments made by the relevant director had nothing to do with the business of the company and were made for personal reasons.[911] This approach cannot, however, would not work if it means that knowledge of breach of *any* fiduciary duty by a company's directors' on the part of a third party constitutes a lack of good faith by that party.[912] This is because all directors are obliged to abide by the constitutions of their companies and any transaction entered into by them exceeding their constitutional powers technically equates to breach of their fiduciary duties. If knowledge that a director is acting in excess of his/her constitutional authority would render a third party in bad faith, then this would be in conflict with the terms of section 40, which expressly provide that this is not so.[913]

The approach in *International Sales* seemed to be echoed in *Ford v Polymer Vision Ltd*,[914] without direct reference. In this case, the court was asked to declare valid via summary judgment a debenture and an option which had been issued by a company. The court held that the first question to be asked was whether the company's directors were misusing their powers by issuing the debenture and/or option, because if they were not then it would be impossible to see how it can be said that the person dealing with the company was not acting in good faith.[915] In casu, it was found that the granting of the debenture could not be faulted, because its terms were not unusual or unfair and that its granting was not a misuse of the directors powers. The validity of the option was, however, sent to be determined at a trial, because the terms of the option were far more striking - the third party was granted the right to purchase the company's entire business and all of its assets at a price not market-related.[916] This meant that the good faith of the third party could at least be doubted, because there was doubt about whether the directors were misusing their powers.

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[911] Supra para 7.3.4.2.2.

[912] Twigg-Flesner op cit note 849 at 197.

[913] Davies & Worthington op cit note 215 para 7-10.

[914] Supra note 828.

[915] Para 80.

[916] Ibid paras 88-89.

It seems therefore that one of the 'ingredients' which may be added to actual knowledge of lack of authority in order to constitute bad faith is knowledge of a breach of directors' fiduciary duties (including the duty not to misuse their powers but excluding the duty not to exceed their powers under the constitution) in dealing with the third party. This approach appears to be in line with *Wrexham Association Football Club Ltd (in admin.) v Crucialmove Ltd*,[917] which dealt with the question of the validity of contracts signed on behalf of a company by directors *prima facie* not acting in the company's interests and without adequate disclosure of those directors' personal interests in the transaction. In that case Sir Peter Gibson wrote:

> 'I do not see that either s.35A or s.35B [ie the first version of the Second Implementing Provision] absolves a person dealing with the company from any duty to inquire whether the persons acting for the company has been authorised by the board to enter into the transaction when the circumstances are such as to put that person on inquiry'

Where suspicious circumstances exist, such as, presumably, the directors acting in breach of their fiduciary duties, a person dealing with a company is still required to make enquiries regarding the authority of the company's representatives. What needs to be kept in mind, however, is that these enquiries have been uncoupled from a company's constitution, of which the person dealing with a company no longer has any constructive notice. This position is not settled, however, and certain commentators argue that only fraud and/or deceit will suffice to render a person dealing with a company as lacking good faith.[918] Other factors indicating lack of good faith will have to be developed by the courts on an ad hoc basis.[919]

7.3.4.4 What does section 40 deem?

Provided that a person can be said to be dealing with a company in good faith, then section 40 deems the power of the directors to bind the company, or authorise others to do so, to be free of any limitation under the company's constitution. This wording also requires careful scrutiny.

First, what does the 'power of directors' refer to? Does this include the power of individual directors to conclude contracts on behalf of companies? As alluded to above, the First Directive probably covered acts purportedly done not only by whole boards, but also by

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[917] [2007] BCC 139 at 164.

[918] Griffin op cit note 17 at 42.

[919] Ferran op cit note 845 at 178.

single executive directors.[920] The text of the Implementing Provisions, forever struggling with the best way to translate 'organ' into English terms, have, however, not been clear on this issue.[921] The First Implementing Provision only applied where there was 'a transaction decided on by the directors'. There was some uncertainty as to how this phrase should be interpreted. Some argued for a wide interpretation, including not only acts by de facto directors in accordance with the common law application of the *Turquand* rule,[922] but also acts of single directors acting in accordance with policies set by the board.[923] Interpreting this phrase too narrowly could deprive the third party of all protection, since companies rarely contract through their boards acting collectively.[924] Other commentators took a more narrow textual approach, excluding single directors[925] as well as de facto boards[926] from the application of the section.

English courts appeared to have adopted a fairly flexible approach to the interpretation of this phrase. In *International Sales & Agencies Limited v Sidney Marcus*[927] it was found that a decision which was taken by only one of the various directors of (each of) two companies would qualify as having been 'decided on by the directors', because that director 'was the sole effective director to whom all actual authority to act for the companies was effectively delegated'. In *TCB* it was held that a transaction had been 'decided on by the directors', despite no board meeting having been held to approve the granting of the relevant debenture, because the directors of the company had each individually decided to grant the debenture, although not at a meeting at which they were all present.[928] Amendment to the phrase was called for already upon the promulgation of the First Implementing Provision,[929] but this only

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[920] Edwards op cit note 224 at 43.

[921] See Farrar op cit note 240 at 47.

[922] Supra para 6.3.2.

[923] Prentice op cit note 785 at 526.

[924] Ibid.

[925] See Collier & Sealy op cit note 783 at 4, when interpreting the phrase 'a transaction decided on by the directors' in the context of the abolishment of the ultra vires doctrine, stated the following (original emphasis): 'the board might appoint a purchasing manager and authorise him to buy for the company. If he decides to buy a ton of coke, the decision is arguably that of the directors, but surely the better view is that it is not. There is no case where a manager has been treated as *the directors'* alter ego'. See also Farrar & Powles op cit note 783 at 273-4.

[926] Collier & Sealy op cit note 783 at 5.

[927] Supra note 792 at 59.

[928] Supra note 795 at 637. See, however, footnote 324.

[929] Farrar & Powles op cit note 783 at 275.

materialised with the introduction of section 35A of the UK 1989 Act (the first version of the Second Implementing Provision).

The Second Implementing Provision no longer referred to any 'transaction decided on by the directors'.[930] Instead, the first version of the Second Implementing Provision, namely section 35A of the UK 1989 Act, merely referred to limitations on the powers of *the board* of directors to bind a company.[931] As we have seen, the reference to the board raised questions regarding whether a valid board decision was necessary to trigger protection under that section.[932] Section 40, however, only refers to the powers of 'directors' and not the 'board of directors', which seems to suggest that decisions of directors are included even if they were not taken at quorate meetings.[933] Some uncertainty remains regarding the effect of section 40 where a contract is concluded by de facto directors.[934]

The Second Implementing Provision, however, did not stop at the deeming the powers of the board/directors to be unlimited. The power of the board/directors to *authorise others to bind the company* is also deemed to be free of any limitation under the company's constitution. This provision was presumably inserted in order to prevent companies from raising constitutional limitations when dealing through single agents. The words 'or authorise others to do so' in section 40(1) should not, however, be interpreted to give third parties the right to assume that the proverbial office boy has been authorised by the board – it is still necessary, based on the principles of agency, for the single agent representing a company to be acting within his/her usual authority.[935]

Secondly, it is the powers of directors only which are subject to this deeming provision. The powers of the body of shareholders to represent the company (however unlikely), are

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[930] This could potentially have been because that phrase was more closely connected to the portion of the First Implementing Provision which dealt with corporate capacity. Therefore when the legislature decided to split the sections which dealt with corporate capacity and directors' authority into different provisions, that reference fell away in respect of the relevant provisions dealing with directors' authority. This reasoning has, however, not found favour with the courts, which applied the phrase 'transaction decided on by the directors' as also applying in instances where a company was concluding intra vires contracts. See *International Sales* supra note 792 at 58-9 and *TCB* supra note 795 at 625.

[931] Walker LJ in *Smith* viewed this change as significant, because the use of the phrase 'board of directors' was closer to the word 'organ' used in the First Directive than merely referring to the 'directors'. See *Smith* supra note 790 at 776.

[932] Para 7.3.4.2.3.

[933] Davies & Worthington op cit note 215 para 7-13.

[934] See Stephen Griffin 'Directors' authority: the Companies Act 1989' *Company Lawyer* (1991) 12(5) 98 at 99.

[935] Poole op cit note 17 at 48, Ferran op cit note 845 at 178 and para 7.3.5 below.

therefore excluded from section 40.[936] Other non-directors, who potentially may receive their powers of representation directly from the constitution, such as the company secretary, would presumably not be covered.[937]

Thirdly, the scope of section 40 may also be better understood by describing what the section does not deem. Section 40 does not apply to mere statements of intent, but only to legal transactions.[938] So, for instance, it should not be assumed that if a director tells a third party that the company will sign a contract that section 40 may be invoked to deem that contract to be valid. In that scenario only once legal obligations have been created in the ordinary course (usually when pen is put to paper) does section 40 become relevant. Section 40, like the other Implementing Provisions, also does not make illegal transactions legal.[939] The section also does not have anything to say about whether the exercise of directors' discretion in any given scenario was proper or not.[940]

7.3.4.5 In whose favour does section 40 operate?

Section 40 operates only in favour of the person dealing with a company.[941] The company cannot, for instance, rely on section 40 to validate the transaction as against the person with whom it is dealing, although nothing prevents the company from ratifying the transaction.[942] The one-sided nature of section 40 accords with article 9(2) of the First Directive.[943]

Section 40 does not, however, affect the internal remedies available to members to restrain directors from exceeding their powers.[944] No such proceedings, however, lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the

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[936] As noted in 243, traditionally the body of shareholders was seen as an organ through which a company could contract, although this has somewhat fallen away in recent times. Davies & Worthington op cit note 215 para 7-13.

[937] It is important not to confuse this with the powers of representation of single agents who are authorised by the board to act on behalf of the company. As discussed above in this paragraph, actions by such agents would be covered by section 40. See Prentice op cit note 785 at 528 in relation to the First Implementing Provision.

[938] Ferran op cit note 845 at 179.

[939] See, in relation to the First Implementing Provision and the First Directive, Prentice op cit note 785 at 527.

[940] *Morshead Mansions Limited v Langford and others* [2003] EWHC 2023 para 121.

[941] Twigg-Flesner op cit note 849 at 196, Ferran op cit note 845 at 177 and Mayson, French & Ryan op cit note 90 at 622. See, in respect of the First Implementing Provision, Prentice op cit note 785 at 524.

[942] Davies & Worthington op cit note 215 para 7-10.

[943] *Smith* supra note 790 at 793.

[944] Section 40(4) of the UK Companies Act. See Griffin op cit note 17 at 43. In relation to the First Implementing Provision, see Prentice op cit note 785 at 526.

company.[945] This effectively means that shareholders are only able to prevent directors from exceeding their powers *before* a transaction is concluded with a third party.[946] Once legal obligations come into being, however, the third party's interests take precedence over those of the shareholders. This remedy is therefore rather timid – before a contract the signed, the shareholders may not even be made aware of its terms, but after it is signed it is too late.[947]

Directors are, quite apart from section 40, subject to the general duty to act within their powers, which means that a director may incur personal liability towards his/her company if he/she exceeded his/her authority.[948] Liability may in this regard conveniently be founded on section 171 of the UK Companies Act, which places a duty on a director to act in accordance with the company's constitution and only exercise his/her powers for the purposes for which they are conferred.

7.3.5 How has the common law been affected?

When considering the effect of section 40 of the UK Companies Act (and the Implementing Provisions in general), it is first apposite to note that none of the Implementing Provisions sought to abolish any common law rules expressly. It is therefore theoretically open to any person dealing with a company to raise the *Turquand* rule against a company where section 40 does not apply or, where section 40 does apply, in the alternative.[949]

As we have seen, under the common law:

1. third parties were bound to Exclusion Clauses by virtue of the doctrine of constructive notice;[950]
2. while third parties were deemed to have notice of Reserved Matters Clauses and other procedural clauses, their position was ameliorated by the *Turquand* rule;[951] and
3. the absence of an Exclusion Clause was noted as one of the requisites for proving a representative's ostensible authority in *Freeman*.[952]

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[945] Section 40(4) of the UK Companies Act.

[946] Davies & Worthington op cit note 215 para 7-10, Poole op cit note 17 at 48.

[947] This may have particularly harsh effect on minority shareholders, as constitutional limitations on authority tend to be reserved matters in their favour – see Griffin op cit note 934 at 98-9.

[948] Section 40(5) (previously section 35A(5) of the UK 1989 Act). This will obviously not be possible where the company has ratified the directors' behaviour. See Poole op cit note 17 at 48 and Griffin op cit note 17 at 43.

[949] Ferran op cit note 845 at 178 (in relation to section 35A of the UK 1989 Act).

[950] Supra para 6.2.

[951] Supra para 6.3.

[952] Supra para 4.5.7.

All three of the abovementioned statements have been affected by the introduction of the Implementing Provisions (and section 40 in particular). Regarding, statement number 1, a company may no longer raise constitutional limits on directors' authority against a third party, even if those limits are unqualified. Furthermore, the constructive notice rule may not be wielded by the company against the third party. Statement 1 has therefore been radically overturned in favour of a third party.[953] For the same reasons, qualified constitutional limitations have become irrelevant from a third party's perspective. Statement 2 has therefore not so much been overturned, as it has been replaced – third parties will now rely on section 40 instead of the *Turquand* rule when qualified constitutional limits are raised against them. Taken together, the changes to statements 1 and 2 means that a third party dealing with a board (acting collectively) in good faith can rest assured that its transaction is safe (provided that the requirements for the application of section 40 are met). Companies with one-person boards should take note.

Regarding statement 3, section 40 does not assume that a director contracting on behalf of a company has been properly authorised in terms of agency principles.[954] When a third party deals with a company agent, it is, quite apart from the requirements of section 40, still required to prove the (ostensible) authority of that agent.[955] The Court a quo in *Wrexham Association Football Club Ltd (in admin) v Crucialmove Ltd* stated that the Second Implementing Provision (in the form of section 35A of the UK 1989 Act) (my emphasis):[956]

> 'is designed to relieve third parties of the need to check limitations on the authority of the board contained in the company's constitution. It removes restrictions on board powers imposed by the

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[953] See Farrar & Powles op cit note 783 at 276 and Collier & Sealy op cit note 783 at 5 in relation to the First Implementing Provision.

[954] See Collier & Sealy op cit note 783 at 5, Prentice op cit note 785 at 528 and Farrar & Powles op cit note 783 at 276, in relation to the First Implementing Provision.

[955] See Prentice op cit note 785 at 528 in relation to the First Implementing Provision. See, in relation to the Second Implementing Provision, Griffin op cit note 17 at 42 and Ferran op cit note 845 at 177 and 179. See also *Criterion Properties* supra note 282 at 1848, where Lord Nicholls confirmed that when considering whether a contract was valid and binding on a company, the relevant legal principles were the principles of agency, having due regard to the *Turquand* rule and the relevant sections of the UK Companies Act. The unmistakable implication therefore is that the Second Implementing Provision was not itself a basis for a valid agreement concluded by a company agent, but must be applied in conjunction with agency principles. See also the opinion of Lord Scott at 1855-6. See, however, Twigg-Flesner op cit note 849 at 196.

[956] Supra note 917 at 152 – this statement was not overruled on Appeal. See also, for instance, Prentice op cit note 785 at 528, who submitted that the First Implementing Provision 'does not modify the normal doctrine of agency as they apply to companies. All that [the First Implementing Provision] does is to provide that restrictions in the articles or memorandum of association cannot curtail the otherwise apparent authority of corporate directors. However, before the a company will be bound by the acts of its directors there will still have to be a finding that they had authority to enter into the transaction in question, in other words, that the transaction fell within the scope of their apparent or actual authority.'

constitution, *but it does not of itself establish those board powers in the first place*. A board of directors simply does not have power to effect transactions which are not for the benefit of the company. That is not because of some restriction in the constitution, *but is part of the ordinary law of agency*.'

As the law currently stands, an agent contravening a constitutional limitation on his/her powers (or on that of the board to authorise him/her) cannot have *actual authority* according to agency principles.[957] Since section 40 will only be raised in circumstances where some constitutional limitation on authority has been breached, this means that section 40 will only be relevant where a third party is attempting to rely on the *ostensible authority* of a company agent. The main effect of section 40 in this enquiry is that reliance on the ostensible authority of an agent can no longer be precluded by constructive notice of constitutional limitations on the authority of the board. Statement 3 has therefore fallen away. This is a good result, since avoiding a contract based merely on constructive notice of a constitutional limitation where the company agent signing that contract otherwise would have had ostensible authority is an unfair result to the third party.

Much more difficult is the (albeit unlikely) situation where a third party has actual knowledge of a constitutional limitation. Section 40 expressly states that a third party with such knowledge is not regarded to be lacking good faith. However, would such knowledge not have an effect on proving the other elements of the *Freeman* test? In particular, the third requirement of the *Freeman* test requires that a third party must have relied on a representation as to the authority of a company's agent. Indeed, how can a person be said to have relied on a representation if they had actual knowledge that such representation could not be true?[958] Perhaps this outcome is not as bad as it may seem – why should a third party who has *actual* knowledge of an unqualified constitutional limitation be allowed to hold a company bound? Remember, the third party is not bound to make inquiries regarding a company's constitution, so this interpretation would only cover the case where a person dealing with a company has actually been informed that the persons representing the company do not have authority *at all*. Actual knowledge of a *qualified* limitation on authority is, of course, another matter. In such circumstances, both section 40 and the common law protects the third party.

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[957] See para 4.4 and Ferran op cit note 845 at 179. See, however, Griffin op cit note 934 at 98.

[958] See, in this regard, Poole op cit note 17 at 48.

Perhaps the simplest way to look at it is to merely take the approach that the sole question now is 'whether the agent was acting within his authority irrespective of the company's constitution'.[959] That approach certainly accords with a Third Party Perspective of corporate contracting. The constitution should therefore be irrelevant except in one instance, where a third party, while not being under any duty to enquire regarding the company's agent's authority, has actual knowledge that the agent does not have authority under the constitution *at all*. In such a case, the third party would not only fail the reliance criterion in the *Freeman* test, but such knowledge could be an ingredient (but not the sole ingredient) in proving that such third party lacked good faith for the purpose of section 40.[960]

7.4 CONCLUSION

Generally, it may be said that section 40 and the other Implementing Provisions have reinforced the Third Party Perspective, by rendering constitutional limitations on board power irrelevant to a third parties. Interpretational issues do, however, persist and the wording of the Implementing Provisions has been criticised.[961] Nevertheless it is submitted that valuable lessons may be gleaned from a South African perspective which is, inter alia, what Chapter 8 intends to do.

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[959] See Girvin, Frisby & Hudson op cit note 207 para 6-013.

[960] Supra para 7.3.4.3.

[961] Farrar op cit note 240 at 45.

CHAPTER 8: CORPORATE CONTRACTING UNDER THE COMPANIES ACT

8.1 INTRODUCTION

This Chapter examines the provisions introduced by the Companies Act which regulate corporate contracting, in light of what has been discussed in previous Chapters.

8.2 THE COMPANIES ACT

8.2.1 Background to the Companies Act

The Companies Act was the result of the first major revamp of corporate legislation since the 1970s.[962] This process began in earnest with the release by the DTI in 2004 of a document entitled 'South African Company Law for the 21st Century: Guidelines for Corporate Reform'.[963] This document sketched the outline of a new corporate law which was to be 'appropriate to the legal, economic and social context of South Africa as a constitutional democracy and an open economy.'[964] The corporate law that it envisaged would promote the international competitiveness of our economy[965] and would be simpler[966] and more flexible[967] than before.

Disappointingly, this document did not deal with the authority of corporate representatives directly, although it did contain statements regarding the related issue of corporate capacity.[968] What is interesting is the document's reference on this point (and others) to legislative developments in the UK, showing that English law's influence on corporate law in

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[962] For a first-hand account of the process which led to the promulgation of the Companies Act, see T Mongalo 'An overview of company law reform in South Africa: from the guidelines to the Companies Act 2008' in T Mongalo (ed) *Modern Company Law for a competitive South African Economy* (2010).

[963] Op cit note 113.

[964] Ibid at 7.

[965] Ibid at 8, 9 and 13.

[966] Ibid at 9, 27 and 30.

[967] Ibid at 8, 28 and 30.

[968] See, in particular, the statement regarding capacity limitations and third parties ibid at 32, which arguably portended section 20(7). Also see at 8, 28 and 30.

this country has not withered away.[969] It is fair to say, however, that corporate representation was not a headline issue in the lead-up to the Companies Act.[970]

The report was followed in 2007 by a Companies Bill, which was amended substantially in the Companies Bill of 2008. The latter Bill formed the basis for the Companies Act, although it required amendments to a substantial number of sections upon promulgation.[971] The Companies Act finally became operative on 1 May 2011.[972]

8.2.2 Some relevant general features of the Companies Act

Before dealing with the provisions of the Companies Act which directly affect corporate contracting, it is necessary to highlight some general features introduced by the Act.

8.2.2.1 The same rules apply to public and private companies

The Companies Act retained public and private companies,[973] the traditional distinctions relating to transferability of shares and offers to the public remaining applicable.[974] As we noted in Chapter 2,[975] from a corporate representation perspective, however, public and private companies have always, at least in legislation, basically been treated the same and that trend is continued under the Companies Act.[976]

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[969] The DTI's report referenced a consultative report by the The Company Law Review Steering Group of the UK, which was undertaking the corporate law reform process which would ultimately result in the UK Companies Act. See also the references to the documents published by the English Department of Trade and Industry ibid at 22. It is, however, undoubtedly also the case that the document draws from American law.

[970] Note, for instance, that this issue is only very briefly mentioned by authors in Mongalo (ed) op cit note 962 at 184, 252 and 468. A notable early exception was Delport op cit note 3.

[971] See Companies Amendment Act 3 of 2011.

[972] See Proc R32 *GG 34239* of 26 April 2011.

[973] As mentioned in Chapter 1, the focus in this thesis will be on public and private companies. These are, however not the only companies which are allowed to be formed under the Companies Act. Other companies allowed under the Act are state-owned companies; personal liability companies and non-profit companies. See section 8 of the Companies Act.

[974] Section 8(2)(b)(ii) of the Companies Act. A public company is simply defined as a profit company which is not a private company, a state-owned company or a personal liability company.

[975] Supra para 2.5.3.

[976] The only practical difference is the fact that sole directorships are allowed in respect of private companies but not in respect of public companies, which means that the provisions facilitating management of such companies, which are dealt with in 8.2.2.2 below, are only intended to apply to private companies.

8.2.2.2 Sole directorships (and sole shareholders)

The Companies Act introduced novel provisions simplifying the internal governance of companies with sole shareholders, sole directors and companies of which every shareholder is also a director.[977] For instance, sole directors and sole shareholders are respectively entitled to exercise functions and voting rights 'without notice or compliance with any other internal formalities'.[978] This provision may, in appropriate circumstances, provide a simple and useful rebuttal to a company seeking to raise non-compliance with internal formalities against a third party.

8.2.2.3 The MOI and 'alterable provisions'

The memorandum and articles of association have been replaced by a single constitutive document, namely the MOI, which outranks any other conflicting shareholders' agreement.[979] In keeping with tradition, the legislature provided a standard MOI which may be used by companies, although the 'long-form' MOI attached to the Companies Act is sparse compared to its predecessor. This is due to the introduction of a range of 'alterable provisions', which are intended as a set of default rules applicable to a company, unless altered in a company's MOI.[980] In fact, the standard long form MOI amounts to little more than a list of statements recording whether a particular alterable provision is applicable to a company or not, with the incorporators/shareholders to provide details of any deviations.[981]

8.3 A STATUTORY BOARD'S GENERAL AUTHORITY CLAUSE

8.3.1 Section 66(1) of the Companies Act

In Chapter 3, it was noted that South African company law followed English example by leaving the board's authority to be regulated by the articles, usually in the form of a Board's General Authority Clause.[982] The board's power or authority to manage a company's business

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[977] Section 57.

[978] Sections 57(2)(a) and 57(2)(b). A company's MOI may, however, negate this section.

[979] See section 15 of, and item 4 of Schedule 5 to, the Companies Act.

[980] The Companies Act defines an alterable provision in section 1 as a 'provision of this Act in which it is expressly contemplated that its effect on a particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by that company's Memorandum of Incorporation.' Compare with definition of 'unalterable provisions'.

[981] See Form CoR 15.1B.

[982] Supra para 3.2.2.

was therefore traditionally regarded has having been given to the board by the shareholders through the articles.[983] This has now irrevocably changed, through the introduction of section 66(1) of the Companies Act, which reads as follows:

> 'The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.'

The granting of management powers to directors directly through statute was the approach traditionally followed in the United States of America[984] and has been adopted in English-based jurisdictions like Australia[985] and New Zealand in recent decades.[986] In the UK, however, the traditional position prevails.[987]

There is some controversy regarding the importance of the source of the board's powers. South African courts have emphasised the conceptual significance of section 66(1). In *Navigator Property Investments (Pty) Ltd v Silver Lakes Crossing Shopping Centre (Pty) Ltd*,[988] for instance, the Court noted that 'the ultimate power in a company is now with the board of directors, and not with the shareholders.'[989] Commentators, too, have noted this section's significance.[990] Cassim has argued that the section represents a shift away from a shareholder-centric contractarian model of the company constitution towards a director-centric 'division of powers model'.[991] This is in line with the views espoused by British commentators, namely that the fact that the board's power stems from the constitution serves to 'underline the shareholder-centred nature of British company law'.[992]

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[983] See, for instance, *Stand 242* supra note 778 para 13; *Farren* supra note 328 para 10.

[984] See Watson op cit note 91 at 604. See, for instance, article 8.01 of the Model Business Corporations Act (2016 revision). See further *Kaimowitz* supra note 240 para 13.

[985] See section 128 of the New Zealand Companies Act No 105 of 1993.

[986] See section 198A of the Australian Corporations Act No 50 of 2001.

[987] Supra note 175.

[988] 2014 JDR 1378 (WCC) para 31.

[989] See also *Kaimowitz* supra note 240 para 12 and *Pretorius and Another v PB Meat (Pty) Ltd* (1057/2013) [2013] ZAWCHC 89 (14 June 2013) para 25.

[990] See Delport et al op cit note 283 at 250(4); Michael M Katz 'Governance under the Companies Act 2008: Flexibility is the keyword' in Mongalo (ed) op cit note 962 at 259.

[991] Rehana Cassim 'The right of a director to participate in the management of a company: Kaimowitz v Delahunt 2017 (3) SA 201 (WCC)' 2018 *SA Merc LJ* 172 at 178.

[992] Davies & Worthington op cit note 215 para 14-2. See further footnote 12 to Watson op cit note 91.

On the other hand, one may point out that, even with the Board's General Authority Clause being contained in the constitution, the board already came to be recognised by the courts as 'the company' when acting within its own sphere.[993] Furthermore, even the early position of the board was never entirely clear – there also exists authority to the effect that directors would have the power to bind a company even in the absence of being granted authority in a company's constitution.[994] Watson has argued that the fact that English law dealt with the board's authority in the articles was not due to 'a philosophical policy-driven desire to ensure that boards derive their powers from shareholders'.[995] Instead, the author argues that this fact was an anomaly brought about by the drafters of the UK 1856 Act using existing precedents of deeds of settlement, all of which contained Board's General Authority Clauses because they were taken from companies formed privately without the benefit of enabling legislation.[996] The author argues that, following on from the law relating to charter corporations, the board's power to manage a company's business was actually a core component of company law, and that 'no significance at all should be attached to this point of difference in UK company law and no conclusions about the legal relationship between boards and shareholders drawn from the allocation of powers being in the constitution rather than the statute.'[997]

Even if the general significance of the inclusion of a Board's General Authority Clause in statute may be questioned, the change has at least brought more certainty regarding the role of the board. In respect of corporate contracting, however, it is submitted that this section has not brought about any significant change to the legal position. Instead, section 66(1) rather represents an entrenchment of the previously applicable principles, namely (i) collegiate

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[993] Supra para 3.2.3. In *Maralco Business Advisors CC v Glowax Proprietary Limited* (GP) (unreported case no 17572/2018 of 2 May 2018) the court did not appear to regard section 66(1) as having changed the position significantly when, with reference to section 66(1) stated that: '[I]t is trite that a company may only act in terms of the board of directors and not the shareholders …'

[994] Tennant op cit note 137 at 42 stated in respect of the Cape 1892 Act that (citations omitted): 'Directors are special agents of the company. Their authority is limited by the articles of association, and where these are silent they have a general authority to bind the company in all things ordinarily and reasonably done in carrying on the defined and legitimate business of the company'. See further Oosthuizen op cit note 210 at 4-5. In *Smith v The Hull Glass Co* (1848) 8 CB 668 at 677 it was said 'it seems to us that the directors, unless restrained by the act of parliament, or the deed, would have all the authority given to partners by the rules of the common law.' It should, however, be noted that section 27 of the 1844 UK Act granted authority to directors directly – supra note 217.

[995] Watson op cit note 91 at 611.

[996] Supra para 2.5.4 and see Watson op cit note 91 at 608.

[997] Watson op cit note 91 at 599.

management and (ii) the shareholders' ability to limit the actual authority of the board in the corporate constitution. These two points are expanded on below.

8.3.2 The entrenchment of collegiate management

Section 66(1) vests management powers in the board as a collective and not in any single director.[998] In this regard, section 66(1) therefore does not represent a departure from the traditional position, but an entrenchment thereof – a single director still does not have the ability to represent a company unless (actually or ostensibly) authorised to do so.[999]

As noted in previous Chapters, the principle of collegiate management carries with it significant implications for corporate representation.[1000] Foremost of these is that a third party will almost always be in a position of uncertainty when dealing with a single director, since that director, unlike a partner in a partnership, does not have any authority *qua* director to bind the company. A 'second step' is needed to pass authority from board to single director, which step invariably takes place out of a third party's sight (even if that third party had read the company's constitution). This remains the law under section 66(1).

Commentators have suggested that it should be considered whether a clause similar to section 54 of the Close Corporations Act[1001] ('CC Act'), should not be incorporated into the Companies Act.[1002] That section essentially provides that, unless a third party knows, or reasonably ought to know, that a member of a CC does not have authority to act on behalf of a CC, an act of that member will bind the CC.[1003]

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[998] See *Flaming Silver Trading 373 (Pty) Ltd v Vantage Goldfields SA (Pty) Ltd* 2019 JDR 1905 (MN) para 51, *Navigator Property* supra note 988 para 31, *Hacker v Hartmann* 2019 JDR 0785 (ECP) paras 20 and 45. See also Delport et al op cit note 283 at 250(3).

[999] *Flaming Silver* supra note 998 para 51. In *Kaimowitz* supra note 240 para 27: '… the management of a company in terms of the overall supervision thereof resides in the board as opposed to individual directors. So much is clear from the wording of s 66(1) of the Companies Act.'

[1000] Supra para 5.1.1.

[1001] No 69 of 1984.

[1002] Lombard & Swart op cit note 467 at 670; Delport op cit note 3 at 139.

[1003] Section 54 reads as follows: '(1) Subject to the provisions of this section, any member of a corporation shall in relation to a person who is not a member and is dealing with the corporation, be an agent of the corporation. (2) Any act of a member shall bind a corporation, whether or not such act is performed for the carrying on of business of the corporation unless the member so acting has in fact no power to act for the corporation in the particular matter and the person with whom the member deals has, or ought reasonably to have, knowledge of the fact that the member has no such power.'

The management regime adopted by the CC Act is, however, based on the decentralised partnership law model –[1004] close corporations do not have boards and each member is, in principle, entitled to equal rights regarding the management of the business of the corporation and to conclude contracts on behalf of the close corporation.[1005] In line with this model, section 54 introduces a simple corporate representation rule – unless the third party knows, or reasonably ought to know, that a member does not have authority to act on behalf of a close corporation, the act of that member will bind the close corporation. Also, like in the case of partnerships, third parties have never been deemed to have constructive notice of the constitutional documents of close corporations.[1006]

The writer agrees that this may have been an option worth exploring in respect of private companies with few shareholders and little separation between ownership and control.[1007] In respect of large public corporations with many shareholders and a de facto separation between ownership and control, however, it seems less appropriate. The boards of these companies usually closely align with the legal conception of how a board should operate, namely consisting of certain designated executive directors who may bind the company and the rest of the board (ie non-executive directors), who may not. A section 54-based solution may upend this balance by allowing third parties to hold companies bound to contracts entered into by non-executive directors, merely because they are directors. Again, while this option is worth exploring further, it should be recognised for what it is – a fundamental reorientation of company law to a decentralised partnership model of representation in

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[1004] Supra para 2.5.3. See further *Northview Shopping Centre* supra note 229 para 25, SJ Naudé 'The South African Close Corporation' (1984) 9 *TRW* 117 at 130 and McLennan op cit note 758 at 323-4. See also JJ Henning 'Close corporations without end. Two remarkable decades of simply "thinking small first"' (2007) 32 *TRW* 187 at 191.

[1005] See section 46(b) of the CC Act and *Amalgamated Banks of South Africa Bpk v De Goede* 1997 (4) SA 66 (SCA) at 75E. Unlike a partnership, however, a CC is a juristic person with all the capacity and powers of a natural person, which continues as such notwithstanding any change in membership. Issues relating to the doctrine of ultra vires therefore do not arise in respect of CCs. See sections 2(2) and 2(4) of the CC Act, *J & K Timbers (Pty) Ltd t/a Tegs Timbers v G L & S Furniture Enterprises CC* 2005 (3) SA 223 (N) at 228C, *Klaas v Summers* 2008 (4) SA 187 (C) para 16 and *Norval v Consolidated Sugar Investments (Namibia) (Pty) Ltd* 2007 (2) NR 689 (HC) at 707G.

[1006] No person is deemed to have any knowledge of the founding statement of a CC - see section 17 of the CC Act. The CC Act goes even further in relation to association agreements. Outsiders are not even allowed to inspect these documents, let alone deemed to have any knowledge of them. See section 45 of the CC Act.

[1007] Naturally, such a change would also ring with it its own challenges. For instance, would actions of de facto directors be included under such a section? It appears as though the acts of de facto members are not covered by section 54 of the CC Act – see *Divine Heights 5 CC v Greg & Sons Enterprises CC* 2011 JDR 1691 (FB) para 9 and PM Meskin, B Galgut & JA Kunst *Henochsberg on the Close Corporations Act* [SI 33 - Aug 2019] at 154. Perhaps this may be justified taking into account the structure of CCs as close-knit owner-managed entities. That justification generally is absent in relation to companies.

substitution of the collegiate model inherited from corporations law almost two centuries ago. For the time being, however, collegiate management remains the law.

8.3.3 Section 66(1) and a third party

Section 66(1) does not significantly change the position of a third party contracting with a company.

First, the basic position from a third party's point of view, namely that the board manages the company's business subject to the constitutional limits set by shareholders, remains the same. Previously, shareholders could in theory simply neglect to grant any powers or authority to the board. Now, they may in theory simply exclude all of the board's powers or authority in the company's MOI.[1008] However unlikely these situations might be, it is clear that the shareholders' ability to control the constitutional flow of actual authority to the board remains unaffected.

Typical *Turquand* situations are therefore as likely to arise now as before. Whereas before shareholders would include the Board's General Authority Clause in their articles and then include a Reserved Matters Clause, now the MOI of a company will just contain the second clause. The net effect is the same, namely that the board lacks actual authority when acting in contravention of that limiting clause and the third party remains uncertain regarding whether shareholder approval was in fact obtained. The third party's position may have been enhanced by the abolishment of constructive notice and the introduction of section 20(7), both of which are dealt with later in this Chapter, but the fundamental position remains the same - shareholders may limit the board's (actual) authority through the constitution.

Secondly, as mentioned in the previous paragraph, due to the fact that section 66(1) grants power to the board collectively, a third party dealing with a single corporate representative will, just like before, have no insight into the delegation (or not) of authority to that representative.

Thirdly, and perhaps most importantly, third parties were already entitled to assume that the board had the general powers to manage a company's business and, in particular, enter into contracts for that purpose.[1009] Section 66(1) has therefore not significantly changed the

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[1008] Delport et al op cit note 283 at 250(3) and Yeats et al op cit note 299 at 2-1249 state that it is now uncertain whether the Memorandum of Incorporation can exclude all management functions.

[1009] Supra para 6.6.5.

scope of the ostensible authority of the collective board in relation to the conclusion of contracts on behalf of the company.

8.4 CONSTRUCTIVE NOTICE ABOLISHED

8.4.1 No inspection rights, no constructive notice

We noted in earlier Chapters that traditional company law logic held as follows: corporate constitutions were, in terms of legislation, disclosed to the registrar and available for inspection by the public, *therefore,* the courts held, it followed third parties could not deny knowing the contents thereof.[1010] The Companies Act has shattered this equation by not only taking away the premise, but expressly overruling the conclusion based thereon.

In terms of the Companies Act, while companies are required to lodge their MOIs with the Companies and Intellectual Property Commission, the only persons who may, as a general rule,[1011] have access thereto are holders of beneficial interests in securities. A third party therefore no longer has the right to obtain a company's constitutional documents *even if the third party wanted to*.[1012] Ditto in respect of special resolutions, which are no longer even required to be registered.

[1010] Supra paras 2.5.1 and 6.2.1.

[1011] A company's MOI may specifically provide members of the public with information rights or a member of the public may bring a successful request for information under the Promotion of Access to Information Act No 2 of 2000. These exceptions are, however, fact-based and third parties are not given the general unqualified access to a company's MOI. See section 26(3) and 26(7).

[1012] The Companies Amendment Bill, 2018 (Notice 969 *GG*41913 of 21 September 2018) proposed to overturn this position, by allowing third parties access to companies' MOIs. The status of this Bill, however, remains uncertain. In any event, even if the Bill were passed in its current form, the abolishment of the constructive notice doctrine in section 19 would remain intact.

One could perhaps reasonably estimate that the absence of a general right to access to MOIs would have led to the eventual abolishment of the doctrine of constructive notice by the courts. No need for conjecture, however, because, as mentioned above, the legislature has, subject to certain exceptions irrelevant for our purposes,[1013] expressly abolished the doctrine of constructive notice. Section 19(4) reads as follows:

> '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 has been filed or is accessible for inspection at an office of the company'.[1014]

It appears to be generally accepted that section 19(4) has successfully abolished the doctrine of constructive notice.[1015]

Section 19(4) is, it is submitted, an improvement over its English counterpart, because its application is not dependent on whether a person is 'dealing with a company' and it relates to all provisions of the relevant documents, not just authority limitations.[1016] The South African section also cuts to the heart of the matter – a person may deny having knowledge of a document even if it has been filed. The English section deals instead deals with a third party's duty to make inquiries, which is actually a separate question. Indeed, the constructive notice rule was not conceived as a rule which placed a positive duty on third parties to examine the constitutions of companies they were dealing with, but was rather a negative rule passing risk on to a third party if they failed to do so.

Lastly, it should be noted that section 19(4) has nothing to say about legislative provisions, knowledge of which are attributed to third parties as before, under the maxim 'ignorance of the law is no excuse'.[1017]

8.4.2 The effect on corporate contracting

The effect of the abolishment of constructive notice on corporate representation is, on its own and without having regard to the new statutory presumption introduced by the Companies Act, revolutionary. In the absence of constructive notice, the principles of agency apply

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[1013] The most notable exceptions relate to RF companies – see section 19(5)(a) of the Companies Act. See also section 19(5)(b) in respect of personal liability companies. Regarding the effect of the rentention of constructive notice in those exceptional circumstances, see Jooste op cit note 9 at 469.

[1014] Section 19(4) of the Companies Act.

[1015] See *Neffensaan* supra note 29 para 49, Delport op cit note 3 at 136, Jooste op cit note 9 at 468 and 472, Olivier op cit note 21 at 619.

[1016] Supra para 7.3.4.1.

[1017] Jooste op cit note 9 at 469.

unhindered to companies. Accordingly, provided a third party can establish the actual or ostensible authority of a corporate representative, the company will be bound regardless of the contents of its MOI, since agency law precludes principals from raising private authority limitations against third parties.

Notably, this applies to any authority limitation contained in the MOI, whether qualified (such as in the case of a Reserved Matters Clause) or unqualified (such as in the case of an Exclusion Clause). Regarding the former case, the writer's position, discussed in Chapter 6, is reemphasised here: the abolishment of constructive notice means that there should be no need to resort to the *Turquand* rule.[1018]

The latter case is a novel development – a company may be held bound based on the ostensible authority of its representatives in contravention of an Exclusion Clause in its constitution.[1019] For example, suppose a company's MOI contains an Exclusion Clause which requires two directors to sign contracts exceeding certain monetary thresholds. Previously, constructive notice of such a clause would arguably have undermined any attempt by a third party to hold a company bound to a contract in excess of that threshold if it was signed by only one director. Now, however, that obstacle has been removed and the third party may rely on ordinary agency principles to hold the company bound. It should be remembered that this has nothing to do with the *Turquand* rule, given that, in the case of an unqualified authority exclusion, a representative's lack of (actual) authority did not arise as a result of non-compliance with internal formalities.[1020]

It is worth pointing out that, while the result in respect of unqualified exclusions is the same, the manner in which that result is achieved is not the same between South Africa and England. In Chapter 7, we saw that section 40 is directly applicable to such a scenario, since it deems constitutional limitations to be irrelevant.[1021] The section introduced by the Companies Act, however, like the *Turquand* rule, will not apply to unqualified exclusions of authority, because there is no 'internal formality' or 'procedural requirement' which applies in these circumstances. Instead, what makes Exclusion Clauses irrelevant under the Companies

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[1018] Supra para 6.6.9. The Turquand rule may, however, still be relevant to RF companies, in respect of which constructive notice still partially applies. See Katz op cit note 990 at 252 and *Neffensaan* supra note 29 para 51.

[1019] *Neffensaan* supra note 29 para 53.

[1020] Ibid.

[1021] Supra para 7.3.5.

Act is the abolishment of constructive notice, together with the common law agency rule precluding principals from raising private limitations of authority against third parties.

If a third party is unaffected by an unqualified constitutional limitation of authority, then how much stronger should his/her position not be in the case of a qualified limitation on authority? Absent constructive notice, the answer of the third party to a company relying on a qualified authority limitation is the same as that of a third party faced with an unqualified one – 'I am not bound by private constitutional limitations as between the company and its agents of which I am unaware'. A special rule is no longer strictly necessary in the case of qualified authority limitations.

This does not mean that companies are now at the mercy of third parties – far from it – as a third party has to establish and rely on the (actual or ostensible) authority of corporate representatives. With the unqualified abolishment of constructive notice, our law has, however, undergone an irrevocable shift to the Third Party Perspective of corporate contracting. Corporate representation cases will now centre on what a company held out to a third party and the world and what the third party knew (or could reasonably have been assumed to know) and not whether there was compliance with a company's constitution (unless the third party had actual knowledge of such constitution).

8.5 SECTIONS 20(7) AND 20(8) OF THE COMPANIES ACT

8.5.1 Introduction

While the effect of the abolishment of constructive notice on corporate contracting would have been ground-breaking on its own, the Companies Act does not leave the matter merely to the common law. For the first time in South African corporate law history, the legislature has attempted a *generalised* section providing protection to third parties dealing with companies. Section 20(7) reads as follows:

> '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.'

For convenience, the 'formal and procedural requirements' referred to in section 20(7) will be abbreviated to 'F/P Requirements'.

Courts and commentators have noted that section 20(7) approximates the (misleading)[1022] positively stated definition of the common law *Turquand* rule. This section has been referred to as a 'statutory *Turquand* rule',[1023] a codification of the *Turquand* rule (or an attempt thereof)[1024] and, less flatteringly, an 'inaccurate rendering' of the *Turquand* rule.[1025] It has also been pointed out that there are important differences between the section and the common law *Turquand* rule.[1026]

The Companies Act does not, however, abolish the common law. Quite the opposite: section 20(8) determines that section 20(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.'

Courts[1027] and commentators[1028] have identified the common law principle referred to in section 20(8) as the *Turquand* rule, although it has also been suggested that this section is referring to estoppel.[1029] To these guesses may be added the common law principle of omnia praesumuntur rite esse acta (all things are presumed to be done correctly),[1030] which perhaps fits the bill better than either the *Turquand* rule or estoppel. It is submitted, however, that this inquiry is not a crucial one, since the effect of section 20(8) is clear enough - whichever relevant common law rules were applicable prior to the promulgation of section 20(7) remain applicable.[1031] This accords with the position under the UK Companies Act.[1032]

[1022] Supra para 6.6.10.

[1023] Jooste op cit note 9 at 467 and 469.

[1024] See *South African Express Limited v Bagport (Pty) Ltd* 2020 JDR 0653 (SCA) para 53; *Neffensaan* supra note 29 paras 51 and 52; *Afrasia* supra note 571 para 50; Richard Jooste 'Financial assistance to directors – the Companies Act 71 of 2008' in Mongalo (ed) op cit note 962 at 184; Katz op cit note 990 at 252; Johan J Henning 'The Impact of South African company law reform on close corporations: Selected Issues and Perspectives' (2010) 1 *Acta Juridica* 456 at 468.

[1025] McLennan op cit note 210 at 152.

[1026] Jooste op cit note 9; Delport op cit note 3.

[1027] See *Neffensaan* supra note 29 para 52 and *Sebenza Shipping* supra note 650 para 16.

[1028] Henning op cit note 1024 at 468; Jooste op cit note 9 at 469.

[1029] Jooste appears to have vacillated on this issue, initially stating that section 20(8) refers to estoppel, but later stating that 'estoppel does not give rise to a presumption of validity, which is what section 20(8) is referring to'. Compare Jooste op cit 1024 at 185 and Jooste op cit note 9 at 474.

[1030] Supra para 6.6.10.

[1031] The court in *Neffensaan* (supra note 29 para 52) was of the opinion that section 20(8) was merely added because 'the lawmaker was concerned that its attempts to formulate the *Turquand* rule in s 20(7) might not cover the whole ground' and to 'foreclose an argument that s 20(7) had inadvertently repealed any part of the *Turquand* rule'. See also Jooste op cit note 9 at 469 and 473. As the author notes, the view that section 20(7) does not

It should, however, at once be recognised that just because section 20(8) retains a common law principle, does not mean that that principle is still *applicable* in the same circumstances as before. In other words, although the *Turquand* rule may technically have been preserved, it is contended that its scope of application has been radically diminished by the abolishment of constructive notice.

8.5.2 Different approaches to the interpretation of section 20(7)

Being a legislative provision, the scope of section 20(7) will have to be determined with reference to the words used in that section. However, it is submitted that, before proceeding to a textual analysis, it is crucial to recognise *what the text of section 20(7) does not say*. The section entitles a third party to presume certain facts, but it does not actually tell us whether the presumption is rebuttable or not.[1033] This section is therefore not like a No Defects Clause, which deems an act of a director to be valid.[1034] Moreover, the section applies when a person is 'dealing with a company', but does not specify the level of unauthorised engagement which is necessary from the company's side to trigger the section.

Most importantly, the section is silent on its relationship to the principles of agency, which are foundational to company contractual liability.[1035] It is not at all apparent from the text of the section whether it applies independently of agency principles, or whether it forms part of the greater agency-based enquiry into the authority of corporate representatives. It submitted that, just as with the *Turquand* rule, the true effect of section 20(7) only becomes apparent once its relationship to agency principles is understood. In this regard, the dichotomy between an Ancillary Rule Approach and an Independent Basis Approach again presents itself. As with the *Turquand* rule, the writer will argue that an Ancillary Rule Approach is to be preferred, as it aligns with the Third Party Perspective of corporate contracting.

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override the common law principles also accords with the principle of interpretation to the effect that legislation should be interpreted as changing the common law as little as possible. See, in that regard, *Nedbank Ltd v National Credit Regulator* 2011 (3) SA 581 (SCA) para 38.

[1032] Supra para 7.3.5.

[1033] In this regard, see Delport op cit note 3 at 137, Olivier op cit note 9 at 23, Jooste op cit note 9 at 473 and Van der Linde op cit note 28 at 841.

[1034] Infra para 8.7.

[1035] Supra para 3.2.2.

This paragraph sets out those two approaches and the effect each is likely to have on the interpretation of section 20(7).[1036] It should be emphasised that this enquiry is not divorced from the text of section 20(7), but closely related to the requirement in section 20(7) that a person must be 'dealing with a company' in order for that section to be applicable. In other words, the differences between the two approaches in relation to section 20(7) may be seen as two divergent ways of interpreting that requirement.

8.5.2.1 An Ancillary Rule Approach to section 20(7)

It is submitted that the proper approach to section 20(7) is, like with the *Turquand* rule, an Ancillary Rule Approach.[1037] The justification for this approach is that the principles of agency remain axiomatic to corporate contractual liability - section 20(7) should therefore, like the *Turquand* rule, be interpreted as playing an ancillary role in the greater (ostensible) authority inquiry. As with the *Turquand* rule, the section itself should therefore not be regarded as giving any authority to a corporate representative, instead it should only act once the (ostensible)[1038] authority of a corporate representative has been established.[1039]

At first glance, it may seem like a contradiction to look to the interpretation of the *Turquand* rule, when the writer has taken the view that that rule has become inapplicable due to the abolishment of constructive notice. Is section 20(7) not also inapplicable due to the abolishment of constructive notice?[1040] The writer submits that it is not. Section 20(7) is not, like the *Turquand* rule, historically tethered to the doctrine of constructive notice – it is clearly a stand-alone legislative section which will apply when the requirements established by its wording are met. It is true that in cases of mere authority limitations in a company's MOI invocation of section 20(7) is, just like *Turquand* rule, *unnecessary* due to the abolishment of constructive notice.[1041] This does not, however, mean that the section is

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[1036] Regarding another (unfavoured) approach to section 20(7), in terms of which the section is limited to ultra vires acts, see Delport et al op cit note 283 at 106(4) and Van der Linde op cit note 28 at 842. This approach has found little support and our courts have applied (or considered applying) section 20(7) to intra vires acts of non-RF companies – see *Bagport* supra note 1024.

[1037] Supra Chapter 6.

[1038] As before, actual authority will usually be lacking when section 20(7) is invoked, because this section finds application in situations where a company can point to some internal formality not having been complied with. There is, however, no obstacle to a third party proving the actual authority of a corporate representative.

[1039] In *Neffensaan* (supra note 29 para 54) it was said that section 20(7) has not brought about any change in the law governing the circumstances in which a company can be held bound on the basis of ostensible authority.

[1040] See Katz op cit note 990 at 252-3.

[1041] See *Neffensaan* supra note 29 paras 54 and 58.

inapplicable. In fact, the convenience of relying on a statutory provision rather than the ill-defined common law prohibition on raising secret limitations may mean that reliance on section 20(7) will become *de rigueur*. It should not be forgotten that section 20(7) was designed to co-exist with any applicable common law principles – not to usurp them. This view appears to be in line with that taken by the SCA in *South African Express Limited v Bagport (Pty) Ltd*[1042] (and that of the court a quo, the decision of which was affirmed by the SCA), where a third party successfully invoked section 20(7) against a company where the company sought to rely on internal requirements of which the third party had no knowledge. Seen in this way, section 20(7) may, if properly understood and consistently applied, be regarded as a welcome legal development in that it increases certainty by providing third parties with a ready-made statutory answer to companies raising internal non-compliances. A proper understanding of section 20(7) will, however, be crucial to its success and this, it is submitted, hinges on appreciating the relationship between the section and agency law principles.

How does the Ancillary Rule Approach fit in with the text of section 20(7)? It is submitted that the Ancillary Rule Approach provides the only workable answer to the question of when may a person be said to be 'dealing with a company'? Just like with section 40 of the UK Companies Act, that phrase cannot be interpreted so literally as to require that third party needs to deal with a duly authorised representative – section 20(7) is, after all, intended to hold a company bound *despite* it being represented by unauthorised representatives.[1043] On the other hand, section 20(7) could not have been intended to cover the acts of complete impostors. The Ancillary Rule Approach provides the via media between these two extremes by requiring the representative to have ostensible authority. In this way, the third party is in effect required to prove that he/she was *acting reasonably* in assuming that he/she was dealing with the company through a particular representative.

[1042] Supra note 1024 para 54. See also decision of court a quo *Bagport (Pty) Ltd v South African Express Airways Soc Ltd* 2018 JDR 0779 (GJ) para 8.

[1043] Supra para 7.3.4.2.3.

Once that hurdle has been cleared, section 20(7) will apply and a company will be precluded through that section from raising non-compliance with the relevant F/P Requirements covered by section 20(7). Section 20(7)'s operation is therefore, like the *Turquand* rule, negative: [1044]

> 'Once the third party has established the actual or ostensible authority of the representative, he cannot be non-suited because of non-compliance on the part of the company with some formal or procedural requirement which would have been necessary to make the ostensible agent's authority complete.'

Lastly, it should be noted that the Ancillary Rule Approach has already found support from the courts. In *Neffensaan*, it was said:[1045]

> '… in order for s 20(7) to apply the third party must establish that he was dealing with someone who had actual or ostensible authority to bind the company, because only in those circumstances can he say that he was dealing with the "company".'[1046]

This approach was also taken in *Afrasia*,[1047] where the court held, that section 20(7) did not relieve a third party from having to establish at least the ostensible authority of the relevant corporate representative to sign the relevant agreement or to convey that board approval had been given. Furthermore, although this approach is not expressly laid out in *Bagport*, it is clear that the fact that the relevant agreement entered into on behalf of the company fell within the authority of the relevant CEO played a large role in the decision to hold the company bound.[1048]

Lastly, it should be mentioned that an Ancillary Rule Approach accords with the approach taken in the UK to section 40 of the UK Companies Act, in that such section is not interpreted as granting company representatives with authority in and of itself – recourse to agency principles is still required.[1049]

[1044] *Neffensaan* supra note 29 para 56.

[1045] Ibid.

[1046] See also *Redefine Properties Limited v Tip Top Nails CC* 2016 JDR 1970 (GP) para 22.

[1047] Supra note 571 para 51.

[1048] See decision of the court a quo (supra note 1042 para 9, my emphasis, citations omitted): 'The former CEO, whose version the respondent has not placed before this court, clearly had the authority, whether express, implied, or ostensible to sign the agreement of settlement. Bagport [ie the third party] was *entitled to and in fact did accept and rely upon the façade of approval by the former CEO*, who after all, par excellence, was the person authorised and required to sign all contracts on SA Express's [ie the company's] behalf.' See also the decision of the SCA supra note 1024 para 50.

[1049] Supra para 7.3.5.

8.5.2.2 An Independent Basis Approach to section 20(7)

An Independent Basis Approach to section 20(7) would regard that section as constituting an independent basis for company liability, with no reference necessary to the principles of agency. In other words, the legislature is regarded as having introduced yet another 'competing alternative' by which a third party may hold a company bound – a third party may now rely on the *Turquand* rule, ostensible authority *or* section 20(7).[1050] Without stating so expressly, this approach appears from commentators' criticism of section 20(7). Most commentators have been content to point out the *prima facie* similarity between section 20(7) and the common law *Turquand* rule and then, with detailed reference to the section's wording, commented on its differences from that rule.[1051] The underlying message is that - third parties now have section 20(7) as a basis to hold companies liable *in addition to* the common law *Turquand* rule (by virtue of section 20(8)).[1052]

The main problem with following an Independent Basis Approach to the section 20(7) is that it will lead to similar confusion as was the case in respect of the *Turquand* rule, because it will not place the section in its proper context. As we saw in Chapter 6, the key to understanding the nature of the *Turquand* rule, was understanding that, when applied to the actions of single representatives, the rule became dependent on usual authority which, in turn, forms the basis for the (ostensible) authority of corporate representatives. Without this understanding the rule appeared to produce anomalous results – sometimes allowing third parties to assume delegations of authority by the collegiate board to one director and sometimes not. The same confusing results will, it is submitted, follow if an Independent Basis Approach is followed in respect of section 20(7).[1053] In cases where an act of the collective board is considered, section 20(7) will be invoked and applied easily enough without express reference to agency principles, thereby conjuring up the idea that

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[1050] So, for instance, Jooste states: '… why it would be necessary to prove estoppel when it is far easier to use s 20(7) is unclear.' See Jooste op cit 1024 at 185.

[1051] Delport op cit note 3 at 136-7, Jooste op cit note 9 at 469-70, Cassim et al op cit note 11 at 185.

[1052] Indeed, Delport (op cit note 3 at 138) has even suggested that the incongruency between section 20(7) and the *Turquand* rule may lead to 'legal arbitrage' See Van der Linde op cit note 28 at 842, where the author envisages the concurrent application between a narrow section 20(7) and a wider *Turquand* rule. See also Locke op cit note 17 at 181.

[1053] While the author did not appear to support such a conclusion, Jooste (op cit note 9 at 471) wondered whether section 20(7) could be relied on by a third party, unlike the *Turquand* rule, to assume that authority had been delegated to an ordinary director. This is exactly the confusion which surrounded the *Turquand* rule prior to the adoption of the Ancillary Rule Approach. Van der Linde op cit note 28 at 842, with reference to Jooste, simply stated that section 20(7) can be relied on in such circumstances.

section 20(7) on its own will bear the weight of contractual liability. The same will happen where ordinary business contracts concluded by CEOs are considered.[1054]

However, where third parties are dealing with single directors in situations which are less clear, such as small private companies with no clearly defined roles, or dealing with persons who hold positions with less usual authority like chairpersons or employees, it will quickly become necessary to divine when section 20(7) should come to a third party's rescue and when not. In *Neffensaan*, the court, correctly it is submitted, stated that just as in the case of the *Turquand* rule, section 20(7) should not be allowed to operate so as to allow third parties to assume that authority had been delegated to an ordinary director.[1055] It is here where the principles of agency will *inevitably* have to play their role - a third party may, just like in the case of a *Turquand* rule, only assume a delegation of authority when the single representative is acting within his/her ostensible authority (often based on the usual authority of the position which the representative holds). The Ancillary Rule Approach recognises this, while the Independent Basis Approach attempts to ignore it.

8.5.3 Further analysis of section 20(7)

Merely deciding on an Ancillary Rule Approach to section 20(7) does not actually tell us anything of the section's scope. Accordingly, it is necessary to investigate the requirements for the section's application and what it allows a third party to presume.

8.5.4 Requirements for the application of section 20(7)

8.5.4.1 'Dealing'

It is submitted that the term 'dealing' should in the context of section 20(7) be interpreted widely to include contracts which give rise to unilateral obligations, such as donations and guarantees. A wide interpretation is, in particular, apposite, given that insiders are excluded from protection under 20(7), which means that more contentious 'dealings' such as receiving bonus shares are less likely to arise.[1056] The wide definition in section 40 of the UK Act[1057] could perhaps be persuasive to a court in respect of section 20(7).

[1054] The SCA's decision in *Bagport* supra note 1024 may be cited as an example of this.

[1055] The court concluded that there was 'no indication that the lawmaker, in enacting s 20(7), intended to introduce so radical a change to the legal position relating to ostensible authority.' See *Neffensaan* supra note 29 para 55.

[1056] Supra para 7.3.4.2.2.

8.5.4.2 Good faith

Like section 40 of the UK Companies Act (and unlike the First Directive) section 20(7) only applies to third parties dealing with companies in 'good faith'. Unlike section 40, however, section 20(7) does not contain further provisions which attempt to clarify the meaning of this requirement.

On the relationship between knowledge and good faith section 20(7) and section 40 of the UK Companies Act diverge. As noted in Chapter 7, section 40 provides that a third party should not be regarded as acting in bad faith by reason only of his/her knowing that an act is beyond the powers of the directors under the company's constitution.[1058] In respect of section 20(7), however, this matter is not likely to arise, because third parties with knowledge of non-compliance with F/P Requirements are expressly excluded from the section's ambit. One could, however, conjecture that the legislature deemed knowledge of non-compliance to equate to a lack of good faith, which would accord with the view taken by commentators in respect of the *Turquand* rule.[1059] With questions of knowledge being dealt with under the specific exclusion, it is likely that the good faith requirement will only be directly invoked where fraud is alleged or where the third party was aware of directors' breaching their fiduciary duties.

Ultimately, it is submitted that the South African legislature was wise not to follow English example on this point. Not only does the English section create confusion regarding what is necessary to constitute a lack of good faith in addition to knowledge of lack of authority, but to decouple knowledge from good faith in that way goes against the organically developed common law understanding of when a third party should be entitled to hold a company bound to an unauthorised contract. More importantly, it should be remembered that the subject matter of section 40 and section 20(7) is not the same – the former relates to provisions limiting the powers of directors, while the latter is much wider, in that it relates to non-compliance with any F/P Requirements, whether contained in statute or a company's MOI. It is submitted that including a deeming provision such as contained in the UK section would be inappropriate in respect of a section which covers such a wide array of formalities.

[1057] Ibid.

[1058] Supra para 7.3.4.3.

[1059] Supra para 6.3.3.

It is, however, submitted that the presumption that a third party is acting in good faith which is contained in section 40 of the UK Companies Act would have been a valuable addition to section 20(7). Such a provision would generally enhance third party protection, by placing the onus on the company to prove that the third party was lacking good faith.

8.5.4.3 The knowledge exception

Section 20(7) excludes from its protection third parties who 'knew or reasonably ought to have known' that the relevant F/P Requirements have not been complied with. The Companies Act does, however, go further by providing a definition of knowledge. Section 1 provides that knowledge does not just include actual knowledge but also a situation where a person was in a position in which that person reasonably ought to have (i) had actual knowledge; (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.

The drafting is clumsy, because both section 20(7) and the definition of knowledge make reference to reasonableness.[1060] What is clear, however, is a third party would not be able to rely on section 20(7) if that third party ought reasonably to have known about non-compliance with F/P Requirements or reasonably ought to have made investigations or taken other measures which would have given the third party actual knowledge of non-compliance with the relevant F/P Requirements.

Several commentators have argued that this objectiveness is a departure from the common law, essentially on the basis that, 'section 20(7) will not protect a person who "reasonably ought to know" of the non-compliance – an objective test – while the *Turquand* rule uses the subjective test of a person having been put on enquiry by suspicious circumstances.'[1061]

The writer wishes to suggest that the reference to objective criteria is not new. The 'suspicious circumstances' limitation has, both in respect of the *Turquand* rule[1062] and estoppel,[1063] been tethered to the requirement that a third party make reasonable inquiries

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[1060] Delport op cit note 3 at 137.

[1061] Van der Linde op cit note 28 at 841. See also Cassim et al op cit note 1051 at 185, Jooste op cit note 9 at 472 and Locke op cit note 17 at 180.

[1062] Delport op cit note 3 at 135, it is submitted is correct, when he states that Turquand rule is not available to 'if the third party is aware of facts which would put a *reasonable person* on inquiry.'

[1063] Supra paras 4.5.5 and 6.3.3.

when dealing with a company. So, for instance, in *Mahony v East Holyford Mining Co*, it was said in the House of Lords that a third party had to make '[a]ll those ordinary inquiries which mercantile men would, in the course of their business make'.[1064] Almost a century later in *Morris*, it was said in the same House in relation to persons dealing with companies (my emphasis): 'He 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.'[1065] These dicta show that third parties have always been under the obligation to make reasonable inquiries. Indeed, upon reflection, it is clear that the *Turquand* rule or estoppel could never have functioned solely on a subjective basis, since a third party could simply maintain that he/she was not placed on inquiry, whatever the circumstances.

The real issue with section 20(7) is not that reliance thereon is made subject to reasonable inquiries, but that it is uncertain whether section 20(7) requires anything more on the part of the third party than what was required under the common law. Delport argues that sub clause (iii) leaves the possibility for an interpretation much wider than the common law.[1066] Although this remains a possibility, it is submitted that the courts should align the application of section 20(7) with the traditional 'reasonable enquiries' requirement under the *Turquand* rule and the 'reasonable reliance' requirement under estoppel (especially given the requirement to prove ostensible authority under the Ancillary Rule Approach).[1067]

What does seem clear, however, is that section 20(7) has not followed English law in watering down what the law expects from a third party since the days of 'mercantile men'. We saw in Chapter 7, that, on the question of reasonable reliance, English law has developed in favour of a third party, by lowering what is expected from a third party from 'reasonable inquiries' to not turning a 'blind eye'.[1068] On this point section 20(7) is clear – reasonable inquiries are required.

[1064] *Mahony* supra note 505 at 895.

[1065] *Morris* supra note 568 at 475

[1066] Delport op cit note 3 at 137.

[1067] The law regarding third parties who do not procure knowledge which they 'reasonably ought to have' under section 54 of the CC Act may also prove useful in this regard. See *Point 2 Point Same Day Express CC v Stewart and Another* 2009 (2) SA 414 (W).

[1068] Supra para 4.5.5.

8.5.5 What may a third party presume?

8.5.5.1 Introduction

Under section 20(7) a third party is entitled to presume that the company, in making any decision in the exercise of its powers,[1069] has complied with all of the *F/P Requirements* in terms of the *Companies Act, its MOI and any rules* of the company.

At the outset, it should be noted that the content of the presumption under section 20(7) differs substantially from what is deemed by section 40 of the UK Companies Act, namely that 'the power of the directors to bind the company, or authorise others to do so' is free of any limitation under the company's constitution.[1070] Comparison with that section on this point therefore has its limits. It may, however, at once be recognised that section 20(7) should, like section 40, not be interpreted so as to (i) allow third parties to hold companies bound to mere statements of intent or (ii) make illegal transactions legal.[1071]

Depending on one's reading of the presumption in section 20(7), the effect of this section may vary greatly.[1072] The writer submits that there are (at least) two fundamentally different ways to read this phrase, (i) a narrow textual approach informed by notions of legal certainty and shareholder protection and (ii) a wide approach, informed by the purpose of section 20(7), namely third party protection,[1073] and the ambit of the common law, in particular the *Turquand* rule. These views are explored below.

Before discussing those views, however, it is necessary to point out something obvious but nevertheless crucial to the interpretation of section 20(7). This section refers to F/P Requirements contained in three sources, namely those in the Companies Act ('Statutory F/P Requirements') and those contained in a company's MOI or rules (collectively referred to as 'Internal F/P Requirements').[1074] The crucial thing to keep in mind is that this distinction only

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[1069] The writer has already indicated supra note 1036 that the phrase 'in the exercise of its powers' should be taken to refer to transactions which are intra vires a company. The paragraphs below therefore focus on the interpretation of the balance of the phrase.

[1070] Supra para 7.3.4.4.

[1071] Supra notes 938 and 939, respectively.

[1072] See Van der Linde op cit note 28 at 841.

[1073] Supra para 7.3.4.2.3 regarding the English courts' focus on the purpose of the Implementing Provisions.

[1074] The sources which may contain F/P Requirements which are covered by section 20(7) are limited. Formal or procedural requirements under, for instance, shareholders agreements or resolutions are not included and any attempts by a company to rely on such restrictions against a third party will have to be dealt with in terms of the

relates to the *sources of the F/P Requirements and has nothing to do at all with the nature of those requirements*. Therefore, if a requirement is deemed to be an F/P Requirement, then it must be so regardless of which of the three sources it is contained in. For example, if one considers that the requirement that a minimum number of days' notice must be given for a shareholders meeting qualifies as an F/P Requirement, then logic dictates that such requirement must be covered by section 20(7) regardless of whether it is contained in a Company's MOI or the Companies Act. [1075]

8.5.5.2 Narrow view

A narrow interpretation entails (i) interpreting the terms 'the company' and 'decision' as limiting the ambit of section 20(7) and (ii) contrasting F/P Requirements with 'substantive' requirements, with section 20(7) only covering the former.

Regarding 'the company', a narrow interpretation would focus on the organs which act as 'the company',[1076] namely the shareholders and the board.[1077] Decisions of board committees would probably also qualify,[1078] which could include committees of one person. Managing directors have on occasion been referred to as organs[1079] but, in corporate representation cases, have always been treated as agents and not as 'the company', so their inclusion on the narrow view is doubtful.[1080] Employees and officers lower down the line would certainly not qualify.[1081]

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common law. However, given that knowledge of these documents are not attributed to third parties, the odds are stacked against companies successfully relying on such restrictions.

[1075] Locke (op cit note 17 at 171 and 178) argues that a statutory requirement for a special resolution can never be designated as merely formal or procedural, while at the same time allowing requirements for special resolutions in a company's MOI to be covered by section 20(7). With respect, it is not clear how a requirement for shareholder approval can be regarded as not being 'formal' or 'procedural' when it is contained in the Companies Act, but be regarded as such when contained in a company's MOI.

[1076] Supra para 3.2.3.

[1077] See Van der Linde op cit note 28 at 842.

[1078] Blackman et al op cit note 2 at 8-298.

[1079] Michele Von Willich 'Die Uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël' 1988 *Modern Business Law* 7 at 7 (footnote 13).

[1080] We should not forget that a managing director's authority usually does not directly flow from a company's constitution, but from a delegation by the board (and his/her employment contract), placing a managing director in a position which is arguably closer to an agent than an organ.

[1081] This interpretation would be in line with that of section 54 of the CC Act which only applies to acts of members of CCs (supra note 1007). The difference, however, is that the CC Act expressly limits the application to certain persons (ie members) while the Companies Act does not.

Regarding a 'decision', section 20(7) obviously does not require a *valid* decision, because the *raison d'etre* of section 20(7) is to allow third parties to hold companies to irregular decisions. However, a narrow interpretation would require at least *some form of a formally or procedurally defective* decision of 'the company'.[1082] In the words of Van der Linde: 'There must at least have been an attempt to adopt a resolution either at a meeting or in one of the other ways provided for in the act …'[1083] On this view, section 20(7) therefore simply cannot be relied on to assume that requirements for board or shareholder approval had been met, if resolutions were not attempted.[1084]

Regarding F/P Requirements, the narrow interpretation attempts to give meaning to the words 'formal' and 'procedural' by contrasting them with what may be termed 'substantive' requirements.[1085] F/P Requirements would presumably include requirements which are obviously procedural in nature, like those relating to the giving of notices, the setting of a record date and proxies. On the other end of the scale, are requirements for shareholder approval. This idea is encapsulated by Van der Linde:[1086]

> 'shareholder approval, whether by special or ordinary resolution or for that matter by unanimous assent cannot be relegated to the status of a formality or procedural step.'[1087]

Applying consistent interpretation to section 20(7), this means that shareholder approvals could not be assumed, whether they be required by the Companies Act or a company's MOI. The latter effect would be a strange result for a section heralded as a statutory *Turquand* rule, given that internal requirements for shareholder approval were the reason the *Turquand* came to be. This is, however, not an unintended result of the narrow view, because opposite view, that requirements for shareholder approval in both the Companies Act and a company's MOI

[1082] See Van der Linde op cit note 28 at 842.

[1083] Van der Linde op cit note 28 at 842. Presumably, Delport (op cit note 3 at 137) intended to convey the same idea when he stated that the presumption created by section 20(7) 'does not presume that the decision was taken'.

[1084] Van der Linde op cit note 28 at 842: 'It follows that the requirement of a decision or resolution, regardless of whether it signifies board or shareholder approval, cannot as such be regarded as a formal and procedural requirement envisaged by section 20(7).'

[1085] Locke op cit note 17 at 171; Van der Linde op cit note 28 at 842-3.

[1086] Van der Linde op cit note 28.

[1087] Locke (op cit note 17 at 171) was more reluctant to categorically exclude ordinary resolutions. It is respectfully submitted that there is no difference in the nature of a requirement for shareholder approval by ordinary from that of special resolution. In both instances, the shareholders are required to exercise their discretion in respect of a proposed resolution – all that differs is the threshold. If we are to distinguish between substantive and procedural requirements, then requirements for shareholders' approval should, it is submitted, either be in or out, without regard to threshold. This reasoning is generally in line with the approach taken in *Stand 242* supra note 778 to downplay the differences between ordinary and special resolutions – both are intended to protect shareholders. Infra at note 1166.

may be covered by section 20(7) are regarded as simply too detrimental to the interests of shareholders.[1088] Including statutory requirements for shareholder approval under section 20(7) would also upend the current law on the subject, which holds that, at least in certain circumstances, a third party cannot rely on the *Turquand* rule or estoppel to hold a company bound to a contract entered into in contravention of a statutory requirement for shareholder approval.[1089] On the narrow view upending those principles would be a bad result.[1090]

There are three main difficulties faced by the narrow approach. The first is that it is not clear where to draw the line between F/P Requirements and substantive requirements. For instance, Van der Linde regards quorum requirements as possibly covered by section 20(7), but does not disclose whether those requirements are, in her opinion, 'formal' or 'procedural' as opposed to 'substantive'.[1091] We noted in Chapter 7 that the English Court of Appeal in *Smith* struggled with the issue of separating nullities and decisions which were merely procedurally flawed. A narrow view would import that uncertainty to our shores.[1092]

Secondly, the narrow approach ignores the central fact upon which the Third Party Perspective of corporate contracting is built, namely that third parties deal with companies based on what has been represented to them. A third party does not know or have any right to know whether the lack of a representative's authority is as a result of non-compliance with a formal or substantive requirement. All a third party knows is what the company has represented to the world in general and the third party specifically. If a third party is dealing with a representative who has ostensible authority to enter into an agreement, the third party should be able to hold the company to that contract, even if the defect is the lack of a quorum. This reasoning is, it is submitted in line with that of the ostensible authority based approach taken by Carnwath LJ in *Smith*.[1093]

Thirdly the narrow approach leaves section 20(7) so eviscerated that it will hardly be of use to third parties. It is submitted that, on the narrow view, section 20(7) may well not be

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[1088] Van der Linde op cit note 28 at 843; Locke op cit note 17 at 172.

[1089] Locke op cit note 17 at 172.

[1090] Ibid.

[1091] Van der Linde op cit note 28 at 842.

[1092] Supra para 7.3.4.2.3.

[1093] Supra note 883.

available to a third party in the following four scenarios, all of which were, at least in principle, covered under common law:[1094]

1. in the classic *Turquand* situation no shareholder approval has been attempted, so reliance on section 20(7) is presumably not possible on the narrow interpretation;
2. sans an actual attempt (either by way of meeting or written resolution) at delegating authority to a single representative, a third party will not be able to rely on section 20(7) to assume that such a delegation was made under section 20(7), even if the representative was acting within his/her usual authority;
3. it is uncertain whether a third party could rely on section 20(7) where a decision of shareholders or directors was attempted, but was inquorate;
4. section 20(7) would arguably not be available to a third party where a company avers that it is not bound to a contract because the director/s concerned were not appointed, since their appointment had nothing to do with the formal or procedural defects attaching to the decision of the company to enter into the relevant contract.

The examples referred to above do not attempt to convey that the narrow interpretation is illogical or necessarily leads to absurd results. What these examples show is that a narrow interpretation of the section will reduce the scope of the section to such an extent that it will hardly perform its purpose, namely protecting third parties in their dealings with companies. This could not have been the intention of the legislature.

8.5.5.3 Wide view

A wide interpretation would essentially regard the narrow interpretation to be correct as far as it goes, but hold that it does not go far enough. The animating principle behind this approach is that the section was intended to protect third parties and should therefore be interpreted with that purpose in mind. At the very least, one would imagine this would entail covering the circumstances covered by the *Turquand* rule. As the court stated in *Neffensaan*, the phrase F/P Requirements must be construed 'consistently with the conventional scope of *Turquand*.'[1095] This is also implicit in the identification of section 20(7) by our courts, including the SCA, with the *Turquand* rule.[1096]

This interpretation regards the narrow view's insistence on equating 'the company' with actions of its collective organs unduly restrictive *for the purposes of section 20(7)*. In other words, for purposes of section 20(7), the term 'company' should be interpreted widely to

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[1094] Supra para 6.3.2.

[1095] *Neffensaan* supra note 29 para 55. The approach in that case to section 20(7) was approved in *Marais v Botbro (Pty) Ltd* (UM26/2018) [2018] ZANWHC 33 (7 March 2018).

[1096] Supra note 1024.

apply to the actions of the persons with whom third parties ordinarily deal, namely those who have ostensible authority to act on behalf of a company in a specific transaction.

This may seem company law counter-intuitive but, it is submitted, such an approach would do no more than mimic the common law. In the classic *Turquand* scenario (ie where the board acted collectively), the board's decision (which is conveyed to the third party) is that of the company and the requisite shareholders' approval is an F/P Requirement in respect of which the third party may assume compliance. Thus in *Neffensaan*, the court held that where 'the board's authority is qualified by a condition of prior shareholder approval, the said condition could be regarded as a formal or procedural requirement'.[1097] Unlike the narrow approach, this would include assuming that shareholder approval had been given even if it was not attempted.

When a third party is dealing with a managing director in respect of a contract ostensibly falling within his/her authority, as far as the third party goes, the decision of the managing director should be regarded as the decision of the company and the delegation of authority to him/her by the board and shareholder approval (if required) should be regarded as the F/P Requirements with which the third party may assume compliance.[1098] Naturally, single directors, who lack any ostensible authority to represent a company, would not be covered (unless the circumstances clothe a particular director with ostensible authority). Actions of employees would be covered by section 20(7), as long as they are acting within their ostensible authority.

Regarding F/P Requirements, the wide approach would recognise that section 20(7) was intended as a 'statutory *Turquand* rule' and therefore interpret F/P Requirements as essentially those requirements covered under the *Turquand* rule. These included not only purely procedural requirements, but also internal requirements relating to quorums, the appointment of directors, the delegation of authority by the board and prior shareholder approval. Would that not, however, be doing to violence to the words used in the section ie 'formal' and 'procedural'? Not necessarily - our law reports are replete with references, both before and

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[1097] *Neffensaan* supra note 29 para 55.

[1098] Ibid: 'Where a person is, or is held out to be, the company's managing director, the precise terms of and restrictions on the authority delegated to the managing director might be regarded as a formal or procedural matter.'

after the promulgation of the Companies Act, to the *Turquand* rule generally being applicable to 'procedures'[1099] and 'formalities'[1100].[1101]

Noteworthy examples include:[1102]

1. In Stand *242 Hendrik Potgieter Road Ruimsig (Pty) Ltd v Göbel NO*[1103] the SCA described the *Turquand* rule as entitling a third party to assume that a company has complied with its internal 'procedures and formalities';
2. In *Wolpert*[1104] the court maintained that, as long as a corporate representative was acting within his/her usual authority, the *Turquand* rule would a third party to assume compliance with any further '*formal* act of internal management'.

In these instances, the courts were generally describing the ambit of the *Turquand* rule and could not have been unaware that such rule covers more than strict procedural requirements.[1105] Yet the terminology used was related to 'formal' and 'procedural'. While these references are far from conclusive, they arguably imply that not too much should be read into the words 'formal' and 'procedural'. Instead, the emphasis arguably should be, as it was under common law, on the fact that the relevant requirements are *internal* – ie relating to the assent of the persons owning the company (the shareholders) or running the company (the board).

On this basis, and taking into account the Third Party Perspective, it is submitted that, F/P Requirements should be interpreted to include any internal requirements needed to regularise the decision of a person acting on behalf of a company to enter into an intra vires transaction on behalf of that company (provided that the conclusion of such transaction falls within the ostensible authority of such person). If this approach were accepted, section 20(7) would, like

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[1099] *Pangbourne Properties Ltd v Basinview Properties (Pty) Ltd* 2011 JDR 0183 (SCA) paras 9 and 10; *Transnet Limited v Vusa-Isizwe Security Services (Pty) Limited* 2014 JDR 1006 (GSJ).

[1100] *McCarthy and Others v Constantia Property Owners' Association and Others* 1999 (4) SA 847 (C) at 860I; *Naidoo v Bhudai NO* 2008 JDR 0357 (D) para 21, *Parker* supra note 753 para 18; *Solidarity & others v Eskom Holdings Ltd* (2012) 33 ILJ 464 (LC) para 12, *Nieuwoudt* supra note 527 para 11; *Van der Merwe No* supra note 751 para 26. See also *Levy* supra note 566 at 487I.

[1101] Van der Linde op cit note 28 at 842 urges that company lawyers seek guidance from insolvency law on the terms 'formal' and 'procedural'. However, surely it is prudent to first have regard to the use of those and related terms by the courts in corporate representation cases?

[1102] See, however, *Farren* supra note 328 para 8 where the court said that the *Turquand* rule applies to 'internal formalities or acts of management'.

[1103] Supra note 778 para 12.

[1104] 1961 (2) SA 257 at 264B.

[1105] It is also worth pointing out that these references were not mere cursory references to the *Turquand* rule – these cases actually dealt with the substance of corporate contracting in general and the *Turquand* rule in particular.

the *Turquand* rule, be wide enough to cover situations relating to non-compliance with formalities relating to quorums, the delegation of authority by the board to a single representative,[1106] prior requirements for shareholder approvals[1107] and formalities regarding the appointment of directors.[1108]

Furthermore, taking into account the consistent interpretation approach to section 20(7), these requirements would, in principle, be covered even if contained in the Companies Act. To be clear, however, the writer is not claiming that all requirements which may be classified as Statutory F/P Requirements under the wide approach will be covered by section 20(7). What the writer suggests is that these requirements are covered *in principle*. In each case, it will still be necessary to determine whether the legislature did not intend to override the operation of section 20(7) by, for instance, visiting non-compliance with a certain requirement with voidness.

8.5.5.4 Conclusion

It is submitted that, taking into account the purpose of section 20(7) and the shift to the Third Party's Perspective in relation to corporate contracting, the wide approach is preferable. Although this approach may stoke fears of abuse by third parties, it is submitted that the application of the section will be limited by (i) the requirement to prove ostensible authority of corporate representatives and (ii) the knowledge exception. Furthermore, although Statutory F/P Requirements are covered in principle, the terms of a specific section may still evince an intention on behalf of the legislature that such section should not be covered by section 20(7) and the shareholders resolutions which are likely to be covered under section 20(7) are actually quite limited.[1109] Furthermore, it is submitted that a wide approach to section 20(7) will lead to sensible pro-third party developments of the pre-Companies Act position – see excurses below.

[1106] The writer therefore agrees with Jooste's assertion (op cit note 9 at 471 and see also at 474-5) that a 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 could be a 'formal' or 'procedural' requirement.

[1107] This was expressly stated in *Neffensaan* supra note 29 para 55.

[1108] There remains some uncertainty regarding de facto directors and section 40 of the UK Companies Act – supra note 934.

[1109] Infra para 8.6.5.

8.5.6 Section 20(7) and internal remedies

It is also worth pointing out that, while the Companies Act does offer protection to third parties in the form of section 20(7), it also contains sections protecting the interests of shareholders. Shareholders, directors and prescribed officers are, in terms of section 20(5), entitled to restrain a company from doing anything inconsistent with the Companies Act or a restrictive condition contained in a company's MOI, but such remedy does not affect rights obtained bona fide by third parties. Section 20(6) furthermore shareholders with a damages claim against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with the Companies Act or such a restrictive condition.[1110] The position of shareholders in relation to the enforcement of constitutional limitations on authority therefore approximates that under UK law.[1111]

What is not entirely clear is how the remedy provided for in section 20(4) is intended to interact with section 20(7).[1112] Section 20(4) provides, inter alia,[1113] shareholders, directors and prescribed officers with the ability to restrain the company from doing anything in the Companies Act, but says nothing about the rights of bona fide third parties. This results in an ostensible conflict between section 20(7) and section 20(4) in the case of Statutory F/P Requirements – a third party is entitled to assume compliance with such requirements under the former, while shareholders may restrain a company from contravening those requirements under the latter.

It is submitted that this conflict should be resolved in favour of the third party, by interpreting section 20(4) as being subject to section 20(7). In other words, the general principle should be, as stated in section 20(4), that third parties cannot claim rights following a contravention of the Companies Act, but that section 20(7) represents an exception to that rule in the interests of third parties, taking into account the fact that even Statutory F/P

[1110] See also section 218(2): 'Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.' It may, however, be difficult for shareholders to prove the quantum of the damages suffered by them, because it would be the company (and not the shareholders) which would usually suffer the actual damages caused by an unauthorised contract. South African courts have affirmed the principle that a shareholder cannot claim damages from a third party on the basis that the shareholder's shares have less value as a result of damages caused by the third party to the company. The proper plaintiff in such circumstances is the company – the shareholder's losses are merely 'reflective' of the company's losses. See *Hlumisa Investment Holdings RF Ltd and Another v Kirkinis and Others* 2020 (5) SA 419 (SCA), especially paras 48 and 52.

[1111] Supra para 7.3.4.5.

[1112] Jooste op cit note 9 at 473-4.

[1113] Trade unions representing company employees may also institute action under this section.

Requirements remain internal requirements to which a third party is not privy. Shareholders will, of course, still be able to restrain a company before third party rights arise, but afterwards a damages claim under section 20(6) will have to suffice.[1114]

8.6 EXCURSUS I: A WIDE VIEW OF F/P REQUIREMENTS AND STATUTORY REQUIREMENTS FOR PRIOR SHAREHOLDER APPROVAL

8.6.1 Introduction

On a wide view of F/P Requirements, requirements for shareholder approval may be included within the scope of section 20(7). Interpreting section 20(7) consistently, this means that requirements for prior shareholder approval contained both in a company's MOI *and the Companies Act* may be covered by that section.

Accepting in principle that the section may cover statutory requirements for shareholder approval would, however, appear to be at odds with current law, at least in the context of a company disposing of the greater part of its assets or undertaking (referred to here as its 'Business'). In those circumstances, the current law is that neither the *Turquand* rule nor estoppel may aid a third party in circumstances where the shareholders' approval required by statute has not been obtained. This excursus makes the argument that interpreting section 20(7) to protect third parties in those circumstances, thereby overturning the current law, would be a welcome legal development.

8.6.2 The disposal of a company's Business, the *Turquand* rule and estoppel

In Chapter 3, we noted that corporate law developed to recognise that, within the sphere allocated to it under a company's constitution, the board was acting as the company and the shareholders could not interfere with the decisions taken by the board.[1115] The board was usually given wide powers to manage a company's business under the Board's General Authority Clause, which authority included the power to sell assets of the company, at least where such disposals were in furtherance of a company's objects.[1116] On general principles,

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[1114] Supra note 1110 in this regard.

[1115] Supra para 3.2.3.

[1116] Von Willich op cit note 1079 at 7 at 7.

therefore, shareholders could not interfere with the disposal by the board of a company's assets.[1117]

This general position was, however, changed in 1952 by the introduction of section 70*dec*(2) into the 1926 SA Act,[1118] which section required shareholder approval for the disposal of a company's Business.[1119] Some years later a recommendation for a similar provision was made by the Jenkins committee in the UK.[1120] That recommendation was, however, never enacted, so there is no identical provision in English law.[1121] The requirement for shareholder approval in section 70*dec*(2) was substantially retained in section 228[1122] of the SA 1973 Act, which section was amended in 2006 to require a special resolution of shareholders and not merely an ordinary one, which had been the case up to then under both section 228 and section 70*dec*(2) (together referred to as the 'Disposal Sections').[1123]

The enactment of these sections necessarily raised the question of what the effects of failure to obtain the required shareholder approval would be, especially where a bona fide third party had acquired assets from a company:

1. Did the Disposal Sections make it ultra vires for a company to sell its Business without prior approval or did those sections merely limit the authority of the board to do so?

[1117] Ibid at 7-8 and 9.

[1118] The relevant portion of this section read as follows (my emphasis): 'Notwithstanding anything in the articles of association the *directors of a company shall not be empowered* without the approval of the company in general meeting to dispose of the undertaking of the company or of the whole or the greater part of the assets of the company.'

[1119] Inclusion of such clauses in companies' articles appears to already have been practice in respect of listed and non-listed companies – see *Standard Bank of South Africa Ltd v Hunkydory Investments 188 (Pty) Ltd and Others (No 2)* 2010 (1) SA 634 (WCC) para 20; *Lindner v National Bakery (Pty) Ltd and Another* 1961 (1) SA 372 (O) at 379B and the Jenkins Report op cit note 783 para 117.

[1120] The Jenkins Report op cit note 783 para 122(e).

[1121] *Sugden and Others v Beaconhurst Dairies (Pty) Ltd and Others* 1963 (2) SA 174 (E) at 179F. See Von Willich op cit note 1079 at 8-11 regarding the traditional positions in other jurisdictions in the Anglo-American, Germanic and Roman traditions. The UK Companies Act does, however, require shareholder approval for substantial property transactions between companies and connected persons and for the acquisition of non-cash assets by public companies from subscribers to their memoranda within an initial period of two years after commencing trading (see sections 190 and 598, respectively).

[1122] Pre-amendment, section 228(1) read (my emphasis): '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 — (a) the whole or substantially the whole of the undertaking of the company; or (b) the whole or the greater part of the assets of the company.'

[1123] Post amendment, section 228(1) read (my emphasis): 'Notwithstanding anything contained in its memorandum or articles, the directors of a company *shall not have the power*, save by a *special resolution of its members*, to dispose of — (a) the whole or the greater part of the undertaking of the company; or (b) the whole or the greater part of the assets of the company.'

2. Could a (bona fide) third party hold a company bound to a disposal of its Business where shareholder approval was not obtained based on the *Turquand* rule or estoppel?[1124]

First, the question regarding capacity. Despite initial uncertainty,[1125] over time, it was accepted by both courts[1126] and academics[1127] that the section merely limited directors' powers and not those of the company – a transaction without shareholder approval was not ultra vires or void.

The question regarding third party rights was much more controversial and eventually two schools of thought arose on this issue.[1128] While both sides agreed that the purpose of the section was the protection of shareholders,[1129] they disagreed on whether such protection should trump the expectations of a third party who contracted with the board but who was unaware that prior approval had not been given.

The view that the third party's interests should carry the day, which may be termed a 'Pro Third Party Stance', enjoyed early support from commentators[1130] and company law commissions (both in South Africa[1131] and England[1132]). In *Levy v Zalrut Investments (Pty) Ltd*,[1133] too, the court also took a decidedly Pro Third Party Stance. Having concluded that contraventions of section 228 were not ultra vires or void, the court held that a third party who is ignorant of non-compliance with section 228 should be entitled to raise estoppel

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[1124] It should at the outset be mentioned that reasons for the recognition of estoppel and the *Turquand* rule largely overlap and can be dealt with together. This approach is even more apposite when an Ancillary Rule Approach is taken to the *Turquand* rule. Courts have also recognised this, viz *Farren* supra note 328 para 18: 'If the *Turquand* rule cannot apply, then for the same reason, estoppel cannot apply.'

[1125] See, respectively, para 44.39 of, and, section 9.03 of Appendix C to, the Main Report op cit note 146.

[1126] *Levy* supra note 566 at 486E-7B, *Farren* supra note 328 at para 11, *Stand 242* supra note 778 para 13 and *Ally and Others NNO v Courtesy Wholesalers (Pty) Ltd and Others* 1996 (3) SA 134 (N) at 145F.

[1127] Basil Wunsh 'Disposing of the Undertaking or Assets of a Company' (1971) 88 *SALJ* 351 at 352; Fourie op cit note 210 at 3.

[1128] The prospect of a third party relying on the *Turquand* rule to overcome section 70*dec*(2) had, however, already been raised earlier by Wunsh – see op cit note 1127.

[1129] *Levy* supra note 566 at 486J; *Farren* supra note 328 para 14. See also *Ben-Tovim* supra note 231 at 1084-5.

[1130] See Ribbens op cit note 1161 at 164; Wunsh op cit note 1127.

[1131] Main Report op cit note 146 para 44.45. It is not entirely clear how this view could be reconciled with the Commission's view that the Disposal Sections affected a company's capacity – supra note 1125.

[1132] The Jenkins Report op cit note 1119 para 122(f)).

[1133] Supra note 566.

against a company.[1134] This conclusion, the court noted *obiter*, was also in line with the *Turquand* rule.[1135] The Pro Third Party Stance also did not lack academic support.[1136]

There was, however, also academic support for the view that the interests of the shareholders should be given effect to, which view will be dubbed a 'Pro Shareholder Stance'[1137].[1138] Fourie[1139] argued for such stance, despite accepting that a contract entered into in contravention of section 228 was not ultra vires[1140] or ab initio void.[1141] In fact, the author went so far as to state that reliance on the *Turquand* rule was not in principle excluded in the circumstances because a transaction in contravention of section 228 was not illegal.[1142] Rather, the author submitted, this was a question of weighing the interests of the third party and that of the shareholders, which question had to take into account the intention of the legislature.[1143] That intention – to protect shareholders – was paramount and could not be subverted by the *Turquand* rule (or estoppel).[1144] Indeed, the intention of the legislature was invoked against every objection raised by Pro Third Party Stance advocates.[1145] Those objections are explored further below.

In *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* [1146] the court, with reference to Fourie's views,[1147] took a Pro Shareholder Stance contra *Levy*, finding that to allow a third

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[1134] Ibid at 487B.

[1135] Ibid at 487C.

[1136] Supra note 1130 and see Wunsh op cit note 775; Von Willich op cit note 1079.

[1137] Referring to this stance as a Pro Shareholder Stance may be disputed. Advocates of this approach may well argue that it is not so much that they are for the interests of the shareholders, but that they are merely arguing for the implementation of the plain wording of the section. Their grievance may therefore be well described with the statement in *Lindner* (supra note 1119 at 380A-B) with respect to section 70*dec*(2) that 'procedure must be followed, even though the consequences of giving effect to the prescribed procedure may be such as to justify the surmise that Parliament did not appreciate the full effect of its pronouncement'. It is clear, however, that the interests of shareholders played an important role in the conclusion of the court in *Stand 242* (see quotation infra note 1155) and in Fourie's influential article (see at 10).

[1138] See Lionel Hodes, 'Disposal of Assets – s228' 1978 *SACLJ* F-6 at F-13.

[1139] Fourie op cit note 210.

[1140] Ibid at 8.

[1141] Ibid at 4.

[1142] Ibid at 6.

[1143] Ibid.

[1144] Ibid at 6-7.

[1145] See Fourie op cit note 210 at 6-8.

[1146] Supra note 328. In this case, a third party signed an agreement with the sole director of a company for the sale of the only asset of that company. The director owned some shares in the company, but the large majority of shares were owned by the company's only other shareholder – a company controlled by the director's mother.

party to hold a company bound in the circumstances would negate the protection which the legislature intended for shareholders.[1148] In essence, the court's reasoning was that the ordinary meaning of the words used in section 228 required shareholders to be protected and there did not exist sufficient reasons to conclude that the legislature intended anything different from the ordinary meaning of the words used.[1149]

The court in *Farren* focussed its judgment on the *Turquand* rule (which it regarded as an independent rule),[1150] despite a major part of arguments before it being based on estoppel.[1151] The application of estoppel was cursorily dismissed, essentially based on the principle that estoppel will not be upheld if doing so would achieve a result which is not permitted in law or contrary to the intention of the legislature.[1152]

Eventually, the issue came before the SCA in *Stand 242*, in which the SCA sided with *Farren* and adopted a definitively Pro Shareholder Stance. In this case, a third party concluded an agreement for the purchase of a company's only asset. The company was represented by two directors, who were presumably the company's only two directors. The shares of the company were owned by the two family trusts of the two directors – in each case the director and his wife were trustees of their trust, together with one further trustee. The two directors had signed a document certifying that section 228 had been complied with.[1153] The SCA found that this statement was false, on the basis that the *other* trustees of the family trusts were not aware of the sale. Naturally, the third party argued that the trusts 'were aware' of the transaction, given the composition of their trustee boards, but the court

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When the purchaser wished to enforce the contract, the company claimed that it was not bound, inter alia, on the basis that section 228 had not been complied with. The court agreed that the company was not bound and dismissed the application to enforce the sale contract.

[1147] It is clear that the views of Fourie (op cit note 210) underpinned the court's judgment in Farren. See Farren supra note 328 paras 13, 14, 17 and 18.

[1148] See also *FPW Engineering Solution (Pty) Ltd v Technikon Pretoria* [2004] 1 All SA 204 (T) para 37.

[1149] *Farren* supra note 328 para 17.

[1150] Supra note 719.

[1151] *Farren* supra note 328 para 18.

[1152] Ibid. Note that the authority given for this conclusion are the same as those provided by Fourie op cit note 210 at 7.

[1153] The statement certified in the alternative that the sale assets did not constitute the greater part of the company's assets, but that was clearly not applicable, since the asset was the company's only asset.

skirted around this issue, choosing to merely refer to the fact that there was no evidence that the other trustees (including the directors' wives) had knowledge of the sale.[1154]

The court therefore limited its inquiry to the more abstract question of whether a third party could rely on the *Turquand* rule or estoppel in the circumstances. In this regard, the SCA definitively sided with *Farren* in following a Pro Shareholder Stance, by holding that a third party could do neither. Regarding the *Turquand* rule, the court held that the purpose of section 228 was to protect shareholders based on the 'clear meaning' of the words used by the legislature and allowing a third party to hold a company bound based on the *Turquand* rule would undermine that purpose.[1155] Just as in *Farren*, the SCA dealt with estoppel in a cursory way, holding that estoppel could not be relied on in the circumstances because of the general principle that 'estoppel cannot operate to allow a contravention of a statute'.[1156]

8.6.3 Critical analysis of the Pro Shareholder Stance

It is submitted that there are valid grounds to question the Pro Shareholder Stance taken in *Farren* and *Stand 242*. These grounds are set out below.

8.6.3.1 A dogmatic Pro Shareholder Stance ignores equity and business convenience and places a third party in an impossible position

The most obvious criticism of the Pro Shareholder Stance is that the approach results in overprotection of shareholders and ignores the legitimate expectations of bona fide third parties who were unaware of non-compliance with section 228. Indeed, it should be pointed out that the Pro Shareholder Stance is, unlike the Pro Third Party Stance, a dogmatic one – there are *no circumstances* in which a third party can hold a company liable sans ratification by shareholders, since reliance on estoppel and the *Turquand* rule are excluded *in principle*.

Stand 242 provides a good example of the inequity which may result from such a view. In that case, (i) the third party was dealing with the entire board of the company, (ii) the entire board had specifically communicated to the third party that section 228 had been complied with[1157] and (iii) the directors and their wives constituted the majority of trustees of the trusts which held the company's shares. It is unclear how much further the court required the third

[1154] *Stand 242* note 778 para 8.

[1155] Ibid para 16.

[1156] Ibid para 23.

[1157] Or, alternatively, that it was inapplicable.

party to go – did the third party have to approach the shareholders directly?[1158] Third parties usually do not deal directly with shareholders and although courts have held that section 228 granted a measure of control over the sale of a company's Business to shareholders,[1159] this section did not divest the board of its general power (under the Board's General Authority Clause) to dispose of assets.[1160] It should not be forgotten that the disposal of assets, even major ones, forms part of many companies' businesses.[1161] Hodes, who took a Pro Shareholder Stance, suggested earlier that third parties protect themselves by obtaining a certificate from a company's auditors that section 228 had been complied with.[1162] On the approach taken in *Stand 242*, this would appear not to be enough.

Furthermore, the factors discussed in Chapter 5 which militate for a general pro third party approach to corporate representation are all relevant here, including the fact that (i) shareholders are protected by limited liability, (ii) shareholders can interdict the sale prior to its implementation, (iii) errant directors remain personally liable to their companies for exceeding their authority and (iv) there is no reason why a third party should carry the risk of a board exceeding its powers as opposed to the shareholders who appointed that board (the *Hern v Nichols* principle).[1163]

Moreover, the two foundational factors to the existence of the *Turquand* rule are also present, First, negating a third party's reasonable expectations runs counter to business convenience.[1164] Secondly, a third party dealing with a company *had no legal means to discover whether section 228 was triggered in the circumstances or whether it was complied with*. A third party dealing with a company does not have access to a company's balance sheet, so therefore cannot determine the relative value of the asset which it wishes to acquire, nor does it have access to a company's minute books. This leaves a third party not merely in an invidious position, but in an impossible position. It could perhaps have been argued that

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[1158] The court's comments regarding estoppel infra note 1202 appear to suggest that a direct representation by the shareholders that their approval had been given is necessary.

[1159] See *Lindner* supra note 1119 at 379D; *Sugden* supra note 1121 at 179F and *Stand 242* supra note 778 para 13.

[1160] Ribbens op cit note 1161 at 163.

[1161] See Ribbens op cit note 1161 at 162.

[1162] Hodes op cit note 1138 at F-13.

[1163] See Wunsh op cit note 775 at 548.

[1164] Business convenience also undergirds estoppel to a degree - supra para 6.6.11. This rule may also be inconvenient to the disposing company – see Jenkins Report op cit note 783 para 117.

once section 228 was amended to require a (registered) special resolution, the third party would then be able to be in a position to tell if section 228 had been complied with.[1165] In *Stand 242*, however, the court held that it made no difference to its decision whether the legislation required a (public) special resolution or (non-public) ordinary resolution – third party protection would be denied in principle.[1166]

The disadvantage into which a Pro Shareholder Stance would entrench a third party did not receive detailed attention in either *Farren* or *Stand 242*. It is submitted that this factor should have been considered far more seriously, not merely out of an inherent sense of fairness, but because the principles of statutory interpretation dictate that it must. Indeed, it is an established principle of interpretation that, when discerning the legislature's intention, inconveniences and impropriety which would result from the rescission of what was done must be taken into account.[1167]

8.6.3.2 Penalties and public interest or policy

There are other indications which favoured a Pro Third Party Stance. First, section 228 did not contain a penalty. While not conclusive, it has long been recognised that the inclusion of a penalty in a statutory provision points towards the intention of the legislature being to render such act void.[1168] This point was not mentioned at all in *Stand 242* and conceded without counterargument in *Farren*.[1169]

Another relevant point is that Van Zyl J's finding in *Levy* that section 228 was enacted for the protection of shareholders alone and not based on public interest or policy considerations has never really been refuted.[1170] In *Stand 242*, the court mentioned this argument but did not

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[1165] See JI Yeats 'The drafters' dilemma: Some comments on the Corporate Laws Amendment Bill, 2006' 123 (2006) *SALJ* 601 regarding the issues with such an approach.

[1166] Stand 242 supra note 778 paras 21-22. See, in relation to this amendment, Yeats op cit note 1165 at 613.

[1167] *Sutter v Scheepers* 1932 AD 165 at 173, *Motloung and Another v Sheriff, Pretoria East and Others* 2020 (5) SA 123 (SCA) para 11, *Swart v Smuts* 1971 (1) SA 819 (A) 830 and *Palm Fifteen (Pty) Ltd v Cotton Tail Homes (Pty) Ltd* 1978 (2) SA 872 (A) at 885. See also Wunsh op cit note 775 at 548.

[1168] Wunsh op cit note 775 at 548.

[1169] *Farren* supra note 328 para 16.

[1170] In *FPW Engineering* supra note 1148, the court, correctly it is submitted, regarded the giving of Ministerial approval to a Technikon as not being an internal formality which may be covered by the *Turquand* rule. It is respectfully submitted, however, that Ministerial approval is not comparable with shareholder approval based on the fact that (i) the Minister is external to 'the company' (ie the Technikon) and (ii) the fact that Ministerial approval is required is indicative of public interest.

challenge it directly.[1171] In *Farren* the court referred to Fourie's reasoning that the 1973 SA Act contained many provisions which limited directors' authority.[1172] In that author's view section 228 'was an example of where the legislature deemed it in the public interest to curb the wide managerial powers of directors by statute to prevent abuse to the detriment of shareholders as a group'.[1173] This reasoning is, with respect, unconvincing. First, the author himself acknowledges that the beneficiaries of the section are 'shareholders as a group'. Secondly, do the interests of third parties, being the members of the public which deal with companies, not better align better with the public interest than those of shareholders?

Furthermore, it is respectfully submitted that characterising section 228 as merely one of many statutory protections against abuse of directors' powers lacks nuance. There are differences between legislative sections which indicate that they should be treated differently. For instance, Wunsh distinguished section 228 from section 226 of the SA 1973 Act, which section required the consent of all members or a special resolution for a company to provide a loan to, or security for the benefit of, a director of that company or a company controlled by such a director.[1174] That author, correctly it is submitted, distinguished the latter section from the former on the basis that (i) the latter section penalised contravention thereof,[1175] (ii) loans granted in contravention of section 226 were held to have been void[1176] and (iii) section 228 was aimed at far more serious mischief than section 228, namely directors siphoning off company funds to themselves or their companies.[1177] The court in *Farren* noted these arguments without substantively addressing them.

8.6.3.3 Undesired results

It is not immediately apparent why the courts' reasoning in *Farren* and *Stand 242* would not apply to lesser procedural requirements contained in legislation. For instance, if a company

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[1171] *Stand 242* supra note 778 paras 14-5.

[1172] *Farren* supra note 328 para 17.

[1173] My translation – see Fourie op cit note 210 at 8. Original text of full sentence: 'Ook artikel 228 is voorbeeld van waar die wetgewer dit in die openbare belang dienstig geag het om die wye bestuursmagte van direkteure statutêr te beperk om misbruik daarvan te voorkom tot nadeel van aandeelhouers as 'n groep.'

[1174] Wunsh op cit note 775 at 548.

[1175] Section 226(4)(b).

[1176] *Neugarten and Others v Standard Bank of South Africa Ltd* 1989 (1) SA 797 (A).

[1177] See Wunsh op cit note 775 at 549.

left its notice period for shareholders' meetings to be determined by the 1973 SA Act[1178] rather than its articles, would a Pro Shareholder Stance not allow the company to rely on defective notice to invalidate a transaction entered into with a bona fide third party? After all, there would have been a contravention of the clear wording of a provision of the Act enacted for the benefit shareholders.

8.6.3.4 Even on a Pro Third Party Stance, the section still protects shareholders

It should be noted that a Pro Third Party Stance does not negate all of the protective effects of the section. First, the section is mandatory, so a company cannot negate its operation through its constitution. Secondly, shareholders may still interdict a disposal before it happens and the company may hold directors personally liable for exceeding their authority (it is obviously not within the authority of the board to dispose of the company's Business if the law requires shareholders' consent to do so). The latter point, in particular, serves to motivate boards of properly run companies to always obtain shareholders' consent.

Although not really relevant from a legal perspective, it may be pointed out that, ironically, the Disposal Sections were often invoked in the context of closely held companies where formal shareholders' approval was lacking because of the proximity of the directors representing the companies to the shareholders. In *Farren* the company's shareholder was controlled by the sole director's mother, while in *Stand 242* the shareholders were the family trusts of the directors. In such circumstances, a Pro Shareholder Stance may succeed less in bona fide shareholder protection and more in giving remorseful boards a 'second bite at the cherry'.

8.6.3.5 An overly narrow view of estoppel

For reasons which are not readily apparent, the court in both *Stand 242* and *Farren* chose to focus almost exclusively on the application of the *Turquand* rule and the *obiter dictum* in *Levy* pertaining to that rule, despite the fact that the relevant portion of the judgment in *Levy* pertained in the main to estoppel (and, in the case of *Farren*, the lion's share of arguments before the court concerned estoppel). This paragraph respectfully suggests that there are good reasons to question the out of hand dismissal of estoppel in both *Stand 242* and *Farren*.

[1178] Section 186(1)(a) of the SA 1973 Act, for instance, set the default notice period for shareholders' meetings at 14 days, which applied unless that company's articles stipulated a longer period.

First, neither the case law relied on in *Stand 242*, nor in *Farren*, supports the wide and unqualified statement made by the SCA that 'estoppel cannot operate to allow a contravention of a statute'.[1179]

The SCA relied a selection of specific paragraphs from *City of Tshwane Metropolitan Municipality v RPM Bricks (Pty) Ltd*.[1180] That case, however, concerned the distinction in our law between acts beyond or in excess of the legal powers of a public authority (ie ultra vires acts), on the one hand, and the irregular or informal exercise of power granted.[1181] Our courts have held that estoppel may be available to a person dealing with a public authority in the latter case, but not the former.[1182] In *RPM Bricks*, the SCA held that section 38(1) of the Gauteng Rationalisation of Local Government Affairs Act[1183] *fell into the first category* as it restricted the power (vires) to amend tender contracts exclusively to the municipal council.[1184] Accordingly, a third party could not hold the municipality to an amendment of a tender which had been agreed to by employees without approval of the municipal council.

The authority relied on in *Farren* (and by Fourie), namely *Strydom v Die Land - en Landboubank van Suid-Afrika*,[1185] also fails to support such a wide conclusion.[1186] In that case, the court considered the application of estoppel in the context of a transaction where formalities prescribed by the Land Bank Act[1187] had not been followed. Crucially, the court in that case held that the provisos which contained those formalities limited the capacity (*bevoegdhede*) of the Land Bank to act within the section which those provisos relate, with the effect that actions taken under the section which did not comply with those formalities

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[1179] *Stand 242* supra note 778 para 23.

[1180] 2008 (3) SA 1 (SCA).

[1181] *RPM Bricks* supra note 1180 paras 11-13.

[1182] Ibid and *National and Overseas Distributors* supra note 666.

[1183] No 10 of 1998.

[1184] *RPM Bricks* supra note 1180 para 14.

[1185] 1972 (1) SA 801 (A). The court, no doubt influenced by Fourie (op cit note 210 at 7), also relied on the following passage from *LAWSA* (which is still unchanged and contained in Harms op cit note 385 para 99) (my emphasis): 'Estoppel is not allowed to operate in circumstances where it would have a result which is not permitted by law. A defence of estoppel will therefore not be upheld if its effect would be to render enforceable that what the law, be it the common law or statute law, *has in the public interest declared to be illegal or invalid*.' Again, it is not entirely clear how this statement conclusively favours a Pro Shareholder Stance, given that the court in *Farren* found contraventions of section 228 neither to be ultra vires nor void.

[1186] Fourie op cit note 210 at 7.

[1187] No 19 of 1944.

were ultra vires and void (*nietig*).[1188] This, together with the fact that the Land Bank was a public body clearly established to serve the public benefit,[1189] precluded any possible applicability of estoppel in the circumstances.[1190]

It is, with respect, difficult to see how either of these two cases supported the conclusion that estoppel was not available to a third party in respect of a disposal contrary to section 228. This is so particularly because in both *Stand 242* and *Farren*, it was specifically held that a contravention of section 228 *did not render a transaction ultra vires or void*. If a contravention of section 228 did not fall within the first category identified in *RPM Bricks*, then surely it fell in the second and estoppel is permissible in principle? That certainly was the approach taken in *Levy*[1191] and, it is submitted, the correct one. It should also be noted that, unlike in the case of a companies formed under the Companies Act, both cases dealt with public entities where the public interest was manifest.

The actual position is that the use of estoppel is not precluded in respect of statutory contraventions per se, but rather that estoppel cannot be used to give effect to acts which the legislature has declared ultra vires, invalid or void. The application of these principles to public bodies is well illustrated by contrasting the Appellate Division decisions in *Hoisain v Town Clerk, Wynberg*[1192] with *Potchefstroom se Stadsraad v Kotze.*[1193] In the former case, the Appellate Division was asked to apply estoppel where its effect would be to force a town clerk to enter the name of a person on a list without that person having been granted a certificate by the council. The court, however, refused to do so on the basis that the town clerk simply had no power to do so in the absence of a certificate. In the court's words, 'we are asked to force him to commit an illegality'.[1194] In the latter case, the court held a city council bound[1195] to an agreement for the cancellation of a lease entered into on its behalf by the city clerk, without such agreement having been approved by the council. The city council raised *Hoisain*, but the court distinguished that case based on the fact that, although the city

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[1188] 812H-813C. See also at 814E.

[1189] See at 814G.

[1190] At 816A.

[1191] *Levy* supra note 566 at 487 et seq.

[1192] Supra note 643.

[1193] Supra note 561 at 622-3.

[1194] *Hoisain* op cit note 1192 at 240.

[1195] *Potchefstroom* op cit note 1192 at 624A.

clerk was unauthorised, there was no illegality in the entering into of the cancellation agreement. The council's approval was therefore a mere formality. Surely a section 228 disposal by the board is closer to *Potchefstroom* than in *Hoisain*, especially given the explicit finding by the courts that section 228 merely limited a board's authority and not a company's capacity?

There is also authority for the application of estoppel (and the *Turquand* rule) to bodies regulated by statute.[1196] For instance, in *Roodepoort Settlement Committee v Retief*[1197] a settlement committee, which was regulated by public ordination, was held to be bound to an agreement entered into on its behalf by its members, despite two of them technically having vacated their posts and the remaining members not forming the sufficient quorum required for the sale of land. The court applied the *Turquand* rule, but held that the settlement committee would also be estopped from denying the sale agreement, despite their having been a contravention of statute, because this was a case of an irregular exercise of power granted and not an ultra vires act.[1198] In *Coetzee v Kakamas Labour Colony Committee*,[1199] a statutorily created body was held bound to an agreement based on the ostensible authority of its superintendent, notwithstanding the fact that the authority to conclude that agreement was, in terms of the applicable proclamations and regulations, with local committee and not the superintendent.

Furthermore, it should be noted that in even if contraventions of section 228 *were illegal or invalid*, this may still not categorically preclude reliance on estoppel if there were no considerations of public policy which militated against estoppel's recognition.[1200] However, this point need not be considered at length here, since courts have held that contravention of section 228 is not illegal.

[1196] See also *Fountaine v Carmarthen Railway Co* (1868 LR 5 Eq 316) where the *Turquand* rule was applied to a company the constitution of which was set out in the Company Clauses Consolidation Act (supra note 81). See Wunsh op cit note 775 at 547.

[1197] Supra note 562.

[1198] *Ibid* at 254.

[1199] 1927 CPD 417.

[1200] See Hoexter AJA (as he then was) in his concurring judgment in *Trust Bank van Afrika Bpk v Eksteen* 1964 (3) SA 402 (A) at 415H - 416A. See also *Levy* supra note 566 at 487F; *Western Credit Ltd v Mike Kopping's Truck Centre (Pty) Ltd* [1966] 2 All SA 392 (T) at 397 and *Credit Corporation of SA Ltd v Botha* 1968 (4) SA 837 (N) at 851H.

Taking the above into account, it is submitted, with respect, that the court's treatment of estoppel in *Stand 242* amounted to an oversimplification,[1201] and that the approach in *Levy*, namely to allow estoppel to operate in principle, was the correct one.

Some further comments made in *Stand 242* regarding estoppel also require scrutiny. In *Stand 242*, the court gave two (less important) reasons as to why estoppel should be inapplicable. First, 'it was not the shareholders themselves who had made the representation'.[1202] With respect, it has never been a requirement that a third party deals directly with a company's shareholders in the case where their approval is needed for a transaction. Third parties almost never have access to shareholders – they rely on the representations made by directors, who have been 'given control' of a company by shareholders. Secondly, the court noted that the document stating that section 228 had been complied with had been prepared by the conveyancer and not by the seller's representative. With respect, it is difficult to see why this should matter given that the entire board of the company signed the document. Surely by signing a document a person represents his/her assent to the contents thereto, regardless of the author thereof?

8.6.4 The Companies Act

Although the wording is different, the Companies Act has essentially retained the essence of the Disposal Sections in section 112 (read with section 115), which requires a special resolution of shareholders for the disposal of a company's Business.[1203] However, crucially, the Companies Act has also introduced section 20(7), which envisages that third parties will be able to hold companies liable despite *some form of non-compliance with legislation*. As noted above, it is reasonable to assume that the legislature envisaged that section 20(7) should at least cover some statutory requirements for shareholder approval.

The courts in *Farren* and *Stand 242* could not bring themselves to override the intention of the legislature, namely to protect shareholders, as evidenced in the wording of section 228. It is submitted, however, that, taking into account the introduction of section 20(7), that that intention is no longer as clearly against the interests of third parties. That, together with the

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[1201] More generally, regarding estoppel and statutory rules, see Sonnekus op cit note 404 at 284.

[1202] *Stand 242* supra note 778 para 23.

[1203] These sections have, however, added new aspects to the approval process for a company's Business. For instance, see the requirements for a notice to shareholders in section 112(3) and the special quorum requirements in section 115(4).

other reasons mentioned in the previous paragraph, suggests that there should now be a good case for arguing that *Stand 242* should be overturned in favour of a Pro Third Party Stance.

A possible counterargument may be based on the different wording of section 112. Whereas the previous Disposal Sections stated that *directors* were not empowered or did not have the power to dispose of a company's Business without shareholder approval, sections 112(2) and 115(1) now state that '*the company* may not dispose' of its Business without such approval.

This change in wording has been interpreted by commentators in leading text books to mean that section 112 relates or refers to the capacity of a company.[1204] The authors do not expand substantially on this claim, but presumably, it follows that if section 112 limits the capacity of the company, then disposals in contravention of that section (read with section 115) are ultra vires the company.[1205] If this is the interpretation put forward, then the writer respectfully disagrees, for the following reasons:

1. First, the plain wording of the sections is inconclusive. The sections do not say 'the company shall not have the power to dispose…', but rather are couched as simple prohibitions, 'the company may not …';
2. Secondly, the idea that the board may be referred to as 'the company' is now uncontroversial, given the contents of section 66(1);[1206]
3. Thirdly, such an interpretation would contradict other provisions of the Companies Act. The Companies Act itself provides that companies now have the legal capacity of natural persons (to the extent possible), which capacity may only be limited by a company's MOI.[1207] Furthermore, section 218,[1208] expressly provides that, unless the Act specifically determines that an agreement is void, such an agreement is not rendered void by the Companies Act unless a court has made a declaration to that effect regarding that agreement. The Companies Act does not specifically declare contraventions of section 112 to be void, which means that such actions may not be

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[1204] Delport et al op cit note 283 at 406, Yeats et al op cit note 299 at 5-6.

[1205] Delport et al op cit note 283 at 406.

[1206] Ibid at 250(3) state that: 'The board is now "the company" and if the Act provides that the company must or may take certain actions, the default organ is the board and not the shareholders, subject, as provided for in sub-s (1), to the provisions of the Act or the Memorandum of Incorporation'.

[1207] Section 19(1)(b) of the Companies Act. When a company's capacity is limited by its MOI, however, this is a 'contractual issue between the shareholders and directors of the company, the outcome of which is not to adversely affect bona fide third party rights' – see Philip Knight 'Keep it simple and set it free: the new ethos of corporate formation' in Mongalo (ed) op cit note 962 at 26.

[1208] Section 218 provides as follows: 'Subject to any provision in this Act specifically declaring void an agreement, resolution or provision of an agreement, Memorandum of Incorporation, or rules of a company, nothing in this Act renders void any other agreement, resolution or provision of an agreement, Memorandum of Incorporation or rules of a company that is prohibited, voidable or that may be declared unlawful in terms of this Act, unless a court has made a declaration to that effect regarding that agreement, resolution or provision.'

regarded as such under section 218. This contradicts the notion that contraventions of section 112 are ultra vires, since ultra vires acts are void ab initio.

For these, reasons, it is submitted that section 112 should be interpreted as a restriction on the powers of the board and not the company, like under the previous legislation.

8.6.5 Limits to applying section 20(7) to Statutory F/P Requirements

Opponents of a wide interpretation of Statutory F/P Requirements on section 20(7) will no doubt raise the spectre of the section being applied too widely. It is submitted, however, that there are sufficient limits to the application of this section.

First, it is worth recalling that a Pro Shareholder Stance does not guarantee company liability – it merely recognises that, in principle, there are circumstances in which an innocent third party should be entitled to hold a company bound even if shareholder approval had not been obtained. The Pro Shareholder Stance is the extreme position – it allows no relief to a third party no matter the consequences.

Secondly, an Ancillary Rule Approach to section 20(7) provides sufficient protection against abuse, since a third party will only be entitled to hold a company bound if that third party was dealing with persons having ostensible authority to deal on behalf of the company.

Thirdly, the provisions of section 20(7) itself provide protection against abuse - mala fide third parties and third parties who should reasonably have known that shareholder approval had not been obtained are excluded. Furthermore, the fact that insiders are excluded makes abuse less likely.

Fourthly, just because section 20(7) aids a third party where section 112 has been contravened does not mean that all statutory requirements for shareholder approvals are covered by section 20(7). As noted above, each legislative provision has to be interpreted on its own to establish what the effects of non-compliance may be. It may well be found that in certain cases innocent third parties are without relief. An example of such an instance may arguably be found in sections 44 or 45. In those sections the legislature, in a move which neatly ties up with the approach taken to the previous section 226,[1209] has expressly declared that a decision of the board to provide such assistance is void.[1210] A contract for providing

[1209] Supra para 8.6.3.2.

[1210] Sections 44 and 45 of the Companies Act.

financial assistance to a non-insider in contravention these sections may therefore be arguably void and unenforceable by a third party.[1211]

8.7 EXCURSUS II: SECTION 20(7), DE FACTO DIRECTORS AND NO DEFECTS CLAUSES

8.7.1 Introduction

Another break from the past comes, not by virtue of the introduction of a new section, but by the omission of an old one. No Defects Clauses have been a staple of corporate legislation (and the articles attached thereto) from the introduction of the general incorporation statutes. The Companies Act, however, does not contain a No Defects Clause in the Act or in the standard MOI attached thereto. The question therefore arises regarding what the effect of such an omission is. This paragraph will argue that section 20(7) should be interpreted to cover at least some of the ground which was previously covered by No Defects Clauses.

8.7.2 No Defects Clauses prior to the Companies Act

The following provision was contained in the corporate laws of both England[1212] and South Africa[1213] for most of the twentieth century:

> 'The acts of a director or manager[1214] shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification.'

Substantially similar clauses were also included in the corporate legislation of the 19th century.[1215]

Curiously, similar (but not identical) No Defects Clauses[1216] were also included in the standard articles of corporate legislation in the UK and South Africa.[1217] Naturally, the

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[1211] Jooste, however, expressed the view that, provided that the requirements of section 20(7) are met, that section would protect a third party receiving financial assistance from a company in contravention of section 45. See Jooste op cit note 9 at 184-5. It is also important to distinguish between the agreement for the provision of financial assistance and the agreement to provide a company with funding to enable it to provide the financial assistance – see *Freshvest Investments (Pty) Limited v Marabeng (Pty) Limited* [2015] JOL 33662 (FB) para 27.

[1212] See section 74 of the UK 1908 Act, section 143 of the UK 1929 Act and section 180 of the UK 1948 Act.

[1213] See section 72 of the Transvaal 1909 Act, section 143 of the SA 1926 Act and section 214 of the SA 1973 Act.

[1214] The reference to 'manager' was deleted from the SA 1973 Act (see *Advance Seed Co (Edms) Bpk v Marrok Plase (Edms) Bpk* 1974 (4) SA 127 (NC) at 132G). The reference was, however, kept in the English statutes – see section 285 of the UK 1985 Companies Act.

[1215] See section 30 of the UK 1844 Act, section 67 of the UK 1862 Act.

[1216] The following No Defects Clause was contained in most sets of model articles: 'All acts done by any meeting of the directors or of a committee of directors or by any person acting as a director shall,

legislative provision carried more weight, but courts did on occasion invoke No Defects Clauses contained in companies' articles.[1218] The wording of the clause in the articles was not identical to that contained in legislation, but courts have generally tended to minimise the differences between the two.[1219] Doubts about the efficacy of a No Defects Clause in a company's articles may also be raised. From the company's perspective, it is unclear how such a clause could be used against a third party who is not bound to the company's articles.[1220] From a third party's perspective, too, such a clause would be of limited use, since the third party would usually be ignorant of a company's articles and the doctrine of constructive notice only operated in the company's favour. A far easier route, irrespective of the party invoking the clause, was relying on the No Defects Clause in generally applicable legislation and that is where the focus of this paragraph mostly lies.

8.7.3 No Defects Clauses and 'de facto' directors

A shorthand description of the operation of a No Defects Clause is that 'as between the company and persons having no notice to the contrary, directors etc de facto are as good as directors etc de jure'.[1221] The term 'de facto director' should, however, be used with circumspection in relation to No Defects Clauses because (i) the term de facto director is not entirely settled and (ii) such clauses have in the past been held to apply only to *certain types* of de facto directors.

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notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such director or person acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director'. See clause 60 of Table B to the schedule to the UK 1856 Act, clause 71 of Table A to the first schedule to the UK 1862 Act, clause 94 of Table A to the first schedule to the UK 1908 Act, clause 88 of Table A to the first schedule to the UK 1929 Act and the clause 105 of Table A to the first schedule to UK 1948 Act. See also clause 70 in Table A to Schedule 3 to the Cape 1892 Act, clause 112 in Table A to Schedule 4 to the Transvaal 1909 Act, clause 112 in Table A to Schedule 1 to the SA 1926 Act and clause 83 in Table A to Schedule 1 to the SA 1973 Act.

[1217] One could speculate that the reason for this duplication was, like the Board's General Authority Clause, more due to the fact that the standard articles were based on previous deeds of settlement, which had to be very comprehensive since there were no incorporation statutes at the time.

[1218] One would have thought that the No Defects Clause would only be relevant to internal matters, since, as we have seen, third parties would usually be unaware of the articles of a company and the doctrine of constructive notice is a negative doctrine.

[1219] *Gorfil v Marendaz* 1965 (1) SA 686 (T) at 691A, *Advance Seed Co (Edms) Bpk v Marrok Plase (Edms) Bpk* 1974 (4) SA 127 (NC) at 131F-G and *Re Canadian Land Reclaiming and Colonizing Company* (1880) 14 Ch D 660 at 663.

[1220] Blackman et al op cit note 2 at 8-262.

[1221] *Channel Collieries Trust Ltd v Dover, St Margaret's and Martin Mill Light Railway Co* [1914] 2 Ch 506 at 515. See also *The Briton Medical General and Life Association v Jones* [1889] QB LT 23 Nov 1889 384 at 385.

The concept of a director has vexed company law jurists for a long time and an in-depth consideration as to what constitutes a director and, more particularly, to what extent the term includes de facto directors falls outside the scope of this thesis.[1222] Traditionally, the concept of a de facto director included not only persons acting as directors who had been defectively appointed as directors, but also persons whose (initially valid) appointment had come to an end and continued to act as director.[1223] Even persons who exercise control over a company in respect of whom no attempt of appointment was made, have been said to qualify as de facto directors.[1224]

While the substance of the designation 'de facto director' is simple enough, it is not always clear to what extent a person who may be said to qualify as a de facto director will be subject to a particular common law duty or section of corporate legislation. Some duties or sections may only apply to de jure directors, while others may include de facto directors and, even then, as we shall see, there may be uncertainty as to exactly which de facto directors are covered.[1225]

When interpreting No Defects Clauses courts have traditionally limited the application of those sections to *certain types* of de facto director – namely directors who lacked the requisite qualification and directors *in respect of which a purported appointment was made* but which was defective. This is hardly surprising, as the section explicitly refers to these two instances. In *Morris,* Lord Simonds said the following regarding the latter category: [1226]

> 'There is, as it appears to me, a vital distinction between *(a.)* an appointment in which there is a defect or, in other words, a defective appointment, and *(b.)* no appointment at all. In the first case it is implied that some act is done which purports to be an appointment but is by reason of some defect inadequate for the purpose; in the second case there is not a defect, there is no act at all. The section does not say that the acts of a person acting as director shall be valid notwithstanding that it is afterwards discovered that he was not appointed a director. Even if it did, it might well be

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[1222] See, generally, JJ Du Plessis 'Some Subtle Distinctions in the Term Director' (1995) *TSAR* 153.

[1223] *Commissioners for HM Revenue & Customs v Holland: Re Paycheck Services 3 Ltd* [2011] BCC 1 at 23 (per Lord Collins): 'For almost 150 years de facto directors in English law were persons who had been appointed as directors, but whose appointment was defective, or had come to an end, but who acted or continued to act as directors.' There is also authority for the term including persons who acted as director without holding the requisite qualification shares or after having been disqualified for office by reason of insolvency – see Blackman et al op cit note 2 at 8-5.

[1224] See *In re Lo-Line Electric Motors Ltd* [1988] Ch 477 at 490, *Re Hydrodan (Corby) Ltd* [1994] BCC 161 at 163, R*e Kaytech International plc* [1999] BCC 390 at 400 and *Holland* supra note 1223 para 54. Kathy Idesohn 'The meaning of 'Prescribed Officers' under the Companies Act 71 of 2008 (2012) 129 SALJ 718 at 720-1.

[1225] See Du Plessis op cit note 1222 at 155-6.

[1226] *Morris* supra note 568 at 471.

contended that at least a purported appointment was postulated. But it does not do so, and it would, I think, be doing violence to plain language to construe the section as covering a case in which there has been no genuine attempt to appoint at all. These observations apply equally where the term of office of a director has expired, but he nevertheless continues to act as a director, and where the office has been from the outset usurped without the colour of authority.'[1227]

Accordingly, for a No Defects Clause to apply there therefore had to be a purported appointment. In the court's view, the clauses were designed to avoid questions being raised as to the validity of transactions where there had been a slip in the appointment of a director, not to be utilised for the purpose of ignoring or overriding the substantive provisions relating to such appointment.[1228] On the interpretation given in *Morris*, which was (at least initially) accepted by South African courts,[1229] a No Defects Clause would therefore not cover a situation where (i) a person acts as a director (with the acquiescence of the board and/or shareholders) but there was no attempt at his/her formal appointment and (ii) a previous director continues to act after ceasing to hold office.[1230]

In an *obiter dictum* in *Marrok Plase (Pty) Ltd v Advance Seed Co (Pty) Ltd,*[1231] Trollip JA wondered whether the approach in *Morris* was perhaps too restrictive (my emphasis):[1232]

'It seems to confine its operation to cases in which a formal appointment has been made which turns out to be defective. But, as the section was enacted primarily for the protection of innocent persons who in good faith deal with the directors believing they have been properly appointed, I have some difficulty in understanding why "appointment" in the section cannot be construed to include a de facto appointment too. If it is so construed, it would include the case where a person, without any formal appointment, acts as a director, or after the expiry of his term of office, continues to act as a director, with the acquiescence of the other directors or the shareholders. And if the lack of any formal appointment in such cases is due to bona fide inadvertence, is that not, par excellence, one of the very kind of defects comprehended by the section? I would have thought so.'

The learned judge, however, fell short of ruling against the House of Lords' view, instead holding that in casu there had been a formal but defective appointment. Some South African commentators have supported a wider interpretation to cover a person acting as director without any formal appointment (or after the expiry of his/her term of office) with the

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[1227] See also *Dawson v African Consolidated Land and Trading Company* [1898] 1 Ch 6 at 14.

[1228] Ibid at 472.

[1229] *Gorfil* supra note 1219 at 691B.

[1230] *Marrok Plase (Pty) Ltd v Advance Seed Co (Pty) Ltd* 1975 (3) SA 403 (A) at 412C-E. See also *Advance Seed Co (Edms) Bpk v Marrok Plase (Edms) Bpk* 1974 (4) SA 127 (NC) at 132A. See also *James North (Zimbabwe) (Pvt) Ltd v Mattinson* [1990] 3 All SA 727 (ZH) at 736. See also Blackman et al op cit note 2 at 8-262.

[1231] Supra note 1230.

[1232] Supra note 1230 at 412C-E.

acquiescence of the other directors (or the shareholders), it being thought that he/she had been formally appointed (or was still acting within his/her term of office).[1233]

In England, the restrictions placed on the ambit of No Defects Clauses by courts' decisions was recognised by the legislature, leading to the expansion of the No Defects Clause in that jurisdiction. Section 161 of that Act now determines that the acts of a person acting as a director are valid notwithstanding that it is afterwards discovered: (i) that there was a defect in his/her appointment; (ii) that he was disqualified from holding office; (iii) that he had ceased to hold office and (iv) that he was not entitled to vote on the matter in question. Point (iii) no places it beyond doubt that ex-directors are also covered, regardless of attempts at formal re-appointment. Section 161 does not, however, cover the actions of a de facto director who has not been appointed at all.[1234]

What the above shows is that the term de facto director, while providing a useful shorthand, should be used with circumspection in respect of No Defects Clauses, as those clauses were, at least initially, interpreted only to cover the acts done by certain types of de facto directors.

8.7.4 The application of No Defects Clauses

A No Defects Clause in legislation could be relied on by outsiders contracting with a company to hold that company bound to acts of its purported directors, notwithstanding their defective appointment or qualification. Indeed, it has held that the main purpose of such clauses was to protect innocent persons who deal with directors in good faith believing that they have been properly appointed (or that they are properly qualified).[1235]

Given the unqualified nature of the wording used in No Defects Clauses, however, courts have held that protection offered by those clauses is not limited to third parties – insiders and even companies[1236] may rely on these sections as well. Furthermore, the defect in qualification has been widely interpreted to not just refer to a director not holding

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[1233] Blackman et al op cit note 2 at 8-263-4.

[1234] Chris Noonan and Susan Watson 'Examining company directors through the lens of de facto directorship' (2008) 7 *Journal of Business Law* 587 at 614.

[1235] *Marrok Plase* (Appellate Division) supra note 1231 at 412C; *Kudumane Investment Holding Limited v Northern Cape Manganese* 2012 JDR 0973 (GSJ) para 38 and *Harben v Phillips* (1883) 23 Ch D 14 at 28.

[1236] *Cyberscene Ltd v iKiosk internet and information (Pty) Ltd* 2000 (3) SA 806 (C) para 15; *The Briton Medical General and Life Association* supra note 1221 at 385.

qualification shares, but also directors disqualified to be directors on other grounds (such as convictions for theft or insolvency etc.).[1237]

Naturally, limits had to be developed to the application of No Defects Clause, lest they be used to validate actions of strangers or 'pretended' directors. We have already noted the (controversial) requirement in *Morris* that there had to be an appointment. Naturally, a No Defects clause may not be relied on by a person who (i) had knowledge of the relevant defect and (ii) where a third party had been placed on inquiry and failed to make inquiries.[1238] Other notable limits on the application of No Defects Clauses are that the defect must be discovered afterwards and not before or during[1239] the purported act.[1240] The section also does not operate to make a defectively appointed person a director – it cures the action performed by him/her and not his/her appointment.[1241] So if a defect or disqualification is discovered, it must first be cured before the director may continue to act. It is, however, the actual defect that must be discovered prior to the relevant act – mere knowledge of the facts which give rise to the defect does not automatically exclude the operation of the section.[1242]

8.7.5 Overlap with the 'general law on the subject'

It is at once obvious that No Defects clauses overlap to some degree with the *Turquand* rule and/or estoppel. Indeed, this is confirmed by the House of Lords in *Mahony*,[1243] where it was held that a company was bound by the acts of de facto directors who had never been appointed, both based on 'general law on the subject' and the applicable No Defects Clause (in the company's articles).[1244] While it has been controversial whether the general law was

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[1237] See *Cyberscene* supra note 1236 para 15.

[1238] *Kudumane* supra note 1235 at para 39 and Blackman op cit note 2 at 8-264.

[1239] *Dowjee & Co Ltd v Waja* 1929 TPD 66 at 79 and *Harben* supra note 1235 at 28.

[1240] *Herald Investments Share Block (Pty) Ltd v Meer; Meer v Body Corporate of Belmont Arcade and Another* 2010 (6) SA 599 (KZD) para 55; *Trek Tyres Ltd v Beukes* 1957 (3) SA 306 (W) at 310F-G. In *Cyberscene* supra note 1236 (para 15) it was held that a statutory No Defects Clause could remedy the institution of legal proceedings by a director who had been disqualified (by virtue of previous convictions for theft). It appears as though the fact of the disqualification only became known upon the respondents raising it in their answering affidavit.

[1241] *Africa's Amalgamated Theatres, Ltd v Naylor* 1912 WLD 107 at 116 and *Kanssen v Rialto (West End) Ltd* [1944] Ch 346 at 361.

[1242] *British Asbestos Co Ltd v Boyd* [1903] 2 Ch 439 at 444; *Channel Collieries* supra note 1221 at 511, *Dey v Goldfields Building Finance & Trust Corporation Ltd* 1927 WLD 180 at 195.

[1243] Supra note 505.

[1244] *Mahony* supra note 505 at 887, 897, 883 and 903.

estoppel or the *Turquand* rule,[1245] *Mahony* clearly affirmed that a No Defects Clause operated a basis for company liability independent of, and in addition to, the common law.[1246]

8.7.6 The Companies Act

Does the omission of a No Defects Clause significantly impact the position of a third party dealing with a company under the Companies Act? Some commentators have criticised the omission and called for a re-introduction of such a clause in our companies' legislation,[1247] while others have suggested that section 20(7) may fill at least some of the void left by such omission.[1248]

It is submitted that section 20(7) should, in principle, be interpreted as capable of providing relief to a third party dealing with de facto directors. This would be in line with the purpose of the section, namely to protect third parties dealing with companies. A third party should be entitled to rely on what has been represented to it – if shareholders and other directors abide by a person acting as a director, then they should be bound by the consequences of that director's actions, regardless of any defect in his/her appointment or even if there has been no attempt at formal appointment. It should further be remembered that the reason why No Defects Clauses were restrictively interpreted to include only some de facto directors was the reference to an 'appointment' contained in those clauses – no similar constraints apply to section 20(7).

Section 20(7) can fill the void left by the omission of a No Defects Clause in two ways. First, a third party could potentially argue that the appointment of director itself is an F/P Requirement with which compliance may be assumed. Advocates for a narrow interpretation will, however, no doubt argue that the F/P Requirements covered by section 20(7) relate to the approval of a transaction with the third party and not the appointment of the company's directors. Indeed, a defective appointment of a director may have occurred years before the third party commenced dealing with the company.

Secondly, and more convincingly, the phrase 'dealing with a company' in section 20(7) could be interpreted as encapsulating not only the actions of de jure directors, but also all

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[1245] Supra note 647.

[1246] Blackman et al op cit note 2 at 8-262.

[1247] Rehana Cassim 'A Critical Analysis of the Grounds of removal of a director by the board of directors under the Companies Act' (2019) 136 *SALJ* 513 at 525-6.

[1248] See Delport op cit note 3 at 137.

types of de facto directors. In other words, a third party should be deemed to be 'dealing with a company' not only when dealing with de jure directors, but also de facto directors, including directors in respect of which no appointment has been attempted.

The effect of such a wide interpretation of F/P Requirements would be that, although section 20(7) would, unlike No Defects Clause, be limited to third parties, contracts entered into by all types of de facto directors would be covered by the section. In other words, unlike under a No Defects Clause, section 20(7) would not only cover the acts of de facto directors who have been appointed in a defective manner, but also –

1. de facto directors who continued to act despite their appointment having lapsed, thereby covering some of the additional instances introduced by section 161 of the UK Companies Act; and
2. de facto directors who are allowed to act as directors of the company with acquiescence of the other directors and/or the shareholders, thereby giving effect to Trollip JA's reservations about the unduly restrictive approach taken in *Morris*.

This development should, it is submitted, be welcomed, as it would further entrench the Third Party Perspective of corporate contracting, by allowing third parties to hold companies bound to actions performed by those who are de facto in control of those companies.

It is submitted that this interpretation will not place companies at the mercy of pretended directors or ex directors, as (i) the concept of a de facto director itself does not include merely pretended directors (ie to qualify as a de facto director a person has to, at the very least, be acting on an equal footing with other directors),[1249] and (ii) the requirement to prove a representative's ostensible authority under the Ancillary Rule Approach to section 20(7) and the bona fide and knowledge requirements of that section should act as effective safety valves to avoid abuse of this section. Lastly, it should be pointed out that this interpretation would do no more than bring the interpretation of section 20(7) into line with the common law, thereby giving effect to the designation of that section as a 'statutory *Turquand* rule'.

8.8 CONCLUSION IN NEXT CHAPTER

This Chapter does not contain its own conclusion, but is summarised in Chapter 9.

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[1249] Idesohn op cit note 1224 at 721.

CHAPTER 9: CONCLUSION

This Chapter provides a high-level summary of the findings and recommendations made in Chapter 8, regarding how corporate contracting ought to be approached under the Companies Act:

1. Although boards' managerial powers are now original by virtue of section 66(1), this change will not have a major impact in relation to third parties contracting with companies. This is because: [1250]

    a. Section 66(1) has retained the principle of collegiate management, which means a single director still does not have the ability to contract on behalf of a company unless (actually or ostensibly) authorised to do so. Like before, a 'second step' is needed to delegate authority from the board to the single director, which step usually takes place out of a third party's sight (even if that third party had read the company's MOI).

    b. Shareholders' ability to control the constitutional flow of actual authority to the board remains unaffected, which means that typical *Turquand* situations are therefore as likely to arise now as before.

    c. Section 66(1) has not increased the scope of the usual authority of the collective board - third parties were already under common law entitled to assume that the board had general powers to manage the company's business and, in particular, enter into contracts for that purpose (or to delegate the authority to others to do so).

2. The unqualified abolishment of constructive notice should be welcomed as this represents an irrevocable shift to the Third Party Perspective of corporate contracting.[1251] Companies simply have no basis for raising constitutional provisions against third parties anymore, whether those clauses are Exclusion Clauses, Reserved Matters Clauses or other procedural clauses (unless those third parties had actual knowledge of such provisions). In the event that a company raises any of these clauses, a third party should be entitled to rely on the prohibition on principals raising

[1250] Supra para 8.3.

private instructions between them and their agent against third parties under agency law. This change is significant from a company law perspective:[1252]

a. Disallowing companies from raising Exclusion Clauses is novel, as these clauses were still binding on third parties under common law.

b. The abolishment of constructive notice in relation to Reserved Matters Clauses and other procedural clauses means that the *Turquand* rule is no longer needed when these clauses are raised. The scope of the *Turquand* rule has therefore been radically diminished under the Companies Act.

3. Section 20(7) is strictly unnecessary insofar as it applies to mere contraventions of constitutional limitations on authority or other procedural clauses, given the abolishment of constructive notice. However, the convenience of relying on a statutory provision rather than the ill-defined common law prohibition on raising secret limitations may mean that reliance on section 20(7) will become the norm. In this way, section 20(7) may be regarded as increasing third party certainty.[1253]

4. That certainty will, however, only manifest if section 20(7) is properly contextualised. In this regard, it is submitted that, as with the *Turquand* rule, section 20(7) should be interpreted as ancillary to agency principles, which historically underlie corporate contracting.[1254] In other words, only once the (ostensible) authority of a specific representative to enter into a contract has been established, should section 20(7) be available to a third party in order to rebuff claims by the company that proper internal approvals were not obtained or procedures were not followed. This approach is not divorced from the text of section 20(7), but essentially amounts to interpreting the requirement that a person must be 'dealing with a company', to require that the third party must be contracting with a representative who has (ostensible) authority to do so in the circumstances. This approach, together with the fact that section 20(7) is only available to outsiders, will prevent the abuse of the section by in effect requiring the third party to prove that he/she was acting reasonably in assuming that he/she was dealing with the company through a particular representative.

[1251] Supra para 8.4.

[1252] Supra para 8.4.2.

[1253] Supra para 8.5.2.1.

[1254] Ibid.

5. Once the abovementioned approach is accepted, it becomes possible to argue for a wider interpretation of section 20(7)'s constituent elements, in particular, the F/P Requirements which are covered by the section. These requirements should, it is submitted, in general be interpreted to include any internal requirements needed to regularise the decision of a person acting on behalf of a company to enter into an intra vires transaction on behalf of that company. This approach will have the following effects: [1255]

    a. Section 20(7) would, like the *Turquand* rule, be wide enough to cover situations relating to non-compliance with formalities relating to quorums, the delegation of authority by the board to a single representative, prior requirements for shareholder approvals and formalities regarding the appointment of directors. On a narrow interpretation of F/P Requirements, it is far from clear whether these non-compliances would be covered under section 20(7).

    b. Interpreting the text of section 20(7) consistently, non-compliances with such internal requirements would, in principle, be covered even if those requirements are contained in the Companies Act. To be clear, however, it is not argued that all requirements which may be classified as Statutory F/P Requirements will be covered by section 20(7). Instead, these requirements ought to be covered *in principle*. In each case, it will still be necessary to determine whether the legislature did not intend to override the operation of section 20(7) by, for instance, visiting non-compliance with a certain requirement with voidness.

6. One instance of a Statutory F/P Requirement in respect of which section 20(7) should apply (provided, of course the requirements for the section's application are met) is where a company disposes of its Business without having obtained shareholder approval as required under section 112 of the Companies Act. If this approach is accepted, this would overturn the SCA's decision in *Stand 242* and markedly improve the third party's position.[1256]

[1255] Supra para 8.5.5.

[1256] Supra para 8.6.

7. Finally, it is submitted that section 20(7) may be used to cover the lacuna left by the omission of a No Defects Clause from the Act.[1257] Moreover, it is submitted that section 20(7) may have improved the third party's position by allowing him/her to hold a company to a contract entered into by all types of (ostensibly authorised) de facto directors and not only certain types, as was the case before. This, too, would represent a welcome legal development from the third party's perspective.

[1257] Supra para 8.7.

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