'A WARNING TO EVERYONE WHO DEALS WITH A TRUST'

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The recent case of *Nieuwoudt & another NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) has raised questions regarding the applicability of the doctrine of constructive notice and the so-called *Turquand* rule to trusts.

The doctrine of constructive notice and the *Turquand* rule form part of the common law governing companies.

In terms of the law of agency a third party dealing with a person purporting to act as an agent cannot hold the principal liable on the ground of ostensible authority (i e estoppel) if he, the third party, knew (had 'notice' of) the 'agent's' lack of authority. The courts brought the fact of the public character of the company's constitution within the framework of this rule of agency by reasoning that a person transacting with a company is deemed to have notice of any restriction upon a director or officer's authority which is contained in the company's articles. This is the doctrine of constructive notice. The public character of the articles of association is taken into account on the theory that they constitute a type of notice to third parties limiting any *ostensible authority* that a director might have. Thus, in *Ernest v Nicholls* (1857) 6 HL Cas 401 at 409, Lord Wensleydale held:

> 'All persons, therefore, must take notice of the [registered] documents . . . If they do not choose to acquaint themselves with the powers of the directors, it is their own fault, and if they give credit to any unauthorized persons they must be contented to look to them only, and not to the company at large. The stipulations of the [registered documents], which restrict and regulate their authority, are obligatory on those who deal with the company; and the directors can make no contract so as to bind

the whole body of shareholders, for whose protection the rules are made, unless they are strictly complied with.'

The doctrine of constructive notice thus deems a person dealing with a company to have knowledge of all internal formalities required by its memorandum and articles. But because such person would not know whether there has in fact been compliance with such internal formalities, the so-called *Turquand* rule operates in favour of that person. The rule provides that a person dealing with a company is entitled (subject to certain limitations) to assume that the internal formalities as set out in the articles have been complied with. There is no duty on such a person to enquire whether the formalities have been complied with. Thus, the *Turquand* rule 'was enunciated by the courts to mitigate the effects of the constructive notice doctrine' (P L Davies *Gower's Principles of Modern Company Law* 6ed (1997) 221).

The *Turquand* rule arose out of *Royal British Bank v Turquand* (1856) 119 ER 886 (Ex Ch) (6 E & B 327; [1843–1860] All ER Rep 435) and is also referred to as the 'indoor management rule'. In *Nieuwoudt's* case the court approved as a modern formulation of the rule what was taken from Halsbury's Laws of England 2ed vol 5 para 698, and approved by Lord Simonds in *Morris v Kanssen* [1946] AC 459 at 474, which is as follows: '[P]ersons 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.'

Important for purposes of this note is that the court in *Nieuwoudt's* case (per Harms JA) questioned (in passing) the judgment in *MAN Truck & Bus (SA) Ltd v Victor* 2001 (2) SA 562 (NC) where it was held that the *Turquand* rule applies to trusts.

In the *Man Truck* case a trustee had entered into a suretyship agreement without the knowledge and consent of his fellow trustee. The court ruled that the lack of consent was no defence to a claim based on the suretyship agreement because the act of obtaining the co-trustee's consent was an act of internal management and the claimant, on the basis of the *Turquand* rule, was entitled to assume that the act had been duly and properly performed.

In *Nieuwoudt's* case one of the two trustees (the appellants) of a trust had signed a contract on behalf of the trust. The other party to the contract, a close corporation, ceded its rights to the contract to the respondent. Clause 23.4 of the trust deed provided: 'Die trustees kan een of meer van hulle magtig om alle dokumente vir amptelike doeleindes wat vir die administrasie van die trust en ter uitvoering van enige transaksie wat met die trust se sake verband hou, nodig is, namens die trustees te teken' ('The trustees may empower one or more of their number to sign, on behalf of the trustees, all official documents necessary to the administration of the trust and the execution of any transaction in connection with the trust's affairs').

The appellants argued that in terms of the trust deed, where there were only two trustees (as was the case) all decisions of trustees had to be

unanimous, and as the second trustee's approval of the contract had not been obtained, the contract was invalid.

In response, the respondent argued that the representative of the close corporation (one Fourie) had at no stage been informed by the appellants that there were two trustees, or that two trustees had to sign the contract. The appellants also did not provide Fourie with a copy of the trust deed. The respondent alleged further that the fact that only one trustee signed the contract did not provide a defence for the appellants. According to the respondent this was so because clause 23.4 of the trust deed provided that the trustees could empower one of their number to sign documents on their behalf, to implement any transaction in connection with the trust's affairs. It was further argued that the respondent had not been in the position, nor was it expected, to enquire into the internal prerequisites for authority, for example, for a decision by the trustees. In this regard, the respondent relied on the *Turquand* rule.

Farlam JA, who presented the court's judgment in which the other four judges concurred, rejected the respondent's argument. He held (at 492B–E):

> 'In my view, however, whether or not the *Turquand* rule should be applied to trusts, particularly business trusts — a matter on which I express no opinion — it cannot be applied in the present case. I say this because I am satisfied that clause 23.4 of the trust deed does not afford a foundation for the contention advanced in this regard by the respondent . . .
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> The clause clearly, on its plain language, applies only to the signing of documents for official purposes. It thus does not apply to the contract signed by the first appellant which was not for official purposes. It follows that no question of internal formalities, such as is dealt with by the *Turquand* rule, can be regarded as having arisen whereby an outsider who had concluded a contract with one of the trustees could assume that, in signing the contract, the trustee concerned had been empowered, as a matter of internal management, by his co-trustee to sign the contract.'

Farlam JA thus ruled that the respondents had misinterpreted clause 23.4 and went on to say (at 492G) that it was unnecessary to consider whether the *Turquand* rule would have applied if the respondent's interpretation had been correct.

Farlam JA's judgment throws little light on the applicability of the *Turquand* rule to trusts. Harms JA (who concurred in Farlam JA's judgment) in a separate judgment (the other four judges concurring) does, however, do so and also raises questions about the role of the doctrine of constructive notice in relation to trusts.

Regarding the doctrine of constructive notice, Harms JA voiced some concern. He referred (at 493–J) to the fact that there is no central register for trusts or trustees as one has in respect of companies and close corporations. He pointed to the fact that a member of the public wishing to do business with a trust would first have to determine in which Master's office the trust deed has been filed and having done so would then have to make application to the Master for permission to inspect the trust deed, something the Master in the exercise of his or her discretion may refuse. He referred (at 494B) to s 18 of the Trust Property Control Act 57 of 1988, which provides as follows:

'Subject to the provisions of s 5(2) of the Administration of Estates Act 66 of 1965 regarding the documents in connection with the estate of a deceased person, the Master shall upon written request and payment of the prescribed fee furnish a certified copy of any document under his control relating to trust property to a trustee, his surety or his representative or any other person who in the opinion of the Master has sufficient interest in such document.'

After stating that whether knowledge of the contents of a trust deed should be attributed in law to the public seems to be 'less than obvious' he said (at 494C):

'An underlying principle of company law and the *Turquand* rule, namely that a person who deals with a company is bound by the limitations contained in the memorandum and articles of association because these documents are accessible to the public, is consequently difficult to apply to trusts.'

Despite his uneasiness with the applicability of the doctrine of constructive notice to trusts, Harms JA held (at 494D–E) that: 'all this does not justify a departure from the principle that trustees have to act jointly [he referred in this regard, with approval, to *Coetzee v Peet Smith Trust* 2003 (5) SA 647 (T)]. And one should not believe, as Cameron *et al Honoré's South African Law of Trusts* 5 ed para 198 point out, that the ambit of authority conferred by a trust deed is a matter of "internal management" with which outsiders need not concern themselves.'

The effect of what Harms JA is saying appears to be that, although the doctrine of constructive notice is not apposite in relation to trusts, a third party dealing with a trust cannot plead ignorance of the ambit of the authority of trustees. Such a principle, accordingly, has a similar effect to the doctrine of constructive notice. If this is so, it raises the question whether a *Turquand*-type rule is not apt, bearing in mind that the *Turquand* rule is there 'to mitigate the effects of the constructive notice doctrine' (Davies op cit 221).

Regarding the applicability of the *Turquand* rule to trusts, Harms JA's judgment, although, with respect, a little unclear, appears to reject the possibility, at least in respect of the delegation of authority. He says (at 494G):

'What does need to be emphasised is that even if the *Turquand* rule is extended to business trusts, and even if a trust deed were to provide that the trustees could delegate their powers to one of their number, the *Turquand* rule would *without more* [emphasis added] be of no assistance to third parties. This is because a third party would not be entitled to assume, merely from the fact that one trustee can be authorised to exercise the powers of all of them, that such authorisation has in fact been given.'

Harms JA did not directly disagree with the decision in the *MAN Truck* case and his only reference (at 494F) to the case is to say: 'Whether, on the facts of the case, the issue in *MAN Truck* . . . concerned the ambit of authority . . . or a matter of internal management need not be considered.' He referred to the fact that Cameron et al suggest that it concerned the ambit of authority. (Cameron et al *Honoré's South African Law of Trusts* 5 ed (2002) para 198 are adamant in this regard and view the *MAN Truck* decision as 'contrary to both principle and authority'. They refer to *Edinburg v Mercantile Credit* 1980 (1) SA 744 (ZH) 746–7) and are of the opinion that the decision 'must be discountenanced'. They are of the view that the decision was reached 'with no allusion to trust law principles or authorities'

and 'disregarded beneficiaries' interests while overlooking the fact that outsiders dealing with a trust know that they are not dealing with a company' (Cameron et al op cit para 53n437).)

What is not clear from Harms JA's judgment is what was meant by the words 'the *Turquand* rule would *without more* [emphasis added] be of no assistance to third parties' (see quote above). He does refer in the next paragraph of the judgment to the possibility of the doctrine of estoppel protecting a person who contracts with a trust, so perhaps what was meant was that if the requirements of estoppel are met, then that, together with the *Turquand* rule, would provide assistance to third parties. But does that make sense? Does estoppel on its own not provide an independent remedy for third parties? How would estoppel *and* the *Turquand* rule together provide assistance?

There is of course the view (see the Australian case of *Northside Developments Pty Ltd v Registrar-General* (1990) 170 CLR 146; (1990) 2 ACSR 161 (HC of A)) that the *Turquand* rule is not an independent rule of law but an adjunct to the doctrine of estoppel, and so perhaps that is what Harms JA is referring to. According to this view, all that the *Turquand* rule does to protect a third party is to provide that a person who made no enquiries is not thereby prevented from proving an estoppel. For example, if a trust deed provides that a trustee, Mr A, can contract on behalf of the trust if he has the consent of the other trustee, Mr B, and Mr B has not given his consent to a contract entered into by Mr A with a third party but has made a representation to the third party that he has given his consent, then the third party will be protected by the doctrine of estoppel (assuming the other requirements thereof have been met), even though he has made no enquiry as to whether Mr A had actually obtained the consent of Mr B. (See also J McLennan 'The ultra vires doctrine and the *Turquand* rule in company law — A suggested solution (1979) 94 *SALJ* 329 at 348, who says:

'Lord Justice Diplock's analysis [in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 (CA); [1964] 1 All ER 630], and particularly his formulation of condition (4), put the entire problem into perspective. The truth emerges that the *Turquand* rule is not a positive rule of the law: it has a 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.')

There is strong argument, however, that the *Turquand* rule is not part of estoppel and exists as an independent sui generis rule (see M S Blackman, R D Jooste, & G K Everingham *Commentary on the Companies Act* Vol 1 (2002) 4–46 to 4–49). It is doubtful too, judging from what he says about the *Turquand* rule and estoppel, that Harms JA was referring to the contrary view when referring to 'the *Turquand* rule without more'. The 'something more' he is referring to appears to be something entirely independent of the *Turquand* rule.

Perhaps all that Harms JA was saying was that the third party will be protected only by estoppel (as an independent *sui generis* rule). This is supported by the fact that in the next paragraph he says (at 494I–J):

> 'However, as mentioned by Farlam JA, the fact that trustees have to act jointly does not mean that the ordinary principles of the law of agency do not apply. The trustees may expressly or impliedly authorise someone to act on their behalf and that person may be one of the trustees. There is no reason why a third party may not act on the ostensible authority of one of the trustees, but whether a particular trustee has the ostensible authority to act on behalf of the other trustees is a matter of fact and not one of law.'

It is to be noted that the applicability of the *Turquand* rule to trusts was rejected by the Full Bench of the Transvaal High Court in an obiter dictum in *Parker NO v Land and Agricultural Bank of SA* [2003] 1 All SA 258 (T) at 264c. Kirk-Cohen J, who delivered the judgment of the court, referring to the decision in the *MAN Truck* case, said:

> 'Counsel for the respondent, in my view quite correctly, argued this aspect *dubitante* in view of the criticism of that decision in *Honoré's South African Law of Trusts* 5 ed by Cameron, De Waal and Wunsh at 34 (paragraph 16), at 95 (paragraph 53) and 324–325 (paragraph 198). I agree with this criticism of the *Man Truck* case (*supra*) that the *Turquand* rule, applicable to companies as separate legal *personae*, cannot be applied to trusts.'

There is no reference to *Parker*'s case in the two judgments in *Nieuwoudt's* case, although it was referred to by counsel.

In *Parker*'s case, the trust deed required a minimum of three trustees to be in office at all times. At a time when there were only two trustees, the two trustees purported to conclude a contract on behalf of the trust. The respondent nevertheless sought to hold the trust to the contract on the basis that the peremptory requirement of three trustees constituted an internal arrangement, the knowledge whereof was privy only to the remaining trustees without any opportunity for the respondent to acquire knowledge thereof. Ergo, it was argued that the trust was bound by the documents executed.

The court found that the basis for invoking the *Turquand* rule, ie ignorance of the contents of the trust deed and the requirements thereof, did not apply in the case. This was because at the time the contract was concluded, the respondent was in possession of the trust deed. Kirk-Cohen J's comments regarding the non-applicability of the *Turquand* rule were accordingly obiter.

CONCLUSION

Harms JA's judgment in *Nieuwoudt's* case has brought into focus the dangers that lie in transacting with a trust. Third parties dealing with trusts have to be on their guard. As Harms JA said in *Nieuwoudt's* case (at 495A): 'This case should consequently serve as a warning to everyone who deals with a trust to be careful.' The warning is most relevant in relation to business trusts (and it was in connection with business trusts that Harms JA's concern lay — see 493E) but the law in this regard applies equally to all trusts.

Although the law is by no means settled, it appears, if Harms JA's judgment is anything to go by, that the Supreme Court of Appeal, when it is called upon to pronounce on the matter, is unlikely to entertain a third party's plea of ignorance of the ambit of a trustee's authority or countenance any *Turquand*-type protection of third parties.

It is hoped that the legal position will soon be clarified, taking into account the interests of all parties — the trustees, the trust beneficiaries and third parties. A willy-nilly adoption of company law doctrines is not the answer. A solution that takes into account the fact that the nature of a trust is sui generis, but that a business trust is in many respects similar to a company, needs to be developed. Sight too must not be lost of the non-public nature of inter vivos trusts and the need in the business world for the swift conclusion of dealings, unhampered by delays in seeking confirmation that internal requirements have been complied with.