

**A MINI-THESIS SUBMITTED IN PARTIAL FULFILMENT OF REQUIREMENTS
FOR THE DEGREE OF MASTER OF LAWS**



UNIVERSITY *of the*
WESTERN CAPE

Title: Promoter liability and protection of third party rights in terms of pre-incorporation contracts under South Africa's Companies Act 2008.

UNIVERSITY *of the*
WESTERN CAPE

Name: Shane Hull

Student number: 3681512

Supervisors: Mrs KL Loedolf

Prof BM Mupangavanhu

FACULTY OF LAW

DEPARTMENT OF MERCANTILE AND LABOUR LAW

DECLARATION

I, Shane Hull, do hereby declare that '*Promoter liability and protection of third-party rights in pre-incorporation contracts under South Africa's Companies Act 2008*' is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Shane Hull

06 October 2023



Signature by Supervisor(s)



Professor BM Mupangavanhu

Mrs. KL Loedolf

UNIVERSITY *of the*
WESTERN CAPE

ACKNOWLEDGMENTS

This mini-thesis is completed through the grace and mercy of our Heavenly Father to whom all praise and adoration are dedicated. The comforting words out of Philippians 4 verse 13 which states “I can do all things through the Lord Christ who gives me strength” has been my strength and shield every day I wrote on this topic.

Thank you to my supervisors Mrs KL Loedolf and Prof BM Mupangavanhu for the constant consultations and motivation to ensure that I get to complete my Masters Degree. To Mrs KL Loedolf, I want to thank you for your understanding nature in the process and willingness to always assist me in every aspect of the writing process. Your constructive criticism has made me a stronger human and gave me a better perspective of how one should approach any challenges faced with in life.

To Prof Mupangavanhu, your expertise in the field of corporate law is inspiring and I am grateful to have learnt so much from you. Your passion for corporate law and the constant smile on your face when we spoke during our consultations have motivated me to look at the challenges as a steppingstone to overcome.

To my parents, Marius and Sharifa Hull, I want to thank you out of the bottom of my heart for the support, understanding, and love on this journey. To my mother, Sharifa, thank you for always being a good listener when I needed one and for the smile you always put on my face. To my father, Marius, your resilience, and your example of a man is inspiring and an attribute I will forever cherish. To my siblings, thank you for always reminding me to take a break and supporting your eldest brother.

To my girlfriend, Kesia Cupido, a special thanks to you for being my anchor at all times. You are the helping hand that kept me on path and cared for my well-being in the process. You believed in me at times I doubted myself and always motivate me to be the best version of myself. Thank you for the endless support and for always showing interest in my passion for writing, researching, and teaching. I really appreciate you.

Finally, I want to thank the Faculty of Law, especially the GLA committee for the opportunity to complete a Master’s mini-thesis and for the unwavering support.

KEYWORDS

Balancing of risks

Company law reform

Incorporation of companies

Normative framework of the Constitution

Personal liability

Pre-incorporation contracts

Promoter

Ratification

Stipulatio alteri

Third-party rights



UNIVERSITY *of the*
WESTERN CAPE

LIST OF ABBREVIATIONS

1926 Act	Companies Act 46 of 1926
1973 Act	Companies Act 61 of 1973
BOD	Board of Directors
Companies Act 2008	Companies Act 71 of 2008
CBCA	Canadian Business Corporations Act, 1985.
The Constitution	Constitution of the Republic of South Africa, 1996
The Commission	Van Wyk De Vries Commission



UNIVERSITY *of the*
WESTERN CAPE

ABSTRACT

Protecting the interests of a promoter, third-party, and a company in pre-incorporation contracts can be a complex issue as it involves legal considerations and potential conflicts of interest. The challenge arises because, before a company is incorporated, it does not have legal personality, which means it cannot ordinarily enter into contracts. At common law, a company cannot be a party to a contract prior to its incorporation because the company comes into existence only upon incorporation. As was underscored in the English case of *Kelner v Baxter*, if an agent purports to enter into a contract on behalf of a company prior to the formation of the company, the company once formed cannot ratify the contract. This is for the reason that ratification operates retrospectively to the time that the agent entered into the contract and thus to a time at which the company was not yet in existence, which common law cannot comprehend. The interests of the parties, therefore, must be safeguarded through various legislative measures. Although this problem has its origin in common law, various jurisdictions have made efforts to address it through statutory reforms. These reforms specify the conditions in which pre-incorporation contracts can be enforced and the liabilities of the promoters and third-parties.

Section 21 of the Companies Act 71 of 2008 plays a significant role in providing statutory protection for parties in pre-incorporation contracts in South Africa. Furthermore, Section 21 addresses key issues such as the recognition of pre-incorporation contracts, promoter liability, third-party rights, and ratification of pre-incorporation contracts. Section 21 of the Companies Act 71 of 2008 provides a legal framework that offers clarity and protection for parties involved in pre-incorporation contracts in South Africa.

This mini-thesis examines whether section 21 of the Companies Act 71 of 2008 strikes a balance between promoter liability and third-party protection, and in promoting legal certainty in business transactions. Furthermore, this mini-thesis seeks to explore the approaches of Australia and Canada regarding the protection of promoters and third-parties. A consideration of best practices from Australia and Canada can provide valuable insights into the best approach for section 21 of the Companies Act 71 of 2008 in South African company law.

TABLE OF CONTENTS

DECLARATION.....	i
ACKNOWLEDGMENTS	ii
KEYWORDS.....	iii
LIST OF ABBREVIATIONS.....	iv
ABSTRACT	v
CHAPTER ONE: INTRODUCTION AND BACKGROUND	1
1.1 INTRODUCTION.....	1
1.2 BACKGROUND TO THE STUDY	3
1.3 RESEARCH PROBLEM AND PROBLEM STATEMENT.....	4
1.4 RESEARCH QUESTIONS.....	7
1.4.1 Main Research Question.....	7
1.4.2 Sub-inquiries	7
1.5 LITERATURE REVIEW AND JUSTIFICATION OF STUDY	8
1.6 METHODOLOGY	12
1.7 SECTION 21 OF THE COMPANIES ACT 71 OF 2008 AND THE NORMATIVE FRAMEWORK OF THE CONSTITUTION	13
1.8 CHAPTER OUTLINE.....	14
1.9 DELIMITATION OF THE STUDY	16
1.9.1 Delimitation Statement.....	16
1.9.2 <i>Stipulatio Alteri</i> Vis-à-vis the Section 21 Contract.....	16
CHAPTER TWO: THE HISTORY OF STATUTORY PRE-INCORPORATION CONTRACTS IN SOUTH AFRICAN LAW.....	19
2.1 INTRODUCTION.....	19
2.2 DEVELOPMENT OF PRE-INCORPORATION CONTRACTS: FROM 1926-2008	19
2.2.1 THE COMPANIES ACT 46 OF 1926	20
2.2.1.1 Requirements of s71 of the Companies Act 46 of 1926	21

2.2.2 SECTION 35 OF THE COMPANIES ACT 61 OF 1973	22
2.2.3 A SUMMARY OF LAW REFORM LEADING TO S21 OF THE COMPANIES ACT 71 OF 2008	26
2.3 CONCLUSION	28
CHAPTER THREE: INTERNATIONAL BEST PRACTICES ON MODERN PRE- INCORPORATION CONTRACTS	29
3.1 INTRODUCTION	29
3.2 AUSTRALIA	29
3.2.1 The common law prior to statutory reforms	29
3.2.2 CORPORATIONS ACT 50 OF 2001 AND AUSTRALIAN STATUTORY PRE- INCORPORATION CONTRACTS	30
3.2.2.1 Sections 131 and 132 of the Australian Corporations Act 2001	30
3.2.2.2 Third-party protection in statutory pre-incorporation contracts	32
3.2.2.3 The limitations on the promoter’s liability and third-party protection	33
3.3 CANADA	34
3.3.1 The common law prior to statutory reforms	34
3.3.2 THE CANADA BUSINESS CORPORATIONS ACT 1985 AND STATUTORY PRE-INCORPORATION CONTRACTS	35
3.3.2.1 Section 14 of the Canada Business Corporations Act 1985	35
3.3.2.2 Third-party protection in statutory pre-incorporation contracts	39
3.4 CONSIDERATIONS OF WHAT SOUTH AFRICA CAN LEARN FROM AUSTRALIA AND CANADA	41
3.4.1 Determining promoters’ rights and liabilities in pre-incorporation contracts	41
3.5 CONCLUSION	42
CHAPTER FOUR: A CRITICAL ANALYSIS OF SECTION 21 OF THE COMPANIES ACT 71 OF 2008	44
4.1 INTRODUCTION	44
4.2 THE ANALYTICAL FRAMEWORK OF SECTION 21 PROVISIONS	44

4.2.1 Examination of international best practices	44
4.2.2 A contextual interpretation of section 21 of the Companies Act 2008 ..	46
4.3 A CRITICAL ANALYSIS OF SECTION 21 OF THE COMPANIES ACT 2008 ...	46
4.3.1 Formalities	48
4.3.2 Disclosure of promoter’s statutory agency status.....	49
4.3.3 Ratification and retrospectivity.....	51
4.3.4 Liability of parties and remedies	54
4.3.5 Third-party protection	55
4.4 GAPS OR LOOPHOLES WITH RESPECT TO SECTION 21 OF THE COMPANIES ACT 2008.....	56
4.4.1 The express exclusion of promoter liability.....	58
4.4.2 Other gaps and potential loopholes.....	59
4.5 CONCLUSION	60
CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS	62
5.1 INTRODUCTION	62
5.2 A SUMMARY OF THE KEY FEATURES ACROSS CHAPTERS 1-4.....	62
5.2.1 An improved statutory reform by section 21	62
5.2.2 Examination of international best practices	63
5.3 RECOMMENDATIONS.....	64
Bibliography.....	65

CHAPTER ONE: INTRODUCTION AND BACKGROUND

1.1 INTRODUCTION

Companies are formed for business opportunities, for purposes of acquiring assets, and for other benefits.¹ Before its incorporation, the promoter of a company must be sure that a company is capable of reaping the said benefits such as the acquisition of assets.² The Companies Act 71 of 2008 (hereafter the Companies Act 2008) defines a promoter as, 'a person who enters into a written agreement in the name of, or purports to act in the name of, or on behalf of a company contemplated to be formed but does not yet exist.'³ Section 21 of the Companies Act 2008 grants the promoter of a non-existent company a statutory agency to enter into a valid pre-incorporation agreement or contract. A pre-incorporation contract to secure the business interests of a company yet to be formed between parties provides investor confidence and legal certainty for investors to be attracted to invest in such ventures.⁴

Through the doctrine laid down in *Kelner v Baxter*⁵ the common law created hurdles for the promoter to act as an agent of a non-existent company.⁶ The position at common law is that once the company is formed and comes into existence, the company cannot ratify a pre-incorporation contract.⁷ Where a promoter acts as an agent and proceeds to act on behalf of a non-existent company, with the expectation that the company will ratify the agreement upon incorporation, the common law rules of agency will preclude the ratification.⁸

The South African legislature has addressed the obstacle posed by the common law principle of no-ratification.⁹ South African company law was one of the first jurisdictions to provide a legislative solution to circumvent the hurdle to allow statutory agency so

¹ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 5.

² Beuthin RC, Luiz SM *Beuthin's Basic Company Law* 3ed (2000) 35.

³ Section 21(1) of the Companies Act 2008.

⁴ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 5.

⁵ 1866 LR 2 CP; para 174.

⁶ *Kelner v Baxter* 1866 LR 2 CP; para 174. See also *McCullogh v Fernwood Estate Ltd* 1920 AD 204.

⁷ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 5.

⁸ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 2.

⁹ Section 71 of the Companies Act 46 of 1926; section 35 of the Companies Act 61 of 1973; section 21 of the Companies Act 71 of 2008.

that entrepreneurs can exploit business opportunities for companies without waiting for the promoters to complete the process of incorporating a company.¹⁰ The Companies Act 46 of 1926¹¹ (hereafter the 1926 Act) and the Companies Act 61 of 1973¹² (hereafter the 1973 Act) provided the statutory exception for the benefit of entrepreneurship.¹³ Section 71 of the 1926 Act sought to protect the promoter by providing a statutory mechanism to avoid personal liability in a pre-incorporation contract.¹⁴ This protection came at the expense of the third-party who had to bear the risk of non-ratification by the company.¹⁵ The underlying policy of s35 of the 1973 Act served to protect the company's position and the promoter's position.¹⁶ Section 35 of the 1973 Act fails to have sufficient regard for the position of the third-party because it failed to address the problems of agency and non-ratification that previously arose from s71.¹⁷ Modern commercial practice imperatives necessitated reforming South African company legislation to align with the prevailing commercial circumstances in South Africa and the world of business.¹⁸ Section 21 was thus inserted into the Companies Act 2008 with the hope that its provisions would respond to the shortcomings identified with s35 of the 1973 Act.¹⁹

The purpose of this mini-thesis is to critically analyse s21 to establish whether company law reform has adequately responded to the challenges which existed prior to the promulgation of the Companies Act 2008. Additionally, this mini-thesis analyses matters of clarity with regards to the subsections under s21 and seeks to compare the statutory pre-incorporation contract provision under the Companies Act 2008 with international best practices from selected comparators of choice.

¹⁰ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 365.

¹¹ Section 71 of the Companies Act 46 of 1926.

¹² Section 35 of the Companies Act 61 of 1973.

¹³ Davies D, Geach W, Loubser A *et al.* *Companies and Other Business Structures in South Africa* 5ed (2021); 4.

¹⁴ Section 71 of the Companies Act 71 of 1926. See also Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 15.

¹⁵ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 15.

¹⁶ Section 35 of the Companies Act 61 of 1973.

¹⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 399.

¹⁸ Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 6.

¹⁹ Jukes C *A comparison between the Companies Acts of 1973 and 2008 in respect of pre-incorporation contracts in relation to the stipulation alteri* (Doctoral dissertation, University of Pretoria, 2018) 24.

1.2 BACKGROUND TO THE STUDY

It is important to note that pre-incorporation contracts can be addressed in terms of the common law and statutory law to determine whether the promoter acted as a principal or an agent.²⁰ Based on the common law, the general rule which applied was that the promoter acts as a principal from the onset.²¹ According to the common law position of pre-incorporation contracts, no pre-incorporation contract was binding on a company, nor could a company ratify a pre-incorporation contract.²²

The *Kelner v Baxter* case brought about confusion for a promoter who wanted to act as an agent rather than a principal of a company yet to be incorporated. In the case of *Kelner v Baxter*, the plaintiff signed a contract with the defendant for the supply of wine to a yet-to-be formed company, Gravesend Royal Alexandria Hotel Company Limited.²³ The defendant signed the contract on behalf of the company.²⁴ Later, the company was incorporated, and it attempted to ratify the contract.²⁵ Prior to the company's attempt to ratify the contract, the plaintiff had supplied some cartons of wine on credit to the company which was used for the company's business.²⁶ The company encountered challenges in running its business and as a result, it could not pay the price for the wine that the plaintiff delivered to it.²⁷ Later, the company declared insolvency and the plaintiff sued the defendant personally for the cost of the wine.²⁸ The court held that the defendant was personally liable because the company did not exist at the time of the contract and the parties were aware of this fact.²⁹ The basis of the court's decision was that there being no company, there could be no contract with it.³⁰

²⁰ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 3.

²¹ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 2.

²² Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 7.

²³ *Kelner v Baxter* (1866) LR 2 CP 174 (hereafter *Kelner* case).

²⁴ *Kelner* case; para 174.

²⁵ *Kelner* case; para 175.

²⁶ *Kelner* case; para 175.

²⁷ *Kelner* case; para 175-6.

²⁸ *Kelner* case; para 185.

²⁹ *Kelner* case; para 185. See also Omar P 'Crossing time's boundaries: A comparative view of the legal responses to the pre-incorporation contract' (2005) *Singapore Journal of Legal Studies* 79.

³⁰ *Kelner* case; para 185.

In the case where a promoter acts as a principal, the promoter might be held personally liable for liabilities incurred.³¹ The law of agency permits a promoter to act on behalf of a company, however, the promoter would not be held entirely liable for liabilities incurred.³² The impediments of the common law necessitated for the establishment of statutory agency to supplement the method of concluding pre-incorporation contracts at common law. The context of this mini-thesis will, therefore, primarily focus on the use and case law principles derived from statutory pre-incorporation contracts, rather than the common law *stipulatio alteri*.

1.3 RESEARCH PROBLEM AND PROBLEM STATEMENT

Scholars such as Cassim have expressed criticism against s35 of the 1973 Act stating that it was found to be outdated and out of step with modern business trends with regards to commercial practices.³³ The deficiencies of s35 of the 1973 Act necessitated the need for s21 of the Companies Act 2008.³⁴ The parties in pre-incorporation contracts experienced contractual injustice, in particular the third-party. The third-party was in a vulnerable position because s35 of the 1973 Act was entirely skewed in favour of the promoter and company, and third parties were left to be in a vulnerable position.³⁵ The Companies Act 2008 was enacted after the creation of the Constitution. The Constitution remains the supreme law of the Republic and any law inconsistent with the Constitution is invalid.³⁶

Section 7(a) of the Companies Act 2008 states that one of the objectives of the Companies Act 2008 is to promote compliance to the Bill of Rights as provided for in the Constitution.³⁷ The application of s7(a) of the Companies Act 2008 amounts to

³¹ *McCullogh v Fernwood Estate Ltd* 1920 AD 204. See also *Mutual Life Insurance Co of New York v Hotz* 1911 AD 556; para 567.

³² *Peak Lode Gold Mining Co Ltd v Union Government* 1932 TPD 48. See also *Nordis Construction Co (Pty) Ltd v Theron, Burke, and Isaac* 1972 (2) SA 535 (N) 272.

³³ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal*. See pages 364-365, 368-369.

³⁴ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 6.

³⁵ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 6.

³⁶ Section 2 of the Constitution of the Republic of South Africa, 1996.

³⁷ S7(a) of the Companies Act 71 of 2008 reads as follows: "The purposes of this Act are to- (a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law...."

promoting the objectives or constitutional values as per the reference to the 'spirit, purport, and objects of the Bill of Rights' in s39(2) of the Constitution.

The application of s7(a) of the Companies Act 2008 influenced the legislature to enact s21, with specific intention of aligning it with the Constitution. This alignment meant that the provisions of s21 could not be out of step with constitutional values such as reasonableness, fairness, equity, and transparency.³⁸ The provisions of s21 of the Companies Act 2008 must portray these constitutional values in line with contractual common law principles which refers to freedom of contract³⁹, *pacta sunt servanda* (all agreements must be honoured)⁴⁰, public policy⁴¹ and good faith.⁴² The need to infuse both the contractual principles and the constitutional values meant that the imbalance of fairness between the promoter liability and third-party rights found in s35 of the 1973 Act was inapplicable as it did not speak to the current constitutional values.⁴³ Section 21 of the Companies Act 2008, therefore, must ensure to balance the position of the promoter liability and third-party rights in pre-incorporation contracts, notwithstanding considering the contractual common law and constitutional values.

The question is whether s21 of the Companies Act 2008 can be interpreted to have responded to these specific challenges of imbalance in protection of parties to pre-incorporation contracts. This question becomes relevant when one considers the fact that Companies Act 2008 can be interpreted to be seeking to promote equity in the treatment of parties and to promote the realisation and enjoyment of rights established by parties. Mupangavanhu makes a compelling point when he argues that the Companies Act 2008 can be read to be promoting an interpretation that advances fundamental human rights including protecting and advancing rights of those previously disadvantaged by any system including in commercial practice.⁴⁴ Thus, a

³⁸ Gwanyanya M 'The South African Companies Act and the realisation of corporate human rights responsibilities' (2015) 18(1) *Potchefstroom Electronic Law Journal* 3107-09.

³⁹ Hutchinson D, Pretorius C, Du Plessis J *et al The Law of Contract in South Africa* 4ed (2022); pages 27-8.

⁴⁰ *Barkhuizen v Napier* 2007 (5) SA 323 (CC); para 15.

⁴¹ *Barkhuizen v Napier* 2007 (5) SA 323 (CC); para 28.

⁴² *Beadica 231 CC v Trustees, Oregon Trust* 2020 (5) SA 247 (CC); para 21.

⁴³ Johnson N *Pre-incorporation contracts in Company Law: A comparative study* (Doctoral thesis, University of the Western Cape. 2000) 183.

⁴⁴ Mupangavanhu BM 'Impact of the Constitution's normative framework on the interpretation of provisions of the Companies Act 71 of 2008' (2019) *PER / PELJ* (22). See pages 3-5 and 9-10.

policy shift was necessary in both matters of substantive fairness and interpretation of company law in line with the spirit, purport, and objects of the Bill of Rights.⁴⁵

With respect to the kind of liability for parties created by the Companies Act 2008, this mini-thesis proposes to establish the liability of the parties in pre-incorporation contracts. A method of attributing liability to parties in a pre-incorporation contract is by means of statutory warranty. Cassim suggests that third-party protection can best be implemented by holding the promoter liable for damages for breach of a statutorily implied warranty that the company will be incorporated within a reasonable time or ratify the pre-incorporation after its incorporation.⁴⁶ Another method of attributing liability to parties in a pre-incorporation contract is known as the personal liability approach. The personal liability approach is where the promoter concludes a contract as if he is a principal of the pre-incorporation contract. The promoter acting as a principal is liable from the word go, enjoys benefits flowing from the contract until such a point when the company adopts the contract after incorporation. Which approach did the legislature intend to be adopted with respect to s21? It seems unclear to some in commercial practice what approach the framers of s21 of the Companies Act 2008 had in mind. Is there a possibility that the drafters of s21 also omitted to clarify the question of who is liable in terms of the contract during the period between the time that the contract is concluded and the time that the company upon incorporation, ratifies the contract? All these questions arising from provisions of s21 need to be clarified and this mini-thesis will interrogate these questions and attempt to find answers in this regard. It is important to look at international best practices to try and find answers to questions of clarity with respect to s21 of the Companies Act 2008.

There are also questions which can be asked with respect to clarity of certain subsections under section 21. For example, s21(2) speaks of the person who concludes a pre-incorporation contract in terms of s21(1) being “jointly and severally liable with any other such person for liabilities created...” It is necessary to deconstruct this subsection. Who is this “other such person” contemplated in s21(2)? Interpretation

⁴⁵ Mupangavanhu posits that section 7(a) of the Companies Act 2008 necessarily and can even be interpreted to be specifically mandating the alignment of company law with the spirit, purport, and objects of the Bill of Rights as provided for in section 39(2) of the Constitution of the Republic of South Africa. Mupangavanhu (2019) *PER / PELJ* 3-10.

⁴⁶ Cassim MF ‘Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act’ (2007) 124 (2) *South African Law Journal* 390.

should be able to provide clarity on the interpretation of the subsection. Is liability discharged from a promoter when concluding a contract or does it include acting in the name of the company which involves giving an instruction to someone to act in the name of the company? The manner of discharging the liability of parties may be clarified by interpretation of s21. Some are convinced that in addition to ratification, novation of the pre-incorporation contract is another way in which liability can be discharged.

1.4 RESEARCH QUESTIONS

The key research question provides the overall direction of the mini-thesis, and how the research will attempt to resolve the research problem identified and articulated in part 1.3 above. The sub-inquiries are designed to provide building blocks towards answering the key/main research question of this mini-thesis.

1.4.1 Main Research Question

The main or key research question pursued in this mini-thesis is an inquiry into whether the Companies Act 2008 through s21, has balanced the interests of parties to the pre-incorporation contracts in a manner that ensures equitable sharing of risks and liability arising from possible non-ratification of the contracts and/or non-incorporation of the companies or business entities as envisaged in the agreements.

1.4.2 Sub-inquiries

The following questions are the sub-inquiries which seek to provide building blocks towards answering the main/key research question:

1.4.2.1 What was the lacuna in law prior to the Companies Act 2008 and the rationale for law reform related to the statutory exceptions in South African company law that necessitated the introduction of statutory pre-incorporation contracts reforms which culminated in the s21 provisions?

1.4.2.2 What can South Africa learn from international best practices to better inform and guide future law reform and interpretation of the pre-incorporation contracts standards in s21 of the Companies Act 2008?

1.4.2.3 In what way has section 21 reformed the policy bias which was said by scholars writing before the promulgation of the Companies Act 2008, to have been skewed in favour of the promoter and in what way can it now be interpreted to have achieved or

struck a balance in terms of ensuring the equitable protection and sharing of risks between the promoter and the third party in case of non-ratification of the pre-incorporation contract by company and/or non-incorporation of the company? This question further seeks to inquire into whether and in what way section 21 could be said to be properly aligned to the purpose of the Act in section 7(a) which relates to the equitable promotion of rights and the realisation and enjoyment of rights by parties to a contract as provided for in South African law.

1.4.2.4 How best can the type of liability of parties to a pre-incorporation contract in terms of s21 of the Companies Act 2008 be characterised and what are the implications of such characterisation?

1.4.2.5 In terms of s21 of the Companies Act 2008, who is liable on the pre-incorporation contract between the time of conclusion of the contract and the time that the company is incorporated and is in a position to decide on ratification?

1.5 LITERATURE REVIEW AND JUSTIFICATION OF STUDY

The sources discussed and referred to in the literature review do not constitute an exhaustive list on the topic.

Discussions and arguments raised by authors with regard to the lacunae in law prior and after the Companies Act 2008 were based on the need for statutory reform. Statutory reform was required in relation to the question of the impact of retrospectivity in terms of s21 of the Companies Act 2008. Statutory reform was also required to clarify the liabilities of the parties in a pre-incorporation contract, particularly the protection of a third-party. Furthermore, statutory improvements will assist in clarifying areas of uncertainty that are still prevalent in pre-incorporation contracts.

Writing on the basis of the 1973 Act, and with reference to the issue of retrospectivity, Jooste highlighted that once there is an express or tacit term in a pre-incorporation contract providing for the retrospective effect of the pre-incorporation contract, then the pre-incorporation contract has such effect from the date prior to the incorporation of the company.⁴⁷ It would mean the pre-incorporation contract was concluded between the third-party and the promoter acting on behalf of the company yet to be

⁴⁷ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 507.

incorporated.⁴⁸ Jooste stated that the promoter could act in any of the following capacities when concluding a pre-incorporation contract with a third-party.⁴⁹

The first would be where the promoter acts as an agent. Section 35 of the 1973 Act created a statutory agency which permitted a promoter to act as an agent of a company yet to be formed, provided that certain requirements were met.⁵⁰ Secondly, the promoter could act as a messenger.⁵¹ The company could appoint the promoter as a messenger to negotiate a suitable offer to the company once it is incorporated.⁵² Lastly, the promoter can act as a stipulans.⁵³ As a stipulans, the promoter enters into a contract as a principal or trustee with the third-party for the benefit of the company.⁵⁴ This is the common law principle of *stipulatio alteri*.

Cilliers and Benade seem to only view the promoter in a position of acting as a principal/trustee, even though there are three different ways in which a promoter can be positioned in pre-incorporation contracts.⁵⁵ As was decided in the case of *Bagradi v Cavendish Transport Co (Pty) Ltd*,⁵⁶ when the promoter acts as a trustee for the company, the company is bound to a contract and that contract has retrospective effect after the company comes into existence. Cilliers and Benade believe that this is the only correct position for the promoter to be acting as a principal/trustee.⁵⁷ Thus Jooste

⁴⁸ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 507.

⁴⁹ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 508-11.

⁵⁰ Companies Act 61 of 1973; through section 35 as amended by section 8 of the Corporate Laws Amendment Act provided that the statutory agency was predicated upon two or perhaps three requirements being fulfilled. First, the promoter was required to expressly disclose that he was contracting on behalf of a prospective company, as 'trustee' or 'agent'. The second requirement was that the memorandum of the company upon its registration should have contained as an object of such company the ratification or adoption of or the acquisition of rights and obligations in respect of such contract. Thirdly, the memorandum of the company upon registration was required to list the ratification of that contract as one of its objects.

⁵¹ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 510.

⁵² Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg, 2019) 12.

⁵³ In context to pre-incorporation contracts, a stipulans is usually referred to as a trustee. A trustee as opposed to an agent act and acquires duties in his own name for the benefit of another. The trustee has in his personal capacity a right of action before the adoption of the contract by the contemplated company. On adoption of the contract the company thus succeeds to the rights and duties of the trustee with effect from the date of the conclusion of the contract. See *Semer v Retief and Berman* 1948 (1) SA 182 (C) 194.

⁵⁴ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 12.

⁵⁵ Cilliers H, Benade M *et al Corporate Law* 3 ed (2000) 5.

⁵⁶ *Bagradi v Cavendish Transport Co (Pty) Ltd* 1957 (1) SA 663 (D).

⁵⁷ *Bagradi v Cavendish Transport Co (Pty) Ltd* 1957 (1) SA 663 (D); para 667-668.

clarified that a pre-incorporation contract only has retrospective effect if there is an express or tacit term to this effect in the contract.⁵⁸ Jooste contends that if the promoter acts as a principal, it means he acquires a right of his own and not someone else's.⁵⁹ Moreroa opines that if the promoter acts in the capacity of an agent, the promoter will bind him/herself personally under an implied ancillary contract.⁶⁰ Based on the implied ancillary contract if the Board of Directors (hereafter BOD) of the company rejects the pre-incorporation contract, the promoter will then be liable for any damages suffered by the third-party.⁶¹

Williams adds to the discussion that the issue of damages is still unclear in instances where the promoter acts as an agent for a company which is not incorporated or that has been previously deregistered.⁶² In a scenario like this, the third-party will be able to claim from the promoter acting as an agent, but the claim will be useless as the quantum of damages will be nil as the company will not have been incorporated or have no liquidity of assets.⁶³

Cassim addressed the liabilities of the parties in pre-incorporation contracts. According to Cassim, s35 of the 1973 Act was skewed in favour of the company and the agent acting on behalf of the company yet to be incorporated.⁶⁴ Cassim advocated for s35 to be amended to incorporate a statutory implied warranty.⁶⁵ According to Boonzaier, a statutory implied warranty takes place when the agent warrants to the third-party that the company will be incorporated and the BOD will ratify the pre-incorporation contract within a reasonable time.⁶⁶ Cassim opines that if the company does not adopt

⁵⁸ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 512.

⁵⁹ Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) *South African Law Journal* 512.

⁶⁰ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 13. Also, an implied ancillary contract is a personal undertaking that the company shall be bound to the contract once adopted and incorporated.

⁶¹ Estey W 'Pre-incorporation contracts: the fog is finally lifting' (2000) *Canadian Business Law Journal* 3.

⁶² Williams RC 'An agent's liability when acting for a non-existent principal' (1990) *South African Law Journal* 206.

⁶³ Williams RC 'An agent's liability when acting for a non-existent principal' (1990) *South African Law Journal* 206.

⁶⁴ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 398-99.

⁶⁵ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 399.

⁶⁶ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria, 2010) 25.

the pre-incorporation contract, the third-party is entitled to claim damages.⁶⁷ To Obayemi, a company that is identifiable with a pre-incorporation contract should be able to adopt it.⁶⁸ A pre-incorporation contract should be adopted within a reasonable time and that it can be concluded based on conduct, action, or can be concluded orally.⁶⁹

The deficiencies of s21 of the Companies Act 2008 include the failure of the legislature to provide clarity on the issue of the retrospectivity of pre-incorporation contracts.⁷⁰ According to Boonzaier, s21 of the Companies Act 2008 does not provide the manner of ratification of the contract by the company's board.⁷¹ From the above, it can be said that at this stage, it appears that while s21 of the Companies Act 2008 has responded to some questions raised with respect to the position of statutory agency in terms of s35 of the 1973 Act, there is still room to improve clarity regarding certain aspects of statutory pre-incorporation contracts in South African company law.

Section 21 of the Companies Act 2008 was enacted to address the lacunae in law with regard to the liabilities and the position of relevant parties in pre-incorporation contracts.⁷² Ncube remarked that the statutory reform brought about by s21 was commendable because it provides better protection for third-parties who engage in pre-incorporation contracts. Ncube makes this assessment after considering that s21 allows the promoter to be held personally liable due to the deemed ratification provisions.⁷³ The anomaly that s35 of the 1973 Act provided a position that was skewed in favour of the promoter and the company while disadvantaging the third-party, which position was criticised by Cassim,⁷⁴ has now been remedied as, according to Ncube, there is a more balanced approach followed by s21 as opposed to s35 of

⁶⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 399.

⁶⁸ Obayemi O 'Pre-incorporation contracts in Nigeria: The need for progressive, expansive, and less restrictive statutory provisions' (2020) *ASPER Review* 152-54.

⁶⁹ Obayemi O 'Pre-incorporation contracts in Nigeria: The need for progressive, expansive, and less restrictive statutory provisions' (2020) *ASPER Review* 135.

⁷⁰ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 269.

⁷¹ Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 31.

⁷² Section 21 of the Companies Act 71 of 2008.

⁷³ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 267-8.

⁷⁴ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 399.

the 1973 Act.⁷⁵ Ncube also expressed that there are deficiencies with s21 of the Companies Act 2008.

The need for statutory legal reform in terms of pre-incorporation contracts is not only an issue for South Africa. This mini-thesis seeks to address the unclear legal position regarding the issue of retrospectivity in pre-incorporation contracts. In addition, the mini-thesis seeks to contribute to knowledge in this area by assessing how damages are awarded in other jurisdictions such as Australia and Canada.

1.6 METHODOLOGY

A critical analysis, comparative research, and desktop methodology will be used. This methodology would require the use of primary sources such as cases, legislation, the Constitution, and secondary sources such as the internet, textbooks, and journal articles. An historical approach will be followed to outline the position of the parties in pre-incorporation contracts, particularly looking at the development of statutory pre-incorporation contracts in South African law. It is important to use a comparative study as it will provide insight on how various jurisdictions have made changes to ensure that the rights of all parties in pre-incorporation contracts are met. A comparative analysis is used because it is crucial and advantageous to learn from other legal systems such as Australia and Canada in order to better analyse and comprehend South African law insofar as it is consistent with the Constitution.⁷⁶ The preferred choice of Australia and Canada was based on the way the legislation regarding the position of parties in pre-incorporation contracts are similar to South African legislation. Also, these jurisdictions attempt to provide solutions for the possible lacuna found in South African company law. Australia and Canada are suitable comparators to South Africa as similar issues were identified in these jurisdictions. The Companies Act 2008 encourages the use of foreign law which handles with similar provisions to the Company's Act, and this is merely used as an interpretation tool.⁷⁷

⁷⁵ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 269.

⁷⁶ Section 39(1)(c) of the Constitution of the Republic of South Africa, 1996.

⁷⁷ Section 5(2) of the Companies Act 71 of 2008 reads as follows: "To the extent appropriate, a court interpreting or applying this Act may consider foreign company law."

1.7 SECTION 21 OF THE COMPANIES ACT 71 OF 2008 AND THE NORMATIVE FRAMEWORK OF THE CONSTITUTION

A reading of the Companies Act 2008, gives the impression that the intention of the legislature was to make sure that the provisions of the Companies Act 2008 are properly aligned to the Constitution.⁷⁸ The interpretation and application of the Companies Act 2008 involves the promotion of the values of the Constitution, which results in adherence to the supremacy clause.⁷⁹ Since the enactment of the Companies Act 2008, courts have confirmed how the Companies Act 2008 is to be applied in line with s5(2) and in a manner that promotes the values of the Constitution as per the purpose of the Act in s7(a).⁸⁰ This is well illustrated in *Nedbank v Bidvest*⁸¹ where the court held that there is a duty to interpret the Companies Act 2008 to promote the founding values of the Constitution in a respectful and progressive manner.⁸² In *Lazarus Mbethe v United Manganese of Kalahari*⁸³ the Supreme Court of Appeal reiterated compliance with the Bill of Rights when interpreting the Companies Act 2008.⁸⁴ In both decisions, the courts dealt with how the law had to be construed in order to establish whether the parties claiming such rights might enjoy the rights they sought.⁸⁵

Section 7(a) of the Companies Act 2008 provides that the purpose of the Companies Act 2008 is to promote compliance with the Bill of Rights.⁸⁶ The interpretation process in terms of the Companies Act 2008 is aligned to the purposes of the Companies Act 2008 found in s7 which provide for the manner to interpret the provisions of the Act.⁸⁷ The interpretation process must comply with the Bill of Rights. The legislature enacted the Companies Act 2008 in such a manner that it aligns to s39(2) of the Constitution

⁷⁸ This is the import of one of the purposes of the Act found in s7(a) of the Companies Act 2008.

⁷⁹ Section 2 of the Constitution of South Africa provides the Constitution is “the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled”.

⁸⁰ *Holomisa v Argus Newspapers Ltd* 1996 2 SA 588 (W); para 618.

⁸¹ *Nedbank Ltd v Bidvest (Pty) Ltd* 2012 5 SA 497 (WCC).

⁸² *Nedbank Ltd v Bidvest (Pty) Ltd* 2012 5 SA 497 (WCC); para 153.

⁸³ *Lazarus Mbethe v United Manganese of Kalahari* 2017 (6) SA 409 (SCA).

⁸⁴ *Lazarus Mbethe v United Manganese of Kalahari* 2017 (6) SA 409 (SCA); para 12.

⁸⁵ *Lazarus Mbethe v United Manganese of Kalahari* 2017 (6) SA 409 (SCA); para 12 and *Nedbank Ltd v Bidvest (Pty) Ltd* 2012 5 SA 497 (WCC); para 153.

⁸⁶ Section 7(a) of the Companies Act 71 of 2008.

⁸⁷ Mupangavanhu, BM ‘Impact of the Constitution's normative framework on the interpretation of provisions of the Companies Act 71 of 2008’ (2019) *PER/PELJ* 4. See also Davies D, Geach W *et al. Companies and Other Business Structures in South Africa* 5 ed (2021) 15.

and gives effect to the manner of interpretation as stipulated in the Constitution.⁸⁸ Section 5 of the Companies Act 2008 states that the Companies Act 2008 must be interpreted and applied in a manner which gives effect to s7 of the Companies Act 2008.⁸⁹ In the case of *Sibakhulu Constructing (Pty) Ltd v Wedgewood Village Golf and Country Estate (Pty) Ltd*, the Constitutional Court emphasised that questions of interpretation of the Companies Act 2008 must be undertaken with the provisions of s5 and s7 of the Companies Act 2008 in mind.⁹⁰ Section 5, therefore, contains a general interpretation clause for the Act.⁹¹ This means that courts must interpret the language of the statute to promote the purposes of the legislation as stipulated in s7 of the Companies Act 2008.

The interpretation process discussed above brings up the question of how statutory law reform in terms of s21 are to be implemented in pre-incorporation contracts in accordance with the principles of the Bill of Rights. Various interpretation processes are used by courts which in most cases must promote the spirit, purport, and objects of the Bill of Rights, and a similar interpretation must be given to the rights of promoters in pre-incorporation contracts.⁹² Courts must interpret pre-incorporation contracts in line with the Constitution.⁹³ The courts are independent and subject only to the Constitution and the law, which they must apply impartially, and without fear, favour, or prejudice.⁹⁴

1.8 CHAPTER OUTLINE

The chapter outline of the thesis will be as follows:

CHAPTER ONE: INTRODUCTION TO THE STUDY

⁸⁸ Mupangavanhu, BM 'Impact of the Constitution's normative framework on the interpretation of provisions of the Companies Act 71 of 2008' (2019) *Electronic Law Journal* 5. See also Davies D, Geach W, Loubser A *et al Companies and Other Business Structures in South Africa* 5 ed (2021) 15.

⁸⁹ See part 1.7 in chapter 1.

⁹⁰ *Sibakhulu Constructing (Pty) Ltd v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2020 (2) SA 325 (CC); paras 19 and 23.

⁹¹ Section 5 of the Companies Act 71 of 2008 reads: "(1) This Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7. (2) To the extent appropriate, a court interpreting or applying this Act may consider foreign company law."

⁹² *Investigating Directorate: Serious Economic Offences and Others v Hyundai Motor Distributors (Pty) Ltd and Others: In re Hyundai Motor Distributors (Pty) Ltd and Others v Smit NO and Others* 2001 (1) SA 545 (CC); pages 21-2.

⁹³ *Newborne v Sensolid (Great Britain) Ltd* 1954 1 QB 45 (CA).

⁹⁴ Section 165(2) of the Constitution of the Republic of South Africa, 1996.

This chapter introduces the background and the research topic to be discussed. This chapter will indicate the objectives which the mini-thesis seeks to cover as well as the methodology which will attempt to provide solutions.

CHAPTER TWO: HISTORY OF STATUTORY PRE-INCORPORATION CONTRACTS, LIABILITY OF PARTIES, AND THE NEED FOR STATUTORY LAW REFORM IN SOUTH AFRICA

Chapter Two traces the history of statutory pre-incorporation contracts in South African law. It considers what the purpose of incorporating pre-incorporation contracts into statute in terms of the 1926 Act and in terms of the 1973 Act. Chapter Two considers the developments in law at each given period in time, until the Companies Act 2008.

CHAPTER THREE: INTERNATIONAL BEST PRACTICES ON MODERN PRE-INCORPORATION CONTRACTS

Chapter Three considers foreign jurisdictions such as Australia and Canada as comparators of choice. The chapter considers developments in those jurisdictions with respect to statutory pre-incorporation contracts and considers the approaches of these jurisdictions to the liability and protection of rights of promoters. The common law will be considered as references will be drawn from case law on the matter of rights of promoters.

CHAPTER FOUR: A CRITICAL ANALYSIS OF SECTION 21 OF THE ACT – A CASE FOR A MORE BALANCED APPROACH TO LIABILITY & PROTECTION OF PARTIES

Chapter four provides a critical analysis of s21 of the Companies Act 2008. The analysis pays attention to the liability of parties; the question whether s21 of the Companies Act 2008 provides equitable and adequate protection to all important pre-incorporation contracts stakeholders, especially the promoter. This chapter discusses interpretation of s21 of the Companies Act 2008 questions whether the content of s21 can be interpreted to be properly aligned to s7(a) of the Act in relation to the purpose to promote compliance with the Constitution in the application of company law. The analysis is also done in light of possible lessons drawn from an examination of developments in statutory pre-incorporation provisions in selected jurisdictions' company statutes similar to s21 of the Companies Act 2008.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

Chapter Five presents critical findings, conclusions, and recommendations. Chapter Five highlights the issues found in chapters 1-4 but solves it by providing well thought-out amendments which can be made to s21 of the Companies Act 2008. These amendments mentioned in chapter Five can provide a solution to the current interpretation of s21 of the Companies Act 2008.

1.9 DELIMITATION OF THE STUDY

1.9.1 Delimitation Statement

There are alternative methods of concluding pre-incorporation contracts followed in South African law and in the laws of most common law jurisdictions, namely the *stipulatio alteri*, a common law device, and the statutory agency, at present represented by s21 of the Companies Act 2008. This mini-thesis focuses on the statutory agency to the exclusion of the common law device, which is the *stipulatio alteri*. The mini-thesis critically analyses s21 of the Companies Act 2008 in light of the position of promoter liability and protection of third-party rights in pre-incorporation contracts. In addition, it points to whether the provisions of s21 of the Companies Act 2008 is aligned with the values of the Constitution in terms of the parties' positions in pre-incorporation contracts. While the study focusses exclusively on the statutory pre-incorporation contract per s21 of the Companies Act 2008, it is considered beneficial to the reader to briefly describe here, the *stipulatio alteri* as juxtaposed with s21.

1.9.2 *Stipulatio Alteri* Vis-à-vis the Section 21 Contract

The common law device, the *stipulatio alteri*, is generally known as a contract for a third-party.⁹⁵ The common law makes it possible for two parties to conclude a valid contract for the benefit of a third person who is not a party to the contract, and who at the stage of contracting need not even exist.⁹⁶ For a *stipulatio alteri* to be valid, the *stipulans* and the *promittens* should intend to create an enforceable obligation in favour of the third-party. The obligation in favour of the third-party operates as an offer

⁹⁵ See the remark by the court in *Crookes v Watson* 1956 (1) All SA 277 (A); para 291B-C where it was stated: 'what is not very appropriately styled a contract for the benefit of a third person is not simply a contract designed to benefit a third person; it is a contract between two persons that is designed to enable a third person to come in as a party to a contract with one of the other two.'

⁹⁶ See the following cases: *Mutual Life Insurance Co of New York v Hotz* 1911 AD 556 567; *Van der Plank v Otto* 1912 AD 353 362; *Brown's Executrix v McAdams, Masterpiece Gold Mining Co Ltd v Brown's Executrix* 1914 AD 231 235; *McCulloch v Fernwood Estate Ltd* 1920 AD 204 206 215. *Commissioner of Inland Revenue v Estate Crewe* 1943 AD 656; *Crookes v Watson* 1956 (1) SA 277 (A), cited by Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 35.

to that third-party, obliging the *promittens* to make a performance to the third-party, thus, giving that party an independent right to enforce the contract or demand performance from the *promittens* upon acceptance of the said offer.⁹⁷

In the context of a company contracting pre-incorporation, while it is important to note that the Companies Act 2008⁹⁸ does not affect the continued application of a *stipulatio alteri*,⁹⁹ there are nonetheless, important differences between the two contracts. For example, whereas both devices are utilised by promoters to secure benefits for a company ahead of incorporation, in the context of a *stipulatio alteri*, the promoter contracts in his/her own name as a principal or *stipulans*, not as an agent in the name of or representing a company to be formed. Common law sets its face against a person deriving authority to act on behalf of a non-existent principal.¹⁰⁰ On the other hand, this is one huge difference with a section 21 contract, because in this kind of a pre-incorporation contract, the statute creates statutory agency which permits a promoter to act on behalf of a company (a principal) before it exists, that is, pre-incorporation.¹⁰¹ There are yet other differences, for example, the fact that the statutory agency creates conditions for a promoter to act on behalf of a company that does not yet exist. One such condition or formality is that the contract must be a written contract,¹⁰² and present in the contract must be an intention or rather the agent must make an undertaking on behalf of the company, that the company will be incorporated, and that it will be bound to the contract upon incorporation and upon ratifying the contract.¹⁰³ A common law contract generally does not require, for its validity, the presence of such

⁹⁷ See Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010) 36. Also see Hutchinson D, Pretorius C, Du Plessis J *et al The Law of Contract in South Africa* 4ed (2022) 255; McKerron RG 'The juristic nature of contracts for the benefit of third parties' (1929) 46(4) *South African Law Journal* 396-98; and *Eldacc (Pty) Ltd v Bidvest Properties (Pty) Ltd* (682/10) [2011] ZASCA para 144.

⁹⁸ Which obviously provides for a statutory agency in a pre-incorporation contract in terms of s21.

⁹⁹ A common law device contractual device for concluding a contract for the benefit of a third-party.

¹⁰⁰ See Hutchinson D, Pretorius C, Du Plessis J *et al The Law of Contract in South Africa* 4ed (2022) 256. See also *Commissioner for Inland Revenue v Estate Crewe* 1943 AD para 658.

¹⁰¹ Section 21(1) read together with the definition of the 'pre-incorporation contract' in s1 of the Companies Act 2008 brings this statutory agency to the fore by putting in place conditions to be fulfilled for such a contract to be in place – namely, that it should be a written contract, that the promoter(s) must have a clear intention and/or make an undertaking that the proposed company shall be incorporated and that it will be bound by the contract upon incorporation and upon ratifying the contract.

¹⁰² See note 103 above.

¹⁰³ See the definition of 'pre-incorporation contract' in s1 of the Companies Act 2008.

formalities as writing or the other formalities found in the section 21 contract, unless the formalities are specifically prescribed by a statute.¹⁰⁴



¹⁰⁴ See s2(1) of the Alienation of Land Act 68 of 1981 for an example of such a writing formality.

CHAPTER TWO: THE HISTORY OF STATUTORY PRE-INCORPORATION CONTRACTS IN SOUTH AFRICAN LAW

2.1 INTRODUCTION

The aim of this chapter is to showcase or demonstrate how statutory pre-incorporation contracts have changed in South African law. In essence, this chapter considers the development of the law from the 1926 Act to the Companies Act 2008. The flow of the chapter will illustrate how pre-incorporation contracts were handled in terms of each Companies Act. Thereafter, a thorough description of the positive and negative aspects of the prior Companies Acts before the present Companies Act 2008 and the legislative efforts to update the law to reflect contemporary trends, will follow. The discussion throughout the chapter is an analysis of the previous Acts, especially s35 of the 1973 Act. An analysis of s35 of the 1973 Act will help reveal the lacuna in law which necessitated the introduction of the successor to s35 namely, s21 of the Companies Act 2008.

2.2 DEVELOPMENT OF PRE-INCORPORATION CONTRACTS: FROM 1926-2008

South Africa was colonised by British people and adopted or enacted legislation influenced by English legislation. It is thus understandable that the 1926 Act almost mimicked the English Companies (Consolidated) Act 1908 at the time.¹⁰⁵ The same could be said about the amendment acts, enacted to amend specific provisions of the 1926 Act.¹⁰⁶ The issue with the English Companies Act 1948 and the Companies Act 1985 was that they did not explain and clarify the position of an agent in terms of pre-incorporation contracts and whether the agent could enforce a pre-incorporation contract.¹⁰⁷

The South African government established the Van Wyk De Vries Commission (hereafter the Commission) to evaluate whether or not the English amendments were effective.¹⁰⁸ At the time, the President of the Republic of South Africa felt it necessary

¹⁰⁵ Section 68 of the Companies (Consolidated) Act 1908. See also *Ex Parte Vickermann and Others* 1935 C.P.D 429-30.

¹⁰⁶ Companies Amendment Act 23 of 1939 and Companies Amendment Act 46 of 1952.

¹⁰⁷ Griffiths A 'Agents without principles: pre-incorporation contracts and section 36C of the Companies Act 1985' (1993) *The Journal of the Society of Legal Scholars* 252-53.

¹⁰⁸ Benade M 'A survey of the main report of the Commission of Enquiry into the Companies Act' (1970) *The Comparative and International Law Journal of Southern Africa* 277.

to appoint the Commission for statutory law reform.¹⁰⁹ The Commission's approach to law reform was based on the lack of consolidation by the 1926 Act. The basis of the Commission's findings on the confusion produced was that the 1926 Act and the amendment acts did not integrate to a point where a relationship could be recognised by legal scholars. Due to legal scholars not being able to recognise which law to apply when confronted with a company law issue, new legislation had to be enacted to correctly and better guide users of company law. The appointment of the Commission in 1963 led to the enactment of new legislation that embodied legislation applicable at the time. The new laws had to bring change to the law to give proper guidance in relation to company law in South Africa.¹¹⁰

2.2.1 THE COMPANIES ACT 46 OF 1926

The 1926 Act might not have provided the most suitable explanation for promoters' position in pre-incorporation contracts. The 1926 Act's wording regarding pre-incorporation contracts featured unique wording about the position of promoters in pre-incorporation contracts when contracting with a non-existent company. Pre-incorporation contracts were regulated by s71 of the 1926 Act.¹¹¹ Therefore, it is imperative to analyse the wording of the 1926 Act. Section 71 of the 1926 Act provided as follows:

any contract made in writing by a person professing to act as agent or trustee for a company not yet formed, incorporated or registered shall be capable of being ratified or adopted by or otherwise made binding upon and enforceable by such company after it has been duly registered as if it had been duly formed, incorporated and registered at the time when the contract was made, and such contract has been made without its authority: provided that the memorandum of the company contains as one of the objects of such company the adoption or ratification of or the acquisition of rights and obligations in respect of such contract.¹¹²

It is clear from s71 of the 1926 Act that specific requirements must be met for a pre-incorporation contract to be binding on the parties. These requirements need to be discussed as it forms part of the reason for amendments to the 1926 Act.

¹⁰⁹ Benade M 'A survey of the main report of the Commission of Enquiry into the Companies Act' (1970) *The Comparative and International Law Journal of Southern Africa* 277.

¹¹⁰ Van Wyk de Vries Commission of Inquiry into the Companies Act Report 1963.

¹¹¹ Section 71 of the Companies Act 46 of 1926.

¹¹² Section 71 of the Companies Act 46 of 1926.

2.2.1.1 Requirements of s71 of the Companies Act 46 of 1926

Three conditions had to be met for pre-incorporation contracts to be enforceable in terms of s71 of the 1926 Act. The conditions were that the contract had to be concluded in writing; the contract had to be concluded by any person who professed to act as an agent or trustee of the company yet to be formed; and that the memorandum of the company provided that such company could adopt or ratify the acquisition of rights and obligations in respect of such a contract.¹¹³ Once a pre-incorporation contract met all these requirements, it was legally binding on the parties.

Based on the first requirement, for a pre-incorporation contract to have been binding, it had to be in writing and could not have been agreed upon by parties by any form of implied authority.¹¹⁴ If a pre-incorporation contract was not in writing, it was declared null and void.

The second requirement was that the person had to act as an agent or trustee for the company yet to be incorporated or registered.¹¹⁵ This second requirement meant that the person had to act with the impression that he/she would conclude a contract on behalf of the company. In *Sentrale Kunmis Korp (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk*¹¹⁶, Trolip J believed that the wording of s71 created a solid *prima facie* impression that it was intended to apply not only to a pre-incorporation contract concluded by an agent but also a *stipulatio alteri*.¹¹⁷ The basis of his opinion was that s71 referred to a contract made by "a person professing to act as a trustee" and it being "adopted by or otherwise made binding upon and enforceable by" the company.¹¹⁸ It should be noted that in South African law, reference made to a 'trustee' is reference to someone capable of acting as a principal which brings about a complexity as to what the nature of the pre-incorporation contract could be. The word 'trustee' can be with reference to a statutory agency or a *stipulatio alteri*.

The final requirement was that the company's memorandum of incorporation had to provide that once the company is incorporated or registered, such company would

¹¹³ Section 71 of the Companies Act 46 of 1926.

¹¹⁴ Section 71 of the Companies Act 46 of 1926. See Boonzaier M *Pre-incorporation contracts and the promoter's liability* (published LLM thesis, University of Pretoria 2010) 13.

¹¹⁵ *Sentrale Kunmis Korp (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk* 1970 (3) SA 342 (A) 359 (hereafter *Sentrale Kunmis* case).

¹¹⁶ *Sentrale Kunmis* case.

¹¹⁷ *Sentrale Kunmis*; para 358.

¹¹⁸ *Sentrale Kunmis*; para 359.

ratify or adopt the pre-incorporation contract.¹¹⁹ The memorandum had to indicate whether the company would be registered or adopted. The company would either had approved/ratified the acquisition of rights and obligations in terms of a contract established by an agent or trustee. This memorandum could bear negative implications for legal certainty and business practices as there would have been no framework which governed pre-incorporation contracts effectively.¹²⁰ The 1926 Act was amended by the legislature to address the absence of a timeframe provision in the 1926 Act. In addition, the timeframe within which a company should ratify the pre-incorporation was not explicitly stated in the 1926 Act. The fact that there was no clarification on a stipulated time for a company to ratify a pre-incorporation contract was problematic for the promoter and the third-party. The promoter and third-party's rights and obligations could be delayed for extended periods while waiting for the company to decide whether to ratify the pre-incorporation contract in question or not.¹²¹ Because of the abovementioned shortcomings, the legislature enacted the 1973 Act.

2.2.2 SECTION 35 OF THE COMPANIES ACT 61 OF 1973

It is clear from the shortcomings experienced with s71 of the 1926 Act, there was a need for a shift from the provisions of the 1926 Act. The need was that there had to be a more balanced approach of the position of the parties, namely the promoter, company, and third-party in a pre-incorporation contract. The balance approach referred to the determination of promoter liability in relation to the protection of third-party rights in pre-incorporation contracts.¹²² It was necessary to discuss whether s35 of the 1973 Act had thus achieved to create the balanced approach needed between the promoter, company, and third-parties in pre-incorporation contracts.

The legislature saw it fit for the 1973 Act to retain the provisions related to pre-incorporation contracts. However, the only difference is that the 1973 Act had to overcome the shortcomings of the previous 1926 Act. The 1973 Act borrowed some

¹¹⁹ *Sentrale Kunsmis*; para 359. *Racec (Mooifontein) (Pty) Ltd v Devonport Investment Holding Co (Pty) Ltd*; para 303.

¹²⁰ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 5.

¹²¹ Boonzaier M *Pre-incorporation contracts and the promoter's liability* (published LLM thesis, University of Pretoria 2010) 14-5.

¹²² Boonzaier M *Pre-incorporation contracts and the promoter's liability* (published LLM thesis, University of Pretoria 2010) 21.

key provisions from the 1926 Act.¹²³ The provisions borrowed by the 1973 Act from the 1926 Act meant little was changed in the 1973 Act from the 1926 Act position on pre-incorporation contracts. Trivial changes such as the words 'on its registration' were inserted in s35 of the 1973 Act, following the decision taken in the *Sentrale Kunsmis (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk* case.¹²⁴ The memorandum had to contain on its registration an object of such a company, the ratification and adoption of rights and obligations in respect of a pre-incorporation contract. Moreover, the legislature did not clarify the potential liability of parties involved in pre-incorporation contracts, especially the liability of the agent or trustee.¹²⁵ The lack of clarity of parties' positions in a pre-incorporation contract called for analysing pre-incorporation contracts in terms of the 1973 Act.

Section 35 was the relevant provision in terms of the 1973 Act which dealt with pre-incorporation contracts. Section 35 of the Companies Act provides the following:

Any contract made in writing by a person professing to act as agent or trustee for a company not yet incorporated shall be capable of being ratified or adopted by or otherwise made binding upon and enforceable by such company after it has been duly incorporated as if it had been duly incorporated at the time when the contract was made and such contract had been made without its authority: Provided that the memorandum on its registration contains as an object of such company the ratification or adoption of or the acquisition of rights and obligations in respect of such contract, and that such contract, has been lodged with the Registrar together with the lodgement for registration of the memorandum and articles of the company.¹²⁶

It can be noted that s35 of the 1973 Act's modification to s71 of the 1926 Act was that the 1973 Act included a requirement for the Memorandum of Incorporation to contain an object for the ratification or adoption of the pre-incorporation contract and rights involved.¹²⁷ The extent to which s35 protected the company's position was done to

¹²³ *Build-a-brick BK v Eskom* 1996 (1) SA 115 (O); para 123A-E.

¹²⁴ *Sentrale Kunsmis*; para 351.

¹²⁵ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 365.

¹²⁶ Section 35 of the Companies Act 61 of 1973.

¹²⁷ Jukes C *A comparison between the Companies Acts of 1973 and 2008 in respect of pre-incorporation contracts in relation to the stipulation alteri* (Doctoral dissertation, University of Pretoria, 2018) 16. Mangano K *Pre-incorporation contracts: A balancing of the interests of the promoter, the company and third-party contractant in South African Company Law* (Doctoral dissertation, University of the Witwatersrand, Faculty of Commerce, Law and Management, School of Law 2013) 12.

ensure that legal certainty was obtained in company law and that there was better guidance when a pre-incorporation contract came into effect.¹²⁸ Section 35 only became effective when the company was incorporated or registered at the time the parties entered a pre-incorporation contract.

There were remaining controversies concerning s35, which continued to arise in South African courts. In *Pledge Investments (Pty) Ltd v Kramer, NO*, the Appellate Division faced a complex scenario arising from a public auction.¹²⁹ An auctioneer reduced the price of a house to a buyer for R40 000.¹³⁰ The court found that this resulted in an oral contract.¹³¹ The signatures of both the auctioneer and the purchaser were appended, where the purchaser signed as an agent on behalf of the company yet to be formed.¹³² The presiding judge in the case, Trollip J explained that after reading the document, he came to the conclusion that a contract of sale was agreed to by the parties.¹³³ Trollip J held that the purpose of signing the document was to record and have certainty of the oral contract concluded by the parties.¹³⁴ In the opinion of Trollip J, such a signed written record of an oral contract sufficiently complied with the requirement in s71 of the 1926 Act.¹³⁵ Therefore, s35 did not reflect significant modifications made to its predecessor, s71 of the 1926 Act. The aspect of a contract having to be in writing did not change from what was contained in s71 of the 1926 Act. The purpose of the formality of writing was merely to ensure that the contents of the contract were certain and readily ascertainable.

The expression "contract made in writing" covered not only written contracts but also oral contracts, which should be reduced to writing.¹³⁶ The word "made" carried a sufficiently broad connotation in the context of embracing both kinds of contracts. Section 35 of the 1973 Act did not make any changes to whether the writing requirement related to written contracts only, or both oral and written contracts.

¹²⁸ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 365.

¹²⁹ *Pledge Investments (Pty) Ltd v Kramer, NO* 1975 (4) All SA (A); 1 (hereafter *Pledge Investments (Pty) Ltd* case).

¹³⁰ *Pledge Investments (Pty) Ltd* case; page 1.

¹³¹ *Pledge Investments (Pty) Ltd* case; page 1-2.

¹³² *Pledge Investments (Pty) Ltd* case; page 6.

¹³³ *Pledge Investments (Pty) Ltd* case; page 6.

¹³⁴ *Pledge Investments (Pty) Ltd* case; pages 6-7.

¹³⁵ *Pledge Investments (Pty) Ltd* case; pages 6-7.

¹³⁶ *Nordis Construction Co (Pty) Ltd v Theron, Burke & Isaac* 1972 (2) All SA 261 (D); para 270.

Therefore, s8 of the Corporate Laws Amendment Act, 2006, amended s35 of the 1973 Act effectively on 14 December 2007.¹³⁷

Before the amendment of s35 of the 1973 Act, the submission of two copies of the pre-incorporation contract was needed. One of those copies was required to be notarised by the Registrar's Office.¹³⁸ Implementing s8 of the Corporate Laws Amendment Act, 2006 removed the requirement to lodge a notarised copy of a pre-incorporation contract. Therefore, companies only needed to lodge the pre-incorporation contract; and one uncertified copy of the relevant pre-incorporation contract would suffice.

Section 8 of the Corporate Laws Amendment Act, 2006 created a kind of statutory law reform by ensuring that a company could ratify a pre-incorporation contract after a person acted as an agent or trustee entered the contract on behalf of the company.¹³⁹ In *McCulloch v Fernwood Estate Ltd*,¹⁴⁰ the court determined that the person signing a pre-incorporation contract would be personally liable if the company had not approved the contract.¹⁴¹

A pre-incorporation contract in terms of s35 of the 1973 Act did not offer third-party protection. Ncube believes that the only form of protection provided to the third-party by s35 was that the promoter had to disclose that he/she was representing a company yet to be incorporated.¹⁴² A warning sign for the third-party was how a promoter disclosed such information to him/her.¹⁴³ For example, how a promoter introduced themselves to a third-party is another provision in s35 of the 1973 Act that presented interpretation challenges.¹⁴⁴ Furthermore, Ncube believes that the third-party was

¹³⁷ Section 8 of the Corporate Law Amendment Act 24 of 2006 speaks to the amendment of section 35 of the Companies Act 61 of 1973. Section 8 stipulates that section 35 of the Companies Act 61 of 1973 is, as a result of this, amended by the substitution for the provision of the following proviso: "Provided that the memorandum of its registration contains as an object such company the ratification or adoption of or the acquisition of rights and obligations in respect of such contract, and that [two copies of] such contract [one of which shall be certified by a notary public,] has been lodged with the Registrar together with the lodgement for registration of the memorandum and articles of the company."

¹³⁸ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal*; 365.

¹³⁹ Mongalo T *Corporate Law & Corporate Governance: A global picture of business undertakings in South Africa* (2003); 204-8.

¹⁴⁰ *McCulloch v Fernwood Estate Ltd* 1920 AD 204.

¹⁴¹ *McCulloch v Fernwood Estate Ltd* 1920 AD 204; para 431.

¹⁴² Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 258.

¹⁴³ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 259.

¹⁴⁴ Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 20.

vulnerable because s35 does not regulate the liability of the promoter and therefore, s35 fails to provide for promoter liability.¹⁴⁵ Ncube makes the point that s35 left third-parties particularly vulnerable because it did not provide for any obligation of a promoter prior to ratification or upon non-ratification due to non-incorporation of the prospective company or a post-incorporation refusal to ratify the pre-incorporation contract by the company.¹⁴⁶ Cassim argues that s35 of the 1973 Act was too restrictive and outdated with modern trends.¹⁴⁷ Hence reform in the form of s21 of the Companies Act 2008 was needed.¹⁴⁸ Therefore, a takeaway from s35 on pre-incorporation contracts was that the section was skewed in favour of promoters and a company to be formed, while a third-party was left vulnerable in the event of something going wrong.¹⁴⁹ The lack of protection of the third party should have provided part of the rationale for including s21 of the Companies Act 2008.

2.2.3 A SUMMARY OF LAW REFORM LEADING TO S21 OF THE COMPANIES ACT 71 OF 2008

Due to s35 of the 1973 Act being heavily skewed in favour of the promoter and company and not the third-party, a fair amount of pressure was applied to the legislature to improve or reform s35 of 1973 Act on pre-incorporation contracts.¹⁵⁰ The legislature drafted and incorporated s21 into the current Companies Act 71 of 2008. Section 21 attempts to improve and reform s35 of the 1973 Act which regulated pre-incorporation contracts.

Section 1 of the Companies Act 2008 defines a pre-incorporation and begins the reform of s35 of the 1973 Act. According to Section 1, a pre-incorporation contract can be defined as:

an agreement entered into before the incorporation of a company by a person who purports to act in the name of, on behalf of, the company, with the intention or

¹⁴⁵ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 259.

¹⁴⁶ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 257.

¹⁴⁷ Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 7.

¹⁴⁸ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 6.

¹⁴⁹ Johnson N *Pre-incorporation contracts in Company Law: A comparative study* (Doctoral thesis, University of the Western Cape, 2000) 183.

¹⁵⁰ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal*; 398.

understanding that the company will be incorporated, and therefore will be bound by the agreement.¹⁵¹

The phrase 'professing to act as a trustee' in s35 of the 1973 Act proved to be problematic as is evident in *Sentrale Kunsmis (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk* (hereafter *Sentrale Kunmis (Edms) Bpk* case).¹⁵² In the *Sentrale Kunmis (Edms) Bpk* case, Trollip J disputed whether s35 of the 1973 Act applied to agency situations alone or also to those situations where a promoter 'professes to act as a trustee'.¹⁵³ The High Court held that the provision pointed to the contract being one by an agent.¹⁵⁴ Section 1 of the Companies Act 2008 attempts to provide certainty on this issue. Section 1 now refers to a person who 'purports to act in the name of, or on behalf of, a company'.¹⁵⁵ When reading s21 in conjunction with s1 of the Companies Act 2008, s21 only applies in cases where the promoter purports to act as an agent and not a trustee when concluding a pre-incorporation contract on behalf of a company yet to be incorporated.¹⁵⁶ A trustee does not act 'in the name of or on behalf of another. A trustee contracts in his/her own name.

Section 21 of the Companies Act 2008 should be viewed through promoting compliance with the Bill of Rights in the company application.¹⁵⁷ By aligning s21 with the Bill of Rights, it gives effect to the notion of the sanctity of a contract¹⁵⁸ which goes hand in hand with freedom of contract.¹⁵⁹ There must be a balancing of freedom of contract on one hand and contractual justice and protection of third-parties on the other hand. Chapter four will analyse s21 of the Companies Act 2008 to establish whether the provision makes room for attaining contractual justice, balanced with other

¹⁵¹ Section 1 of the Companies Act 71 of 2008.

¹⁵² *Sentrale Kunmis* case; para 359.

¹⁵³ *Sentrale Kunmis* case; para 358.

¹⁵⁴ *Sentrale Kunmis* case; para 359.

¹⁵⁵ Section 1 of the Companies Act 71 of 2008.

¹⁵⁶ Section 21 of the Companies Act 71 of 2008.

¹⁵⁷ Mupangavanhu, BM 'Impact of the Constitution's normative framework on the interpretation of provisions of the Companies Act 71 of 2008' (2019) *PER/PELJ* 5-6.

¹⁵⁸ Freedom of contract is meant that the parties are free to decide whether or not to contract, with whom to contract, and on what terms to contract. See Hutchinson D, Pretorius C, Du Plessis J *et al. The Law of Contract in South Africa* 4ed (2022); 27-28.

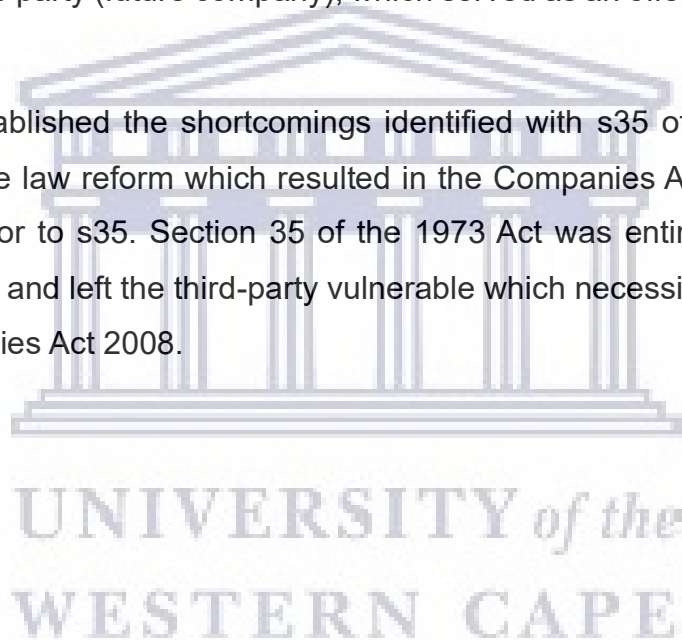
¹⁵⁹ The sanctity of a contract goes hand in hand with freedom of contract. Parties should be free to determine the contents of their contracts free of external control, and the role of the State should, by and large, be limited to enforcing agreements that have been freely concluded. See Hutchinson D, Pretorius C, Du Plessis J *et al. The Law of Contract in South Africa* 4ed (2022); 27.

concepts above, seeing that s35 was skewed in favour of the promoter or company while leaving the third-party vulnerable.¹⁶⁰

2.3 CONCLUSION

Chapter Two managed to establish that South Africa has been progressive since 1926 as expressing in statute a provision to bypass the common law hurdle in *Kelner v Baxter* which made it difficult for anyone to act on behalf of a company yet to be formed, and thus secure assets or opportunities ahead of incorporation. Prior to 1926, the only way to secure benefits for a company yet to be formed was through the common law method, the *stipulatio alteri*, which was a contract between two principals for the benefit of a third-party (future company), which served as an offer to a company to be formed.

This chapter also established the shortcomings identified with s35 of the 1973 Act which necessitated the law reform which resulted in the Companies Act 2008 and a s21 that is a successor to s35. Section 35 of the 1973 Act was entirely skewed in favour of the promoter and left the third-party vulnerable which necessitated the need for s21 of the Companies Act 2008.



¹⁶⁰ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 6.

CHAPTER THREE: INTERNATIONAL BEST PRACTICES ON MODERN PRE-INCORPORATION CONTRACTS

3.1 INTRODUCTION

The aim of Chapter Three is to consider the role of international best practices drawn from Australia and Canada in assisting with the interpretation of s21 and in contributing to possible future reform of the statutory pre-incorporation contract provisions in South Africa. It is for this reason that this mini-thesis deliberately sets out to assess the contribution of international best practices from the aforementioned comparators of choice in aiding interpretation of s21 and possible future reform. This chapter seeks to answer the relevant research question: what can South Africa learn from international best practices to better inform interpretation, to guide future law reform and in view of improving pre-incorporation standards in s21 of the Companies Act 2008? Australia is the first jurisdiction to be examined regarding the similarities and differences with the statutory pre-incorporation contracts as provided in s21 of the Companies Act 2008. Thereafter, an analysis of pre-incorporation contracts in Canada will follow. The analysis of international best practices in terms of the position of parties in a pre-incorporation contract will be addressed in Chapter Three.

3.2 AUSTRALIA

3.2.1 The common law prior to statutory reforms

One of the identified shortcomings of the common law pertained to its prohibition to adopt pre-incorporation contracts upon before its incorporation.¹⁶¹ The common law position created many practical difficulties and could create instances where the third-party and company were not bound, despite intending to be bound to the pre-incorporation contract.¹⁶²

Another issue was that the common law did not specify the correct legal test to determine whether the promoter or agent was liable in terms of the pre-incorporation contract.¹⁶³ There was uncertainty as to whether the parties' intention could be derived

¹⁶¹ *Kelner* case; para 174. See also *Natal Land Co v Pauline Colliery and Development Syndicate Ltd* [1904] AC; para 120 and *North Sydney Tramway Co v Higgins* [1899] AC; para 263.

¹⁶² Victorian Law Reform Commissioner, Report 8, *Pre-incorporation contracts* (1979); para 14-5.

¹⁶³ described by Oliver LJ in *Phonogram Ltd v Lane* [1981] 3 WLR 736; para 741-2. Oliver LJ preferred a test of "the real intent revealed by the contract". See also Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8 *Adelaide Law Review* 122.

from extrinsic circumstances or could be found in the specifics of the written agreement because liability was not apportioned where it needed to be.¹⁶⁴ The difficulty around liability was whether the parties needed to have the intention to be bound, if it depended on the parties' knowledge, or whether a party's signature could determine personal liability.¹⁶⁵

The respective legislature countered the common law position by enacting legislation as it was clear that problems would arise because of issues found with the common law position. The inadequate legal protection and remedies for a third-party were insufficient.¹⁶⁶ The Australian Corporations Act 50 of 2001 (hereafter the Corporations Act 2001), which sought to correct the anomalies at common law, is discussed below. The Corporations Act 2001 was enacted to solve these problems and provide a better form of protection to third-parties.

3.2.2 CORPORATIONS ACT 50 OF 2001 AND AUSTRALIAN STATUTORY PRE-INCORPORATION CONTRACTS

3.2.2.1 Sections 131 and 132 of the Australian Corporations Act 2001

It has been suggested that the most comprehensive and complex provisions in the statutory form of the pre-incorporation contract are those in Australia.¹⁶⁷ In Australia, s131 and s132 of the Corporations Act 2001 are the relevant provisions relating to pre-incorporation contracts.¹⁶⁸

¹⁶⁴ Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8 *Adelaide Law Review* 120.

¹⁶⁵ *Marblestone Industries Ltd v Fairchild* (1975) 1 NZLR; para 542. See also *Vickery v Wood* (1952) 85 CLR 336; para 343-44 and *Phonogram Ltd v Lane* (1981) 3 WLR 736; para 741-42.

¹⁶⁶ *Black v Smallwood* (1966) 117 CLR 52; para 61.

¹⁶⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 366.

¹⁶⁸ Section 131 and Section 132 of the Corporations Act 50 of 2001 reads as follows: 131 Contracts before registration

"(1) If a person enters into, or purports to enter into, a contract on behalf of, or for the benefit of, a company before it is registered, the company becomes bound by the contract and entitled to its benefit if the company, or a company that is reasonably identifiable with it, is registered and ratifies the contract: (a) within the time agreed to by the parties to the contract; or (b) if there is no agreed time--within a reasonable time after the contract is entered into.

(2) The person is liable to pay damages to each other party to the pre-registration contract if the company is not registered, or the company is registered but does not ratify the contract or enter into a substitute for it: (a) within the time agreed to by the parties to the contract; or (b) if there is no agreed time--within a reasonable time after the contract is entered into. The amount that the person is liable to pay to a party is the amount the company would be liable to pay to the party if the company had ratified the contract and then did not perform it at all.

(3) If proceedings are brought to recover damages under subsection (2) because the company is registered but does not ratify the pre-registration contract or enter into a substitute for it, the court may do anything that it considers appropriate in the circumstances, including ordering the company

Section 131 and s132 of the Corporations Act 2001 exclude the use of other rule of law applicable to rights and liabilities of parties in pre-incorporation contracts.¹⁶⁹ In terms of s131 and s132 of the Corporations Act 2001, a contract entered into purportedly on behalf of a company or that benefits that company may be ratified, provided the company is registered within the period stipulated in the pre-incorporation contract or fails within a reasonable period after that. At that point, the company becomes bound to the pre-incorporation contract and is entitled to any benefit it confers.¹⁷⁰

Damages are payable by the promoter if the company is not registered or if it does not ratify the pre-incorporation contract agreed upon by the parties.¹⁷¹ The assessment of damages is made on the basis that the company entered a pre-incorporation contract but subsequently failed in its performance.¹⁷² When the company has been registered, a court may order it to compensate all or part of the promoter's burden and make payments received by the pre-incorporation contract.¹⁷³ The promoter may receive a release from the third-party waiving liability but is not entitled to an indemnity from the company.¹⁷⁴

Based on the above, s131 and s132 of the Corporations Act 2001 attempts to provide statutory relief and protection to all parties involved in a pre-incorporation contract by balancing the conflicting rights and liabilities of the promoter, company, and third-party.

to do 1 or more of the following: (a) pay all or part of the damages that the person is liable to pay (b) transfer property that the company received because of the contract to a party to the contract (c) pay an amount to a party to the contract.

(4) If the company ratifies the pre-registration contract but fails to perform all or part of it, the court may order the person to pay all or part of the damages that the company is ordered to pay.

132 Person may be released from liability but is not entitled to indemnity-

(1) A party to the pre-registration contract may release the person from all or part of their liability under section 131 to the party by signing a release.

(2) Despite any rule of law or equity, the person does not have any right of indemnity against the company in respect of the person's liability under this Part. This is so even if the person was acting, or purporting to act, as trustee for the company. 133 This Part replaces other rights and liabilities.”

¹⁶⁹ Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8 *Adelaide Law Review* 133. See Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 399.

¹⁷⁰ Section 131(1) of the Corporations Act 50 of 2001. See also Ford HA, Austin RP & Ramsey IM *Ford's principles of Corporations Law* 9ed (1999); para 15.

¹⁷¹ Section 131(3) of the Corporations Act 50 of 2001. See Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 383.

¹⁷² Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 370.

¹⁷³ Section 131(4) of the Corporations Act 50 of 2001.

¹⁷⁴ Section 132(2) of the Corporations Act 50 of 2001.

3.2.2.2 Third-party protection in statutory pre-incorporation contracts

Third-party protection can be implemented in many ways. Some jurisdictions use the method of rendering the promoter personally liable in terms of a pre-incorporation contract pending ratification by the company.¹⁷⁵ Another method is to hold the promoter liable for damages for breach of a statutory implied warranty that the company will be incorporated within a reasonable time and that it will within a reasonable time after its incorporation ratify the pre-incorporation contract, which is the approach followed by Australia.¹⁷⁶ The practical ramifications of the statutory warranty approach require consideration, particularly regarding the interim period before ratification.¹⁷⁷ There is effectively no pre-incorporation during the interim period if the promoter is not held personally liable for the pre-incorporation contract. If the statutory implied warranty approach is to be followed, the parties' positions during the interim period must be clarified by legislation.¹⁷⁸

Another question from the statutory warranty approach was who would be liable for damages when there was more than one promoter in the pre-incorporation contract. The statutory provisions of Australia imposed liability on the signatory to the pre-incorporation contract in terms of s131(1).¹⁷⁹ Imposing liability on the signatory to the pre-incorporation contract, however, led to inequitable results, as pointed out in the case of *Bay v Illawarra Stationery Supplies (Pty) Ltd*.¹⁸⁰ (hereafter, the *Bay* case). In the *Bay* case, four promoters used the services of Dyke, as their promoter to conclude a pre-incorporation contract with Illawarra.¹⁸¹ Upon the breach of the statutory warranty of the pre-incorporation contract, Illawarra claimed payment of damages.¹⁸² The statutory warranty approach rendered the four promoters liable for damages because the four promoters acted as principals for the company.¹⁸³ The court rejected

¹⁷⁵ See section 14 of the Canada Business Corporations Act, 1985 and section 72 of the Nigeria Companies and Allied Matters Act, 1990.

¹⁷⁶ Ford HA, Austin RP & Ramsey IM *Ford's principles of Corporations Law* 9ed (1999); para 549.

¹⁷⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 371.

¹⁷⁸ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 371. See also Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8 *Adelaide Law Review* 148.

¹⁷⁹ Section 131(1) of the Corporations Act 50 of 2001.

¹⁸⁰ *Bay v Illawarra Stationery Supplies (Pty) Ltd* 1986 (4) ACLC; para 429 (hereafter *Bay* case).

¹⁸¹ *Bay* case; para 429.

¹⁸² *Bay* case; para 429.

¹⁸³ *Bay* case; para 429-31.

the claim for damages by Illawara. The court stated that only Dyke was liable for breach of the statutory warranty even if he was merely the promoters' agent.¹⁸⁴ The result of the *Bay* case was that the signatory could be held liable.¹⁸⁵ It was worth noting that in most cases, only one promoter signed the pre-incorporation contract and was held liable if the company did not incorporate or did not ratify the pre-incorporation contract. The position in which the promoter found him/herself, one can ask what the limitations regarding the promoter's liability are and whether Australian law protects both the promoter and third-party in a pre-incorporation contract.

3.2.2.3 The limitations on the promoter's liability and third-party protection

Based on Australian company law, when a pre-incorporation contract is not ratified but is substituted by a contract between the company and a third-party on the same terms, the promoter should be released from liability because of the company's failure to ratify the pre-incorporation contract.¹⁸⁶ Concerning a group of promoters who acted on behalf of the company, it is inequitable in certain circumstances to impose liability on the agent for the failure of ratification or of incorporation within a reasonable time where a group of promoters become executive directors and refuse to ratify the pre-incorporation signed by one of them.¹⁸⁷ Thus it has been held that the court should be granted a discretion where it would be just and equitable to do so, to relieve the promoter from his/her liability for breach of dual warranty and to impose secondary liability instead of the company for the breach of warranty.¹⁸⁸

An expressed exemption from liability, as agreed between the promoter and the third-party, should provide a third way of limiting the promoter's liability.¹⁸⁹ The third-party may not be aware of the legal complexities and implications of a contract made on behalf of a company that is not yet in existence. The Australian legislature has gone so far as to suggest that a prescribed standard exemption form should be introduced to release the promoter from liability. The inclusion of an exemption clause provides

¹⁸⁴ *Bay* case; para 433.

¹⁸⁵ *Bay* case; para 433.

¹⁸⁶ Section 131(2) of the Corporations Act 50 of 2001.

¹⁸⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 378.

¹⁸⁸ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 379-80.

¹⁸⁹ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 378.

for a desirable protective mechanism in the current South African business environment.¹⁹⁰

The identified challenges associated with the common law are to the allocation of liability in pre-incorporation contracts and safeguarding of third-party interest. Sections 131 and 132 of the Australian Corporations Act 2001 attempted to provide clarity on the aforementioned challenges. It was challenging for s131 and s132 to provide guidance regarding a group of promoters who acted on behalf of the company. Hence, it is useful to examine Canada's approach to the attribution of liability in pre-incorporation contracts and the safeguarding of third-party interests.

3.3 CANADA

3.3.1 The common law prior to statutory reforms

The federal government of Canada has prioritised pre-incorporation contracts.¹⁹¹ Pre-incorporation contracts are governed differently by the federal government than in the Ontario province.¹⁹² This section of analysis will specifically refer to how Canada deals with the common law position regarding pre-incorporation contracts and the development of statutory provisions in Canada.

Before enacting legislation for pre-incorporation contracts, pre-incorporation contracts were governed by common law principles like in the case of Australia. According to the common law, a party must have the legal capacity to perform a function that another party wishes to perform on its behalf.¹⁹³ This rule was extended to pre-incorporation contracts.¹⁹⁴ In common law, a promoter who entered into a contract on behalf of an unincorporated company was held personally liable for the contract's failure.

¹⁹⁰ *Hall-Thermostat Natal (Pty) Ltd v Hardman* 1968 (4) SA 818 (D) where Henning J stated "I know of no rule in our law, and counsel did not refer to any authority, to the effect that an exemption clause does not avail a party who has committed a fundamental breach of contract. It appears to me that such a clause, like other terms and conditions, must be construed in the light of the provisions of the contract as a whole." See also *Gov RSA (Dept of Ind) v Fibre Spinners and Weavers* 1977 (2) SA 324; para 339.

¹⁹¹ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 32.

¹⁹² Etsey W 'Pre-incorporation contracts: The fog is finally lifting' (2000) 33 *Canadian Business Law Journal* 10.

¹⁹³ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 31.

¹⁹⁴ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 31.

A third-party could only enforce a pre-incorporation contract if he engaged into a new contract with the company after its incorporation, according to the position held in *Kelner v Baxter*.¹⁹⁵ The position of the common law could be attributed to its devotion to the company's legal status which holds that a company cannot confer any right to a person to act on its behalf until incorporation.¹⁹⁶ The common law rule created hardship on promoters because the company could not ratify the contract after it has been incorporated.¹⁹⁷ In other words, the promoter remained personally liable even if the company subsequently adopted the pre-incorporation contract. The common law rule is defective because it fails to consider the reasonable expectation of the promoter that the company on whose behalf, he entered the contract would be liable under the contract.¹⁹⁸

As a result of the common law rule, it could deprive the company of contracts that would have been beneficial to it upon incorporation and ratification. It is against these backgrounds that the common law is not as successful in either facilitating transactions, or in meeting the reasonable expectation of the parties. Canada and Australia are among countries in the common law jurisdiction that have statutorily repealed this critical area of company law.

3.3.2 THE CANADA BUSINESS CORPORATIONS ACT 1985 AND STATUTORY PRE-INCORPORATION CONTRACTS

3.3.2.1 Section 14 of the Canada Business Corporations Act 1985

Most of the provinces in Canada apply the common law rules on company law.¹⁹⁹ As a result, most of them adopted the common law rule on pre-incorporation contracts.²⁰⁰ Owing to the defects inherent in the law on pre-incorporation contracts at the common law, the province of Ontario and the federal government of Canada made frantic efforts to reform the common law through a statutory scheme.²⁰¹

¹⁹⁵ Gillen M *Corporations and partnerships in Canada* (2018) 54. See also part 1.2 in chapter 1.

¹⁹⁶ Stanford Intramural Law Review 'Outmoded concepts dominate law of promoters' (1948) 2 *Stanford Law Review* 120.

¹⁹⁷ Puri P 'The promise of uncertainty in the law of pre-incorporation contracts' (2001) 80(3) *Canadian Bar Review* 1051.

¹⁹⁸ MacPherson D 'Law reform in corporate/commercial law in Manitoba' (2012) 35(2) *Manitoba Law Review* 50.

¹⁹⁹ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 32.

²⁰⁰ *Wickberg v Shatsky* 1969 (4) D.L.R.; para 540.

²⁰¹ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 32.

At the federal level, the government established the Dickerson Committee (hereafter the Committee) who recommended that the common law rule on pre-incorporation contracts should be reviewed.²⁰² The Committee adopted the provision in s21 of the Ontario Business Corporations Act 1970 (hereafter OBCA) which exempted the promoter from liability once the company adopted the contract.²⁰³ Further, the Committee recommended that the promoter could insert a clause in the contract that would expressly waive his liability and courts should uphold such clause. Similar to the provisions of the OBCA, the Committee proposed that courts should exercise their discretion in apportioning liability between the company and the promoter upon an application by the third-party.²⁰⁴ These recommendations informed the provisions of s14 of the Canada Business Corporations Act 1985 (hereafter CBCA).²⁰⁵

For analytical purposes, it is important to state the provisions of s14 of the CBCA.²⁰⁶ Section 14(1) of the CBCA provides that: “subject to this section, a person who enters into, or purports to enter into a written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to its benefits.”²⁰⁷

²⁰² Etsey W ‘Pre-incorporation contracts: The fog is finally lifting’ (2000) 33 *Canadian Business Law Journal* 11.

²⁰³ Section 21 of the Ontario Business Corporations Act 1970.

²⁰⁴ Puri P ‘The promise of uncertainty in the law of pre-incorporation contracts’ (2001) 80(3) *Canadian Bar Review* 1054.

²⁰⁵ Section 14 of the Canada Business Corporations Act, 1985 reads as follows:

“(1) Subject to this section, a person who enters into, or purports to enter into a written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to its benefits thereof.

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt a written contract made before it came into existence in its name or on its behalf, and on such adoption (a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto ; and (b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

(3) Subject to subsection (4), whether or not a written contract made before the coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order respecting the nature and extent of the obligations and liability under the contract of the corporation and the person who entered into, or purported to enter into, the contract in the name of or on behalf of the corporation. On the application the court may make any order it thinks fit.

(4) If expressly so provided in the written contract, a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof.”

²⁰⁶ Section 14 of the Canada Business Corporations Act, 1985.

²⁰⁷ Section 14(1) of the Canada Business Corporations Act, 1985.

Section 14(2) of the CBCA allows a company to adopt an existing written contract within a reasonable time after its incorporation by action or conduct indicating intent to be bound.²⁰⁸ Upon adoption of the contract, the company is bound by the agreement and entitled to its benefits as if it had existed at the time of the agreement and was a party to it.²⁰⁹

The CBCA also provides that subject to s14(3), after the company adopts the pre-incorporation contract, the promoter acting on behalf of the company no longer holds any contractual obligations or benefits.²¹⁰ Further, s14(3) provides that subject to s14(4), whether or not a pre-incorporation contract is adopted by the company, a third-party can seek court orders regarding the obligations and liabilities of the company and the promoter who entered into the contract on its behalf.²¹¹ The CBCA, in terms of s14(3), permits the court to issue any order that deems appropriate given the prevailing circumstances.²¹²

The CBCA deals with pre-incorporation contracts in s14.²¹³ The CBCA balances the conflicting interests of the company, promoter and third party by making the promoter personally liable with a co-existent right to benefits.²¹⁴ There are three principles which are discussed in s14 of the CBCA. The first principle is that a promoter will be personally liable if the company refuses to adopt or ratify a pre-incorporation contract. Personal liability is found in s14(1) of the CBCA.²¹⁵ Canadian law is best described as following the best and most formal manner of adoption by way of the BOD deciding on whether or not to adopt the pre-incorporation contract.²¹⁶ A legal contract can be inferred from the statutory provisions that specify that the promoter is personally bound. If the promoter is personally bound, then a contract exists which can be adopted later by the corporation.²¹⁷

²⁰⁸ Section 14(2) of the Canada Business Corporations Act, 1985.

²⁰⁹ Section 14(2) of the Canada Business Corporations Act, 1985.

²¹⁰ Section 14(3) of the Canada Business Corporations Act, 1985.

²¹¹ Section 14(4) of the Canada Business Corporations Act, 1985.

²¹² Section 14(3) of the Canada Business Corporations Act, 1985.

²¹³ Section 14 of the Canada Business Corporations Act, 1985.

²¹⁴ Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 411.

²¹⁵ Section 14(1) of the Canada Business Corporations Act, 1985.

²¹⁶ Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 411.

²¹⁷ *Gargatzidis v. South Towne Developments Ltd. and MacPherson, Leslie & Tyerman* (1980) 6 SASK R 151 (QB); para 155.

The second principle is that a party to a pre-incorporation contract may apply to a competent court to address the liability issues experienced by the parties.²¹⁸ This principle would balance the pressing situation between a promoter and a company in pre-incorporation contracts. Mere silence, however, of the BOD or its failure to object when a claim is made on a pre-incorporation contract is not enough, although it might indicate an intention to adopt some or all the liability.²¹⁹ The most apparent evidence of adoption by conduct is performance by the company in terms of the pre-incorporation contract or acceptance of the benefits of the pre-incorporation contract.²²⁰

The final provision of the CBCA refers to when an exemption clause is incorporated in a pre-incorporation contract. The promoter is exempt from liability even if the company does not ratify or adopt the pre-incorporation contract.²²¹ Even if the corporation does not adopt the contract, the promoter may still be relieved from liability either because the contract so provided or because the court is willing to exempt the promoter.²²² This position was held in the common law case of *Diary Supplies v Fuchs* (hereafter *Diary Supplies* case), where the court held that if sufficient evidence points to the promoter being exempted from personal liability, a third-party cannot sue a promoter.²²³ In contrast to what the court decided in the *Dairy Supplies* case, the court in *Landmark Inns of Canada Ltd v Horeak* (hereafter *Landmarks Inns* case) rejected this argument.²²⁴ In the *Landmark Inns* case, the court held that the contract must contain a specific and clear provision exempting the promoter from liability.²²⁵

The provisions of s14 of the CBCA are commendable. The provisions recognise the fact that as a matter of business interests, the promoter, unlike the third-party, is normally in control of the pre-incorporation contract until the company either adopt or ratify the pre-incorporation contract.²²⁶ As noted, in terms of s14(2), it could be argued

²¹⁸ Etsey W 'Pre-incorporation contracts: The fog is finally lifting' (2000) 33 *Canadian Business Law Journal* 12.

²¹⁹ *Stone v First Wyoming Bank* (1980) 2d 332; para 625F.

²²⁰ *Dealers' Granite Corp. v Faubion* (1929) 2d 737; para 18.

²²¹ Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 411.

²²² Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 426.

²²³ *Dairy Supplies Ltd v Fuchs* (1959) 18 D.L.R (2d) 408.

²²⁴ *Landmark Inns of Canada Ltd v Horeak* (1982) 2 WWR 377.

²²⁵ *Landmark Inns of Canada Ltd v Horeak* (1982) 2 WWR 377; para 18.

²²⁶ Dickerson R, Howard J & Getz L *Proposal for a new business corporations law for Canada* (1971) 54.

that the provision seek to protect the company.²²⁷ The provisions will allow the company the opportunity to evaluate and determine the extent to which the contract would be beneficial to it.²²⁸

3.3.2.2 Third-party protection in statutory pre-incorporation contracts

The provisions of the CBCA will, however, work a hardship on a third-party and the promoter because they fail to provide the timeframe within which the company should be incorporated.²²⁹ A company may take advantage of the provisions against the third-party or even the promoter through late incorporation.²³⁰ The implications of this is that where time is of the essence in the contract, a third-party or the promoter would incur losses. The defect also applies to the principle of adoption within a reasonable time. The use of the phrase “may” in the CBCA seems to be permissive and not mandatory.

A company could exercise its discretion in such a manner that would harm a third-party and a promoter. For instance, the provision would not bode well for a third-party and a promoter where the subject matter of the contract is a perishable good or involves a contract that accrues interest rates against a third-party or a promoter.

In the case of *Shoppers Drug Mart Inc. v. 6470360 Canada Inc*, Shoppers Drug Mart executed an agreement with Energyshop Consulting Inc to manage and pay its utility bills across Canada in October 2005.²³¹ In terms of the contract, Mr. Beamish acted on behalf of Energyshop, which at the material time of the contract was not registered. After some weeks of the execution of the agreement, Beamish registered 6470360 Canada Inc as Energyshop Consulting Inc./Powerhouse Energy Management Inc (hereafter 647).²³² Both Shoppers Drug Mart and 647 did not formally sign the 2005 contract but they consented that the agreement would be binding upon them and that they could comply with their obligations in terms of the agreement.²³³ The contractual obligation of Shoppers Drug Mart was to direct utility firms to forward their bills to

²²⁷ Section 14(2) of the Canada Business Corporations Act, 1985.

²²⁸ Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 430.

²²⁹ Perrel P 'Pre-incorporation contracts and 1394918 Ontario Ltd v 1310210 Ontario Inc Some answers, some questions' (2002) 37(2) *Canadian Business Law Journal* 303.

²³⁰ Perrel P 'Pre-incorporation contracts and 1394918 Ontario Ltd v 1310210 Ontario Inc Some answers, some questions' (2002) 37(2) *Canadian Business Law Journal* 304.

²³¹ *Shoppers Drug Mart v. 6470360 Canada Inc* (2014) 314 O.A.C. 341 (CA) (hereafter *Shoppers Drug Mart case*).

²³² *Shoppers Drug Mart case*; para 5.

²³³ *Shoppers Drug Mart case*; para 6.

Energysshop. 647 collected and arranged the bill and occasionally forwarded to Shoppers Drug Mart the invoice of the gross utility fees it collected from firms and the cost it incurred in processing the bills.²³⁴ Thereafter, Shoppers Drug Mart would transmit the invoiced sum to a designated clearing account opened in the name of 647 and Mr. Beamish at TD Bank.²³⁵ Another operating account was opened in the names of 647 and Mr. Beamish through which 647 used the monies it got from Shoppers Drug Mart to pay Shoppers Drug Mart's utility bill or 647's operating expenditures.²³⁶ In August 2008, Shoppers Drug Mart got an anonymous telephone call and fax showing that the funds it had deposited in the clearing account for the purpose of offsetting its utility bills were not used for the purpose.²³⁷ Instead, they were used for other purposes. Miffed by this, Shoppers Drug Mart terminated the contract with 647.²³⁸ It also instituted an action against 647 and Mr. Beamish personally to recover the monies that were not used for the purpose for which they were given to 647.²³⁹ Shoppers Drug Mart, which thought that Energysshop was registered, only became aware that it was not incorporated after it instituted the action.²⁴⁰ Also, it was not aware of the existence of 647 until after it instituted the claim.²⁴¹ On the issue of whether 647 adopted the contract, the court held that by its acts, it signified its intention to be bound by the contract and thereby affirmatively adopted the contract; and that no formal adoption was required to satisfy the provision of s14(2) of the CBCA.²⁴²

The provisions of s14 of the CBCA seem to be more favourable to the promoter and third-party. The provisions strongly attempt to resolve the uncertainty that prevailed at common law where promoters and third-parties were locked in disputes whenever companies on whose behalf pre-incorporation contracts were entered into were not incorporated. The s14 provisions may incentivise the promoter to take reasonable steps to incorporate the company and avoid personal liability. On the contrary, a promoter could impede the process in terms of the provisions to frustrate the

²³⁴ *Shoppers Drug Mart* case; para 9.

²³⁵ *Shoppers Drug Mart* case; para 10.

²³⁶ *Shoppers Drug Mart* case; para 12.

²³⁷ *Shoppers Drug Mart* case; para 12-3.

²³⁸ *Shoppers Drug Mart* case; para 14.

²³⁹ *Shoppers Drug Mart* case; para 17-8.

²⁴⁰ *Shoppers Drug Mart* case; para 18.

²⁴¹ *Shoppers Drug Mart* case; para 8.

²⁴² *Shoppers Drug Mart* case; para 35.

incorporation of the company so that he/she would take the benefits arising from a profitable agreement.

3.4 CONSIDERATIONS OF WHAT SOUTH AFRICA CAN LEARN FROM AUSTRALIA AND CANADA

3.4.1 Determining promoters' rights and liabilities in pre-incorporation contracts

As stated in part 3.2.2 above,²⁴³ Australia imposes statutory warranty liability on the promoter and Canada imposes personal liability on the promoter of the pre-incorporation contract.

In Australia, the Corporations Act 2001 attempts to correct the deficiencies of the common law as it applies to pre-incorporation contracts. The statutory remedy provided in s131 and s132 in most cases provides the third-party with a more substantial remedy than would have been available at common law.²⁴⁴ The statutory warranty approach may be important where the company have deeper pockets than the promoter who bears the statutory liability, or where the company has obtained some benefit that the third-party seeks to have discharged.²⁴⁵

In terms of Australia, when the company fails to be incorporated, or becomes incorporated but then is insolvent, the third-party will be able to recover, at best nominal damages from the promoter.²⁴⁶ This is because in these circumstances, the third-party would have been able to recover nothing, or at best the nominal amount, from the principal company for non-performance.²⁴⁷ This analysis suggests that the action for breach of warranty of authority should be available in terms of s131-s133 of the Corporations Act 2001. Section 133 of the Corporations Act 2001 only affects rights or liabilities with respect to the pre-incorporation contract. An action for breach of warranty is based on a separate contract between the promoter and the third-party.²⁴⁸ Even if the promoter raises estoppel, it is clearly not an action taken by the third-party

²⁴³ See in particular, part 3.2.2.2 above.

²⁴⁴ Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 244.

²⁴⁵ Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 244.

²⁴⁶ *Delta Construction Company Ltd v Lidstone* 1979 (96) DLR (3d); para 462.

²⁴⁷ Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8 *Adelaide Law Review* 126.

²⁴⁸ Section 133 of the Corporations Act 2001.

based on the pre-incorporation contract.²⁴⁹ The action for breach of warranty of authority is based on the amount that the company would be liable to pay in an action against it for non-performance, rather than what the third-party could ultimately recover from the company.²⁵⁰ In Canada, it is on the strength of the discretionary powers granted to the court to determine how to apportion liability upon an application of a third-party that the provisions of the CBCA is better suited to provide an opportunity for third-parties to make a choice of debtors or obligators through courts.²⁵¹

The legislature of the Canadian jurisdiction provides that adoption of a pre-incorporation contract can be by way of an action or conduct, thus signifying the company's intention to be bound by the pre-incorporation contract.²⁵² As such, the parties can be certain of some factors, namely the company must perform some act or acts.²⁵³ The performance of the act or acts must be with knowledge of the terms of the contract which is in the nature of intention.²⁵⁴ This implies that the company is deemed to have adopted the contract and the promoter is relieved of liability for the contract, subject to a court application to apportion liabilities.²⁵⁵

3.5 CONCLUSION

This chapter has demonstrated that the inevitability and importance of the concept of pre-incorporation contracts in the business world cannot be over-emphasised. Pre-incorporation contracts allow companies to set important agreements in motion before the actual incorporation. This concept suffered severe deficits and uncertainty in terms of the common law jurisprudence.

This chapter has shown that although the provisions in the Corporations Act 2001 and CBCA have, through statutory reform, attempted to address the challenges in the

²⁴⁹ Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 242.

²⁵⁰ Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 242.

²⁵¹ Ubochioma W 'Pre-incorporation contract: A comparative analysis of the Canadian and Nigerian corporate law regime' (2021) 3 *Corporate Law & Governance Review* 40.

²⁵² Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 409.

²⁵³ Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) *Canadian Business Law Journal* 439.

²⁵⁴ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 21.

²⁵⁵ Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 21-2.

application of the common law rule, they have not completely eradicated them. The provisions of the Corporations Act 2001 and CBCA have achieved a greater milestone in the protection of the company, the promoter, and third-parties through the principles of apportionment of liability, the rule on reasonable time for adoption of the contract, and what amounts to adoption by the company.

Notwithstanding the milestone achieved by the Corporations Act 2001 and CBCA, it is suggested that the laws should be reformed in the area of reasonable time for the adoption of pre-incorporation contracts. The laws should state with certainty what amounts to reasonable time and the implication of the fact of non-adoption after the passage of the time.



CHAPTER FOUR: A CRITICAL ANALYSIS OF SECTION 21 OF THE COMPANIES ACT 71 OF 2008

4.1 INTRODUCTION

The aim of Chapter Four is to consider how s21 can be interpreted to balance the equitable protection and sharing of risks between the promoter and the third-party in the case of the non-incorporation of the company or the non-ratification of the pre-incorporation contract by the company.

Chapter Four also attempts to determine whether s21 is properly aligned with s7(a) of the Companies Act 2008's goal of promoting the fair realisation and enjoyment of rights by parties in a pre-incorporation contract. In addition, the chapter adopts a thematic approach to the analysis of the critical provisions of s21. The analysis of s21 focuses on themes such as formalities under the section, promoter's statutory agency status, issues of ratification and retrospective effect of the s21 contract, liabilities of parties, remedies available to affected parties, third party protection and a commentary on any gaps identified in the analysis.

4.2 THE ANALYTICAL FRAMEWORK OF SECTION 21 PROVISIONS

4.2.1 Examination of international best practices

Section 5(2) of the Companies Act 2008 permits courts to the extent appropriate to consider foreign company law when interpreting or applying the Act. It is, therefore, permissible to learn from international best practices to act as a guide for future law reform.

The Corporations Act 2001 imposes a high level of liability on the promoter of a pre-incorporation contract.²⁵⁶ Section 132(1) of the Corporations Act 2001 allows the promoter to be released from this liability if the other parties to the contract sign a release of liability.²⁵⁷ Section 132(2) of the Corporations Act 2001 states that after the release, the promoter will not have any right of indemnity against the company regarding their liability in terms of the law on pre-incorporation contracts.²⁵⁸

²⁵⁶ Section 131(2) of the Corporations Act 50 of 2001.

²⁵⁷ Section 132(1) of the Corporations Act 50 of 2001.

²⁵⁸ Section 132(2) of the Corporations Act 50 of 2001.

From the analysis of the statutory warranty approach followed by Australia, the approach ensures that somebody has to bear the loss and it falls upon the party who has failed to verify, or to realise the significance of the company's non-existence at the time of contracting.²⁵⁹

The statutory provisions were intended to provide a complete set of default rules on pre-incorporation contracts. At common law, courts have held that if the parties intended that only the company would be liable, then no contract can be formed because the company does not exist at the time of contracting.²⁶⁰ A contract formed under such circumstances is a nullity in terms of common law.²⁶¹ On the contrary, the legislative pre-incorporation provisions seem to assume that a valid contract has been formed and that the only issue is who is liable in terms of the pre-incorporation contract.²⁶² The statute may read as saying that once a company adopts a pre-incorporation contracts, this action is sufficient to validate the contract.²⁶³ In cases where the company does not adopt the contract or where the company is never formed, it is more difficult to assume that a contract has been created which can then be placed on the promoter.²⁶⁴

There remains a policy issue in Canada jurisprudence. The policy issue that remains to be addressed in relation to pre-incorporation contracts is whether it is the promoter or third-party that ought to bear the risk of loss when a company is not formed or does not adopt a pre-incorporation contract.²⁶⁵ The promoter is almost always in the best position to determine if and when a company will come into existence.²⁶⁶ Even when parties mistakenly believe a company to be in existence, it appears that the promoter, rather than the third-party, ought to know the true nature of the ostensible company.²⁶⁷ An argument can be advanced that where a third-party is a sophisticated lender who has experience with pre-incorporation contracts, s/he should bear some of the risk of loss.

²⁵⁹ See part 3.2.2.1 in chapter 3.

²⁶⁰ See part 3.3.1 in chapter 3.

²⁶¹ See part 3.3.1 in chapter 3.

²⁶² See part 3.3.2.1 in chapter 3.

²⁶³ See part 3.2.2.2 in chapter 3.

²⁶⁴ See part 3.3.2.1 in chapter 3.

²⁶⁵ See part 3.3.2.2 in chapter 3.

²⁶⁶ See part 3.3.2.2 in chapter 3.

²⁶⁷ See part 3.3.2.2 in chapter 3.

In the context of South African company law, there exists the option for companies to adopt either the statutory warranty approach or the personal liability approach. The issues that come up are whether imposing personal liability on the promoter or providing statutory warranty guarantees better third-party protection. Furthermore, in the case of fly-by-night companies, would a statutory warranty guarantee a third-party the right to recover any benefits accrued to the promoter? This illustrates how important it is to assign the appropriate kind of liability in South African company law.

4.2.2 A contextual interpretation of section 21 of the Companies Act 2008

South Africa was historically progressive in providing a legislative solution to the conundrum of pre-incorporation contracts.²⁶⁸ South Africa was among the first jurisdictions to enact such statutory provisions through s71 of the 1926 Act, followed by s35 of the 1973 Act, which is the predecessor of s21 of the Companies Act 2008.²⁶⁹ Section 35 of the 1973 Act needed to be reformed because of the multitude of practical problems encountered with it.²⁷⁰ There was a challenge with its fundamental underlying policy namely, matters of contractual injustice.²⁷¹ As already established in this study,²⁷² the fundamental underlying policy of the Companies Act 2008 is to be seen through the contextual interpretation which the Act itself provides for. Again, as already stated,²⁷³ the Act is to be interpreted in a manner that gives effect to its twelve purposes provided for in s7.²⁷⁴ One of these purposes demands an alignment with the spirit, purport and objects of the Bill of Rights in the interpretation and application of company law in South Africa.²⁷⁵ Thus quite clearly the fundamental values in the Bill of Rights have to inform the interpretation of provisions dealing with a contractual relationship as is the case with the s21's pre-incorporation contracts.

4.3 A CRITICAL ANALYSIS OF SECTION 21 OF THE COMPANIES ACT 2008

Section 1 of the Companies Act 2008 defines what constitutes a pre-incorporation contract.²⁷⁶ This definition of a pre-incorporation contract is fundamental because it

²⁶⁸ See part 1.1 in chapter 1.

²⁶⁹ Section 71 of the Companies Act 46 of 1926; section 35 of the Companies Act 61 of 1973; section 21 of the Companies Act 71 of 2008.

²⁷⁰ See part 1.3 in chapter 1.

²⁷¹ See part 1.3 in chapter 1.

²⁷² Per part 1.7 of Chapter 1.

²⁷³ See part 1.7 in Chapter 1.

²⁷⁴ See s5(1) of the Companies Act 2008.

²⁷⁵ See s7(a) of the Companies Act 2008.

²⁷⁶ Section 1 of the Companies Act 71 of 2008.

indicates that the Companies Act 2008 only applies when a promoter purports to act as an agent, not a principal when concluding a pre-incorporation contract. The implication is that where a promoter acts as a principal, the position will be regulated by the common law rules of *stipulatio alteri*.²⁷⁷

Before providing a critical analysis of provisions of the provisions of s21 of the Companies Act 2008, it is considered important to present the provisions of the Act as stated in the text. Section 21 is lengthy and provides as follows:

- (1) A person may enter into a written agreement in the name of, or purport to act in the name of, or on behalf of, an entity that is contemplated to be incorporated in terms of this Act but does not yet exist at the time.
- (2) A person who does anything contemplated in subsection (1) is jointly and severally liable with any other such person for liabilities created as provided for in the pre-incorporation contract while so acting, if-
 - (a) the contemplated entity is not subsequently incorporated; or
 - (b) after being incorporated, the company rejects any part of such an agreement or action.
- (3) If, after its incorporation, a company enters into an agreement on the same terms as, or in substitution for, an agreement contemplated in subsection (1), the liability of a person under subsection (2) in respect of the substituted agreement is discharged.
- (4) Within three months after the date on which a company was incorporated the board of that company may completely, partially, or conditionally ratify or reject any pre-incorporation contract or other action purported to have been made or done in its name or on its behalf, as contemplated in subsection (1).
- (5) If, within three months after the date on which a company was incorporated, the board has neither ratified nor rejected a particular pre-incorporation contract, or other action purported to have been made or done in the name of the company, or on its behalf, as contemplated in subsection (1), the company will be regarded to have ratified that agreement or action.
- (6) To the extent that a pre-incorporation contract or action has been ratified or regarded to have been ratified in terms of subsection (5)-
 - (a) the agreement is as enforceable against the company as if the company had been a party to the agreement when it was made; and
 - (b) the liability of a person under subsection (2) in respect of the ratified agreement or action is discharged.

²⁷⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal*. See pages 370-71.

- (7) If a company rejects an agreement or action contemplated in subsection (1), a person who bears any liability in terms of subsection (2) for that rejected agreement or action may assert a claim against the company for any benefit it has received, or is entitled to receive, in terms of the agreement or action.

Below I will provide a thematic analysis of the Act in line with the focus of this study as established in Chapter 1,²⁷⁸ and in line with the analytic framework confirmed in part 4.2 above.

4.3.1 Formalities

One of s21 of the Companies Act 2008's improvements was the removal of the formal requirements relating to the lodgement of a pre-incorporation contract with the Registrar and listing its ratification as one of the company's objects in the memorandum of incorporation.²⁷⁹ The requirement that a pre-incorporation contract must be reduced in writing is retained.²⁸⁰ Section 21(1) of the Companies Act 2008 reads as follows: "a person is allowed to enter into a written agreement in the name of, or purport to act in the name of, or on behalf of, a company that is contemplated to be formed but does not yet exist."²⁸¹

A written contract is an important component of a company's records and ensures full and accurate disclosure within the company.²⁸² The retention of the written requirement is understandable because it is dictated by the need for certainty and full disclosure.²⁸³

The removal of the lodgement requirement was encouraged by s8 of the Corporate Laws Amendment Act, 2006.²⁸⁴ The ultimate removal of the lodgement requirement contemplated by the Companies Act 2008 is a welcomed and overdue development because the lodgement was inequitable to companies and their co-contracting parties.²⁸⁵ Lodging copies of pre-incorporation contracts robbed companies and their contractual partner of confidentiality and possibly exposed them to unfair practices

²⁷⁸ See part 1.4 of Chapter 1 which presents research questions for this study.

²⁷⁹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 259.

²⁸⁰ Section 21(1) of the Companies Act 71 of 2008.

²⁸¹ Section 21(1) of the Companies Act 71 of 2008.

²⁸² Easson A and Soberman D 'Pre-incorporation contracts: common law confusion and statutory complexity' (1992) 17 *Queen's Law Journal* 447.

²⁸³ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 260.

²⁸⁴ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 261.

²⁸⁵ Cilliers H, Benade M *et al. Corporate Law* 3 ed (2000); para 5.

such as undercutting by competitors. The removal of the lodgement requirement prioritised the protection of promoters, companies, and third-parties with whom they enter into pre-incorporation contracts.²⁸⁶

4.3.2 Disclosure of promoter's statutory agency status

The phrase 'professing to act as agent or trustee' which was found to be an interpretative issue with s35 of the 1973 Act²⁸⁷ was addressed by s21 of the Companies Act 2008. Section 21(1) refers such an agent or trustee to a person who 'purports to act in the name of or on behalf of a company'.²⁸⁸ Instead of using suggested words 'declares' or 'states', s21 uses the term 'purports'.²⁸⁹ When used as a verb, 'purports' means representing a specific state of affairs or status intentionally, expressly or by implication.²⁹⁰ 'Purport' has a broader meaning than the word 'declares' in that, it also refers to an implied representation. Expanding the scope of such a person in s21(1) of the Companies Act 2008 does not contribute significantly as it can be challenging to provide evidence of an implied representation made by a promoter.²⁹¹ Providing proof of an implied representation is ultimately a question of fact dependent on the circumstances of the particular case.²⁹² Therefore Ncube states that: "it seems that 'purports' is an appropriate word to use instead of the word 'declares' as it extends s21 of the Companies Act 2008 to situations where a promoter implies that he/she is acting on behalf of, or in the name of, a future company and thus provides a legal remedy for a third-party to rely on the implied representation of a promoter."²⁹³ The third-party can, therefore, exercise his/her rights because of the implied representation of a promoter.

A reading of s21(1) in line with the s1 definition of a pre-incorporation contract leads one to conclude that s21 applies only in cases where a promoter has disclosed or

²⁸⁶ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 394.

²⁸⁷ *Sentrale Kunmis* case; para 397.

²⁸⁸ Section 21(1) of the Companies Act 71 of 2008.

²⁸⁹ Section 21(1) of the Companies Act 71 of 2008.

²⁹⁰ Collins Dictionary "Purport" available at:

<https://www.collinsdictionary.com/dictionary/english/purport#:~:text=to%20present%2C%20esp.,document%20purporting%20to%20be%20official> (accessed 3 April 2023).

²⁹¹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 263.

²⁹² Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 263.

²⁹³ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 263.

implied that he/she is the agent of an unincorporated company.²⁹⁴ Although s21 applies only to promoters acting as agents, s21 can only be relied upon in terms of statutory pre-incorporation contracts. In the case of where a promoter acts as principal, the possibility for the BOD of the company to adopt the relevant pre-incorporation contract in terms of common law rules will trigger the applicability of the *stipulatio alteri*.²⁹⁵

In the case of *CShell 271 (Pty) Ltd v Oudtshoorn Municipality*, a municipality had awarded a tender to a company to be formed named Newco.²⁹⁶ Another company named CShell sought to enforce the tender.²⁹⁷ The municipality contended that CShell was not the same company as that which had to be formed and to whom the tender had been awarded, and the municipality accordingly cancelled the tender.²⁹⁸ Mr C had submitted a tender 'on behalf of Newco' which was a company to be registered.²⁹⁹ The court held that the award of the tender to Newco was clearly a pre-incorporation contract which was to be ratified by the company after its registration.³⁰⁰ CShell, however, was a fly-by-night company and was in existence at the time of submission of the tender.³⁰¹ The High Court held that the wording of the contract was clear.³⁰² A company was to be registered which would in law have to ratify and adopt the pre-incorporation contract concluded by Mr C on behalf of Newco.³⁰³ This was, however, never done. Mr C, in concluding the pre-incorporation contract, quite clearly did not act as an agent for CShell who was in existence at the time, but acted as an agent of Newco.³⁰⁴ In addition, Mr C did not act as a principal, as he acted at all times as an agent for the company to be formed.³⁰⁵ The High Court, therefore, concluded that there

²⁹⁴ Boonzaier M *Pre-incorporation contracts and the promoter's liability* (published LLM thesis, University of Pretoria 2010) 27. See also Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 263.

²⁹⁵ De Waal E *The distribution of liability in terms of pre-incorporation contracts* (published LLM dissertation, University of Pretoria, 2021) 34-5. See also Johnson NM *Pre-incorporation contracts in Company Law: A comparative study* (Doctorate dissertation, University of the Western Cape, 2000) 32.

²⁹⁶ *CShell 271 (Pty) Ltd v Oudtshoorn Municipality* (2012) 3 All SA 527 (WCC); page 4 (hereafter *CShell case*).

²⁹⁷ *CShell case*; page 5.

²⁹⁸ *CShell case*; page 5.

²⁹⁹ *CShell case*; page 6.

³⁰⁰ *CShell case*; pages 6-7.

³⁰¹ *CShell case*; page 9.

³⁰² *CShell case*; page 23.

³⁰³ *CShell case*; page 23.

³⁰⁴ *CShell case*; page 33.

³⁰⁵ *CShell case*; page 42.

could be no basis for any argument that CShell acquired any rights to the contract, by way of *stipulatio alteri*.³⁰⁶ The High Court also found that it was clear by reference to the express terms of the contract that Mr C never acquired the right to sue personally for specific performance of the contract.³⁰⁷

The case of *CShell 271 (Pty) Ltd v Oudtshoorn Municipality* illustrates the importance of whether a promoter acted as a principal or an agent, and that if a promoter acts as a principal, he/she will find no protection in terms of statutory legislation. The inapplicability of s21 of the Companies Act 2008 regarding a promoter acting as a principal is unfortunate because if a third party concludes a pre-incorporation contract with a promoter acting as a principal, a third-party does not have the same protection as is extended to those who contract with promoters who act as agents.³⁰⁸

4.3.3 Ratification and retrospectivity

Section 21(4) of the Companies Act 2008 deals with issues of ratification and retrospectivity.³⁰⁹ Section 21(4) of the Companies Act 2008 grants the BOD of a company three months after incorporation within which to completely, partially, or conditionally ratify or reject any pre-incorporation contract entered into on their behalf by a promoter and a third-party.³¹⁰ Section 21(4) provides that the BOD of a company must ratify a pre-incorporation contract if it wishes to perform.³¹¹ Two issues arise in the terms of the wording of s21(4). The first issue relates to the provision limiting the decision of the BOD to three months during which to decide whether or not to ratify a pre-incorporation contract.³¹² The general rule is that the BOD should ratify a pre-incorporation contract within the contractually agreed time or within a reasonable time.³¹³ Section 21(4) of the Companies Act 2008 trumps the general rule to limit BOD to a three month period. Consequently, a third-party who concluded a pre-incorporation contract that do not stipulate a time for ratification may find their affairs being held in limbo for lengthy periods while waiting for the BOD of a company to

³⁰⁶ *CShell* case; page 46.

³⁰⁷ *CShell* case; pages 49 and 52.

³⁰⁸ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 263-4.

³⁰⁹ Section 21(4) of the Companies Act 71 of 2008.

³¹⁰ Section 21(4) of the Companies Act 71 of 2008.

³¹¹ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 383.

³¹² Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 21-2.

³¹³ Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 21.

decide to ratify or reject a pre-incorporation contract. Section 21's modification of the current position by providing a specified period to ratify or reject a pre-incorporation contract is in the interests of third-parties and the state of affairs of companies. Section 21(4) of the Companies Act 2008 provides the BOD of a company sufficient time to consider ratifying or rejecting a pre-incorporation contract. The BOD of a company will know exactly the timeframe of making a decision and not left in confusion as to what a 'reasonable time' constitutes. At the same time, a third-party benefit from this provision as he/she will receive a decision within three months from the BOD of a company.³¹⁴

The second issue is that section 21(4) of the Companies Act 2008 provides for positive declaration of whether the BOD of a company decided to ratify or reject a pre-incorporation contract. On the contrary, section 21(4) does state in what form the ratification or rejection must take place. It is entirely up to the BOD of a company to determine the manner of ratification or rejection. For legal certainty to prevail, it would be more considerable to provide a manner of ratification and rejection similar to section 53(2) of the South African Close Corporations Act 69 of 1984 (hereafter the Close Corporations Act).³¹⁵ The Close Corporations Act provides that ratification shall be in the form of consent in writing of all corporation members, given within a specified time in the contract or within a reasonable time after incorporation.³¹⁶ A similar provision on the part of s21(4) of the Companies Act 2008 for the manner of ratification or rejection is desirable because it increases the level of legal certainty for all parties involved in pre-incorporation contracts.

When the BOD of a company fails to declare whether a pre-incorporation contract is ratified or rejected, s21(5) of the Companies Act can be invoked. Section 21(5) of the Companies Act 2008 provides that if a company fails to ratify or reject a pre-incorporation contract within three months of the company's incorporation, it will be regarded as having ratified the agreement.³¹⁷ Section 21(5) of the Companies Act 2008 coincides with s21(4) of the Act. After s21(4) provides three months for a company to either ratify or reject a pre-incorporation contract, s21(5) then provides the consequences of a company's failure to act within three months. Section 21(5) of the

³¹⁴ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 264.

³¹⁵ Section 53(2) of the Close Corporations Act 69 of 1984.

³¹⁶ Section 53(2) of the Close Corporations Act 69 of 1984.

³¹⁷ Section 21(5) of the Companies Act 71 of 2008.

Companies Act 2008 provides the necessary protection for third-parties, forcing the BOD of a company to apply their minds to pre-incorporation contracts and take the necessary action within three months.³¹⁸ Section 21(5) of the Companies Act 2008 relieves promoters from liability.³¹⁹ To the extent that a pre-incorporation contract or action has been ratified or regarded to have been ratified, the agreement is enforceable against the company as if the BOD of the company had been a party to the agreement when it was made and the liability of the promoter is discharged.³²⁰ A shift of liability from a promoter to the BOD of a company is helpful where the failure to make a decision is not attributable to the promoter's fault.³²¹ For a promoter to be held liable in terms of circumstances where the BOD of a company has not responded would be unfair to promoters. Section 21(4) and s21(5) of the Companies Act 2008 have equitably balanced the interests of promoters, companies, and third-parties in a pre-incorporation contract.³²²

Regarding retrospectivity of a pre-incorporation contract, the Companies Act 2008 attempts to clarify the matter using s21(6)(a) of the Companies Act 2008.³²³ The wording of s21(6)(a) follows the famous formulation by the legislation of several jurisdictions.³²⁴ Unfortunately, Cassim believes the formulation has proved to be problematic because it does not indisputably provide for retrospective effect.³²⁵ The wording of s21(6) of the Companies Act 2008 is unclear whether to mean that ratified pre-incorporation contracts were retrospective to the date of their conclusion or whether they were retrospective to the date of the company's incorporation.³²⁶ Any reform must use unambiguous wording to resolve the confusion as to when a pre-incorporation contract finds applicability.

³¹⁸ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 265.

³¹⁹ Section 21(5) of the Companies Act 71 of 2008.

³²⁰ Section 21(6)(a) and (b) of the Companies Act 71 of 2008.

³²¹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 265.

³²² Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 9.

³²³ Section 21(6) of the Companies Act 71 of 2008.

³²⁴ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 388.

³²⁵ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 388.

³²⁶ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 266.

4.3.4 Liability of parties and remedies

Section 21(2) of the Companies Act 2008 states that a third-party can seek relief against the promoter.³²⁷ Section 21(2) of the Companies Act 2008 extends liability for the failure of a pre-incorporation contract to persons in addition to, or instead of, a promoter.³²⁸ The first portion of s21(2) refers to promoters acting as a company's agent.³²⁹ The word 'such' indicates that s21(2) not only refers to promoters but also applies to other persons. The reference of s21(2) of the Companies Act 2008 to 'any other such persons' are simply promoters acting as company agents who, if not legally appointed as such, are de facto occupying such positions.³³⁰ The reasons for including the reference to 'any other such person' in s21(2) are unclear.³³¹ It may have been included to cater for circumstances where there are two or more promoters, but a pre-incorporation contract is signed only by one of them.³³² However, without s21(2) of the Companies Act 2008, only the promoter who executed the contract would be liable. Section 21(2) of the Companies Act 2008 may have been intended where there is more than one promoter and to provide such persons being jointly liable so that a third-party can sue each one for their pro rata share of the liabilities. One could be sued jointly and severally liable for the total liabilities, leaving a promoter to recover pro rata shares from the others involved.³³³

Section 21(3) and s21(6)(b) of the Companies Act 2008 provide that a promoter will be released from liability where ratification occurs.³³⁴ These provisions' significance is that a promoter will be released from liability when the company is deemed to have ratified the pre-incorporation contract in issue.³³⁵ Section 21(3) and s21(6)(b) of the

³²⁷ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 14-5.

³²⁸ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 17.

³²⁹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 266.

³³⁰ Section 21(2) of the Companies Act 71 of 2008.

³³¹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 266.

³³² Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 377.

³³³ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 377.

³³⁴ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 267. See also Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020) 24-5.

³³⁵ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 267.

Companies Act 2008 achieve fair treatment of promoters by releasing them from liability.

Section 21(7) of the Companies Act 2008 provides that a promoter who bears liability after a company rejects a pre-incorporation contract may claim against the company concerned for any benefit it has received or is entitled to receive in terms of the pre-incorporation contract.³³⁶ Section 21(7) of the Companies Act 2008 protects a promoter who finds him/herself accountable to a third-party in circumstances where the BOD of a company has received some benefit from a rejected pre-incorporation contract.³³⁷ After discharging his/her liability to the third-party, a promoter can obtain full or partial reimbursement from the company.³³⁸ If the BOD of a company has rejected a pre-incorporation contract, the BOD must return any benefit it had acquired in terms of the contract. These benefits are not precisely described in the Companies Act 2008, but it would be reasonable to assume that a company would have to return the exact goods or services acquired in terms of the pre-incorporation contract or value in money.³³⁹ The Companies Act 2008 requires the return of benefits acquired in terms of a pre-incorporation contract because the company would be unjustifiably enriched at the expense of the promoter or third-party.³⁴⁰

4.3.5 Third-party protection

Section 21(5) of the Companies Act 2008 protect a third-party through a promoter's automatic personal liability provided by s21(2) of the Companies Act 2008 and the deemed ratification provided by s21(5) of the Companies Act 2008.³⁴¹ Section 21(2) of the Companies Act 2008 states that a promoter is liable in terms of a pre-incorporation contract if a company is not incorporated or is incorporated but the BOD rejects the pre-incorporation contract.³⁴² Section 21(5) of the Companies Act 2008 is an innovation which gives third parties two significant benefits.³⁴³ First, third-parties only have to wait a maximum of three months for companies to decide whether or not

³³⁶ Section 21(7) of the Companies Act 71 of 2008.

³³⁷ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 17-8.

³³⁸ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 267.

³³⁹ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 267.

³⁴⁰ Section 21(7) of the Companies Act 71 of 2008.

³⁴¹ Section 21(5) of the Companies Act 71 of 2008.

³⁴² Section 21(2) of the Companies Act 71 of 2008.

³⁴³ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 268-69.

to ratify or reject the pre-incorporation contract.³⁴⁴ Secondly, third-parties do not have to litigate to hold companies accountable after the three months have lapsed. It would have been more costly for a third-party to enforce litigation against the BOD of a company. Furthermore, promoters are protected in terms of s21(5) of the Companies Act 2008 for deemed ratification. Promoters are released from liability when companies fail to ratify or reject the pre-incorporation contract within three months.³⁴⁵ Finally, companies are also fairly treated as the BOD of a company is given a reasonable period to ratify or reject the pre-incorporation contract.³⁴⁶ Section 21(5) of the Companies Act 2008, therefore, provides a balance of interest of promoters, companies, and third-parties.

Compared with its predecessor, s21 of the Act made commendable improvements in simplifying the pre-incorporation agreements, protecting the third-party, and allowing the promoter to claim against the company.³⁴⁷ In saying this, s21 leaves certain loopholes that may cause practical problems. Some were referred to in this chapter. It might be safer to make provisions for rights and obligations before and after the ratification of the pre-incorporation contract. For this reason, the South African legislature needs to learn from foreign jurisdictions to provide solutions for loopholes and gaps found in South African pre-incorporation agreements. Discussing the necessary provisions of Australia and Canada will point to lessons which can be borrowed from these jurisdictions to better inform the South African legal framework on the issue of ratification and liability of the parties. Borrowing from these jurisdictions may improve and provide better law reform and legal certainty.

4.4 GAPS OR LOOPHOLES WITH RESPECT TO SECTION 21 OF THE COMPANIES ACT 2008

The lacunae which need to be addressed namely, the lack of judicial discretion of South African courts, the use and abuse of fly-by-night companies by promoters to avoid liability, and the regulation of the interim period between the conclusion and the ratification by the company.³⁴⁸ Each will be discussed concerning how the legislature

³⁴⁴ Section 21(4) of the Companies Act 71 of 2008.

³⁴⁵ Section 21(5) of the Companies Act 71 of 2008.

³⁴⁶ Section 21(5) of the Companies Act 71 of 2008.

³⁴⁷ Ncube C 'Pre-Incorporation contracts: Statutory reform' (2009) *South African Law Journal* 269.

³⁴⁸ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 19.

of Australia and Canada have covered these issues and the willingness to reduce potential confusion between parties who conclude a pre-incorporation contract.

Section 21 of the Companies Act 2008 omits the broad judicial discretion that empowers courts to better balance the liabilities between the promoter and the company by apportioning the liability between the promoter and the BOD of a company.³⁴⁹ A better way to handle the problem of apportionment of liabilities is how the legislature of Australia and Canada regulate the current lacunae in South African statutory pre-incorporation contracts.³⁵⁰

Section 14(3) of the Canadian Business Corporations Act states that whether or not a written pre-incorporation contract made before the coming into existence of a company is adopted by the company, a party of the contract may apply to a court for an order fixing obligations in terms of the contract as joint and several or apportioning liabilities between or among the corporation and any person purported to act in the name of or on behalf of the company, and upon the application of the court may make any order which it deems fit.³⁵¹ By giving the court greater leeway in adjudicating matters of apportionment of liabilities in pre-incorporation contracts, it rectifies two of the most deep-rooted issues found in South African pre-incorporation contracts.³⁵² A similar provision that speaks to that of s14(3) will enable the South African judiciary to better balance the liabilities between the promoter and company and provide courts to hand down a better outcome regarding damages.³⁵³ Subsequently, circumstances will arise where it will be correct in law to hold the BOD of a company liable for a pre-incorporation contract which it did not ratify. Cassim refers to this as a secondary liability of a company.³⁵⁴ The opposite may also be true where attributing liability to a promoter for breach of a pre-incorporation contract after ratification will be permissible.

Secondary liability of a company refers to instances where the promoter turns into an executive director of the company who has knowledge of a pre-incorporation contract

³⁴⁹ Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 20.

³⁵⁰ Section 131 of the Corporations Act, 2001; s14 of the Canada Business Corporations Act, 1985.

³⁵¹ Section 14(3) of the Canada Business Corporations Act, 1985.

³⁵² Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) *Business Law International* 19-21.

³⁵³ Buckley F, Gillen M & Yalden R *Corporations: Principles and policies* 3ed (1995) 146-47.

³⁵⁴ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 379.

and the company plans to ratify the same pre-incorporation contract.³⁵⁵ The problem arises when a promoter is induced as an executive director and refuses to ratify a pre-incorporation contract he/she has concluded as promoter and does this without legal reasons.³⁵⁶ Apportioning secondary liability on the promoter means that it would be unjust to hold the promoter liable for a decision taken by the BOD of a company, even though the promoter might have influenced the final decision. A promoter, therefore, cannot be the one paying damages to a third-party for a decision taken by the entire BOD. The just and equitable manner of dealing with such a situation would be for the court to have complete judicial discretion to apportion the entire liability of the promoter to the company and has the decision to ratify or reject the pre-incorporation contract. This complete judicial discretion attributed to courts will allow a third party to have legal recourse for damages against the company on account of the decisions or actions taken by the BOD of a company. The complete judicial discretion would ensure that companies cannot enrich themselves at the expense of a promoter or third-party. Once a third-party concludes a pre-incorporation contract with a promoter who used a fly-by-night company, a third-party is left with a company without assets or capital. A third-party has no protection in such circumstances. Judicial discretion should be given to courts by apportioning a promoter's gains to the damages suffered by the third-party due to the company's breach of a pre-incorporation contract.³⁵⁷

Based on what was discussed above, giving courts broad discretion, and allowing courts to decide on the legality of a pre-incorporation contract would be a favourable and advantageous step for South African company law.

4.4.1 The express exclusion of promoter liability

Certain amendments to s21 are needed where a promoter is wholly prohibited from switching positions in a pre-incorporation contract, namely, from promoter to an executive board member of the company yet to be incorporated. A promoter must be held personally liable in such circumstances. A promoter being held personally liable

³⁵⁵ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 380-81.

³⁵⁶ De Waal E *The distribution of liability in terms of pre-incorporation contracts* (published LLM dissertation, University of Pretoria, 2021) 67.

³⁵⁷ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 380.

should be codified in law to prevent burdensome circumstances for parties in pre-incorporation contracts.

As a result of attempts by promoters to escape personal liability, Australia and Canada have regulated the actions of promoters.³⁵⁸ Australia and Canada allow a promoter to exclude his/her liability in a pre-incorporation contract.³⁵⁹ In the respective legislative provisions of Canada, section 14(3) of the Canadian Business Corporations Act states that a promoter can contract out of his liability provided that the exclusion is in writing and contained in a pre-incorporation contract. Similarly, Australia has a provision for the action of a promoter to contract out of a pre-incorporation contract which should be deduced in writing.³⁶⁰

Freedom of contract is a cornerstone of modern contract law, and, therefore, even though a promoter can exclude his/her liability in a pre-incorporation contract, this exclusion should not put a third-party in a vulnerable position.³⁶¹ For an exclusionary clause to be legally valid and binding on the parties, an exclusionary clause must be in writing, and the clause should be written in plain language for a layperson to understand the wording of the clause. In the *Landmark Inns* case, the court stated that implied exemption clauses would never be allowed in law.³⁶² However, implied exemption clauses should be included in South African law as it protects third parties if an exclusionary clause is not contained in a written format. In addition, if an exclusionary clause is written down, the clause should allow a court's presiding officer to use his/her interpretation and knowledge of the law to ascertain what the meaning of the clause means and whether there can be a recourse in law for a third-party.

4.4.2 Other gaps and potential loopholes

Section 21(2) requires clarity perhaps through interpretation to establish who exactly is comprehended by the words "any such person".³⁶³ This phrase is wide enough to

³⁵⁸ Dickson R, Howard L & Getz L *Proposals for a new Business Corporations Law for Canada* (1971) 24-5. See also Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019) 20 and De Waal E *The distribution of liability in terms of pre-incorporation contracts* (published LLM dissertation, University of Pretoria, 2021) 68-9.

³⁵⁹ Section 14(3) of the Canada Business Corporations Act, 1985.

³⁶⁰ Section 131 and s132 of the Corporations Act 50 of 2001.

³⁶¹ Cassim MF 'Pre-Incorporation Contracts: The Reform of Section 35 of the Companies Act' (2007) 124 (2) *South African Law Journal* 379.

³⁶² *Landmark Inns of Canada v Horeak* (1982) 2 WWR 377.

³⁶³ Section 21(2) of the Companies Act 71 of 2008.

bring within its ambit other people who should share liability with the promoters. Section 21(2) of the Companies Act 2008 could relate to a situation where a promoter is utilised to conclude pre-incorporation contracts, which makes it fair for not only the promoter to be held liable alone, but to share liability with incorporators of the company. Section 21(2) can be confusing and result in interpretative issues, thus it makes sense that Cassim is of the opinion that the phrase “any such person” is vague.

The rights of parties during the interim period between the conclusion of a pre-incorporation contract and ratification is still uncertain. The silence of the Companies Act 2008 creates potential for problems or abuse. An example can be the unilateral withdrawal from the contract by a third-party. Does this promoter have any remedy against the third-party in such circumstances? Can a party like a promoter contract out of its liability? Or can a party contract out of its rights as established by the Companies Act 2008? These are loopholes still existing within the Companies Act 2008 with regards to the position of parties in pre-incorporation contracts.

4.5 CONCLUSION

Section 21 of the Companies Act 2008 has placed parties in a pre-incorporation contract in a better position than the previous position under the now repealed s35 of the 1973 Act. Overall, it appears that s21 creates an equitable balance as far the rights of the company, promoter, and third-party. Promoters can claim against a company for any benefits a company has received from a pre-incorporation contract.³⁶⁴ It is evident that the promoter is placed in a better position than in the previous Companies Acts such as the promoter can expressly contract out of the liability that was imposed on him/her.³⁶⁵ Section 21 makes provision for a specified period within which a company must ratify a pre-incorporation contract.³⁶⁶ This provision is in the interests of both third-parties and companies. It affords the company a fair amount of time in which to apply its mind to the pre-incorporation contract before deciding to ratify or to repudiate the contract, with the understanding that liability will be imposed on it for inaction.³⁶⁷ In the same vein, third parties will only have to wait a maximum of three months for

³⁶⁴ See part 4.3.3 in chapter 4.

³⁶⁵ See part 4.3.4 in chapter 4.

³⁶⁶ See part 4.3.5 in chapter 4.

³⁶⁷ See part 4.3.5 in chapter 4.

the company's decision in this regard. They will, therefore, not be subjected to long, unnecessary delays.³⁶⁸

The Companies Act 2008 suffers from some defects. The rights and liabilities of the company, promoter, and the third-party during the interim period (that is, between the conclusion of the pre-incorporation contract and ratification or adoption of the contract by the company) are still left unsettled. Section 21 of the Companies Act 2008 does not expressly stipulate that the promoter will be liable in terms of the pre-incorporation contract before the corporation is formed. Section 21 does not prohibit the third-party from unilaterally withdrawing from the agreement pending ratification by the company. It is also not clear whether the agent and the third party are able to cancel a pre-incorporation contract by agreement prior to its ratification by the company.

A call is made to broaden the judicial discretion of a court in apportioning the sum of damages based on the circumstances of each case brought before a court of law. An inclusion of a provision which allows for the broadening of judicial discretion in s21 of the Companies Act 2008 will provide better protection to a third-party as there will be certainty to the amount of damages to be awarded as well as caution promoters against the use of fly-by-night companies to deceive a third-party. An inclusion of such a provision will give effect to the principle of good faith as it will ensure that promoters refrain from using fly-by-night companies. If a fly-by-night company is used to deceive a third-party to contract with a promoter, judicial discretion must be used by courts to assist third-parties with reclaiming performances made to the promoter.

³⁶⁸ Section 21(5) of the Companies Act 71 of 2008.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The aim of this chapter is to summarise the research findings in a manner that leads to possible amendments to s21 of the Companies Act 2008. Section 21 was analysed using a contextual and purposive approach to interpretation as explained in the analytical framework in Chapter Four.³⁶⁹ This study established that s21 of the Companies Act 2008 sets out the position of the promoter, the company, and third-party with regards to pre-incorporation contracts. In doing so, the section attempts to balance the interests of the parties by providing for the promoter's agency status, liability in stated circumstances, the time period for a company to ratify the pre-incorporation contract, and to ensure that the third-party can make use of certain remedies to circumvent losses. In addition, unlike its predecessor s35 of the now repealed 1973 Act, s21 ensures the sharing of risks among all parties involved in pre-incorporation contracts. After noting key features across chapters in 5.2 below, this chapter concludes with a presentation of a couple of recommendations in 5.3.

5.2 A SUMMARY OF THE KEY FEATURES ACROSS CHAPTERS 1-4

5.2.1 An improved statutory reform by section 21

Section 21 of the Companies Act 2008 can be said to have effectively improved the stance of pre-incorporation contracts in South African company law. Previously, s35 of the 1973 Act caused the balance of power to be skewed in favour of the promoter and the company to be incorporated and to the detriment of the third party as already established in this study.³⁷⁰ Whereas it could be said that the fundamental underlying policy of the predecessor to s21 (that is, s35 of the 1973 Act) caused contractual injustice as already established, provisions of the Companies Act 2008, including s21, can only be interpreted to promote the spirit, purport and objects of the Bill of Rights as provided for in s39(2) of the Constitution. This is the true import of s7(a) of the Companies Act 2008, with the result that constitutional values such as fairness, equality or equity can be applied to result in contractual justice or equity even in terms of statutory pre-incorporation contracts. Subsections 21(3) and s21(5) have now attempted to ensure that the interests of all parties in pre-incorporation contracts are

³⁶⁹ See part 4.2.1.3 in chapter 4.

³⁷⁰ See part 1.3 in chapter 1 and see part 2.2.2 in chapter 2.

addressed.³⁷¹ In overall, s21 has provided equitable protection for all parties and ensured to distribute the sharing of risks of contractual failure effectively, as already pointed out in this study.³⁷²

5.2.2 Examination of international best practices

The model of pre-incorporation contracts followed by Canada is similar to that of South Africa namely, to protect third-parties by imposing liability on the part of the company or the promoter in the event the contract is adopted or rejected.³⁷³ The Canadian statutes, however, afford a promoter the opportunity to escape liability.³⁷⁴ There is some form of confusion within Canadian company law on what is considered 'a reasonable time' when adopting the pre-incorporation contract. South Africa is clear on what constitutes 'a reasonable time' and limits it to three months after the date of incorporation.³⁷⁵

The laws should also be reformed in Canada through the insertion of provisions that would require the companies on whose behalf promoters enter into pre-incorporation contracts to be incorporated within a reasonable time after the incorporation of pre-incorporation contracts.³⁷⁶

Australia follows a statutory warranty approach that requires the promoter to be held liable in the event the company refuses to adopt or reject the pre-incorporation contract.³⁷⁷ This points to all parties having certainty as to what is expected once a pre-incorporation contract is concluded. This is different to the method followed by South Africa in that the promoter will be held jointly and severally liable if the company is not incorporated. The problem of the statutory warranty approach is in deciding whether the action for breach of warranty is contractual or delictual in nature. This determination would be important for many reasons such as the measure of damages, the choice of governing law and the availability of defences and remedies.³⁷⁸ Promoter liability when applying the statutory warranty approach is harsher to implement

³⁷¹ See part 4.3.3 in chapter 4.

³⁷² See parts 4.3.4 and 4.3.5 in chapter 4.

³⁷³ Section 14(3) of the Canada Business Corporations Act, 1985.

³⁷⁴ Section 14(4) of the Canada Business Corporations Act, 1985.

³⁷⁵ Section 21(4) of the Companies Act 71 of 2008.

³⁷⁶ See part 3.3.2.1 in chapter 3. Also see Etsey W 'Pre-incorporation contracts: The fog is finally lifting' (2000) 33 *Canadian Business Law Journal* 30.

³⁷⁷ See part 3.2.2.2 in chapter 3.

³⁷⁸ Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 244.

because the apportionment of liability does not seem to be distributed equally to all parties involved in the pre-incorporation contract.

5.3 RECOMMENDATIONS

The following recommendations are made in line with the analysis of s21 given in Chapter Four and elsewhere in the mini-thesis:

- i. As established in this study, the judiciary and anyone else interpreting and applying s21, should take note of the underlying policy of interpreting provisions of the Act which is aligned to the promotion of the fundamental values of the Constitution as provided in the Bill of Rights.
- ii. In terms of the issue of retrospectivity, if the pre-incorporation contract takes effect from the time it is concluded between the promoter or the third-party, it may give rise to potential abuse of s21(5) by the BODs. Thus, it is recommended the pre-incorporation contract takes effect upon ratification by the BOD. Thereafter, it allows s21(7) to take effect in the case there are any benefits owed to the promoter, should the BOD reject the pre-incorporation contract or prevent unilateral withdrawal from the contract by the third-party.
- iii. It is also recommended that a new subsection, namely subsection 21(8) be inserted into the Companies Act 2008. Section 21(8) must provide for judicial discretion in s21 of the Companies Act 2008 to protect third-parties when promoters utilise fly-by-night companies in pre-incorporation contracts. Section 21(8) should read as follows: 'This section allows courts to have judicial discretion and provide a remedy where a 'fly-by-night' company was used to the detriment of the third-party.' In effect, the inclusion of a s21(8) provision will discourage the use of fly-by-night companies and provide legal certainty to parties in a pre-incorporation contract.
- iv. It is further proposed that the parties (that is, the promoter and the third-party) should have the flexibility to exclude liability of any party in the contract. As such, s21 should permit the inclusion of a written exclusion clause in a pre-incorporation contract. This is in keeping with the virtues of freedom of contract and the principle of flexibility permitted by the Companies Act 2008.

Word count- 29403

Bibliography

BOOKS

Cassim FHI, Jooste R, Shev R *et al Contemporary Company Law* (2012) Juta: Claremont.

Cilliers H, Benade M, Henning J *et al Corporate Law* (2000) Butterworths: Durban.

Beuthin RC, Luiz SM *Beuthin's Basic Company Law* (2000) Butterworths: Durban.

Buckley F, Gillen M & Yalden R *Corporations: Principles and policies* (1995) Emond Montgomery: Toronto.

Davies D, Geach W, Loubser A *et al. Companies and Other Business Structures in South Africa* (2021) Oxford University Press Southern Africa: Cape Town.

Dickson R, Howard L & Getz L *Proposals for a new Business Corporations Law for Canada* (1971) Information Canada: Ottawa.

Ford HA, Austin RP & Ramsey IM *Ford's principles of Corporations Law* 9ed (1999) Butterworths: Sydney.

Gillen M *Corporations and partnerships in Canada* (2018) Kluwer Law International B.V: Netherlands.

Hutchinson D, Pretorius C, Du Plessis J *et al The Law of Contract in South Africa* 4ed (2022) Oxford University Press: Pretoria.

Mongalo T *Corporate Law & Corporate Governance: A global picture of business undertakings in South Africa* (2003) Juta: Pretoria.

CASE LAW

Constitutional court

Barkhuizen v Napier 2007 (5) SA 323 (CC).

Beadica 231 CC v Trustees, Oregon Trust 2020 (5) SA 247 (CC).

Investigating Directorate: Serious Economic Offences and Others v Hyundai Motor Distributors (Pty) Ltd and Others: In re Hyundai Motor Distributors (Pty) Ltd and Others v Smit NO and Others 2001 (1) SA 545 (CC).

Sibakhulu Constructing (Pty) Ltd v Wedgewood Village Golf and Country Estate (Pty) Ltd 2020 (2) SA 325 (CC).

Supreme Court of Appeal

Brown's Executrix v McAdams, Masterpiece Gold Mining Co Ltd v Brown's Executrix 1914 AD.

Commissioner for Inland Revenue v Estate Crewe 1943 AD.

Eldacc (Pty) Ltd v Bidvest Properties (Pty) Ltd (682/10) [2011] ZASCA.

Lazarus Mbethe v United Manganese of Kalahari 2017 (6) SA 409 (SCA).

Mercurius Motors v Lopez 2008 (3) SA 572 (SCA).

Van der Plank v Otto 1912 AD.

High Court

Bagradi v Cavendish Transport Co (Pty) Ltd 1957 (1) SA 663 (D).

Build-a-brick BK v Eskom 1996 (1) SA 115 (O).

CShell 271 (Pty) Ltd v Oudtshoorn Municipality (2012) 3 All SA 527 (WCC).

Crookes v Watson 1956 (1) All SA 277 (A).

Ex Parte Vickermann and Others 1935 C.P.D.

Gov RSA (Dept of Ind) v Fibre Spinners and Weavers 1977 (2) SA 324 (D).

Hall-Thermotank Natal (Pty) Ltd v Hardman 1968 (4) SA 818 (D).

Holomisa v Argus Newspapers Ltd 1996 2 SA 588 (W).

Nedbank Ltd v Bidvest (Pty) Ltd 2012 5 SA 497 (WCC).

Nordis Construction Co (Pty) Ltd v Theron, Burke, and Isaac 1972 (2) SA 535 (N).

Peak Lode Gold Mining Co Ltd v Union Government 1932 TPD.

Pledge Investments (Pty) Ltd v Kramer, NO 1975 (4) All SA (A).

Racec (Mooifontein) (Pty) (Ltd) v Devonport Investment Holding Co (Pty) Ltd 1976 (1) SA 299 (W).

Semer v Retief and Berman 1948 (1) SA 182 (C).

Sonap Petroleum (SA) (Pty) Ltd v Pappadogianis 1992 (3) SA 234 (A).

Standard Bank of South Africa Ltd v Dlamini 2013 (1) SA 219 (KZD).

CONSTITUTION

Constitution of the Republic of South Africa, 1996.

FOREIGN CASE LAW

Australia

District Court

Delta Construction Company Ltd v Lidstone 1979 (96) D.L.R (3d) 540.

Wickberg v Shatsky 1969 (4) D.L.R 540.

High Court

Bay v Illawara Stationary Supplies (Pty) Ltd 1986 4 ACLC.

Black v Smallwood 1966 117 C.L.R 52.

Canada

District Court

Dairy Supplies Ltd v Fuchs (1959) 18 D.L.R (2d) 408.

High Court

Gargatzidis v. South Towne Developments Ltd. and MacPherson, Leslie & Tyerman (1980) 6 SASK R 151 (QB).

Landmark Inns of Canada Ltd v Horeak (1982) 2 WWR 377.

New Zealand

Marblestone Industries Ltd v Fairchild (1975) 1 NZLR.

United Kingdom

Court of Appeal

Natal Land Co v Pauline Colliery and Development Syndicate Ltd [1904] AC 120.

Newborne v Sensolid (Great Britain) Ltd 1954 1 QB 45 (CA).

North Sydney Tramway Co v Higgins [1899] AC 263.

Phonogram Ltd v Lane (1981) 3 WLR 736.

Court of Common Pleas

Kelner v Baxter 1866 LR 2 CP 174.

McCullogh v Fernwood Estate Ltd 1920 AD 204.

Mutual Life Insurance Co of New York v Hotz 1911 AD 556.

United States

Dealers' Granite Corp. v. Faubion, (1929) 2d 737.

Stone v First Wyoming Bank (1980) 2d 332.

FOREIGN LEGISLATION

Canada Business Corporations Act of 1985.

Companies Act, 1985.

Companies Act, 2006.

Corporations Act 50 of 2001.

Companies (Consolidated) Act of 1908.

Nigeria Companies and Allied Matters Act of 1990.

Ontario Business Corporations Act of 1970.

INTERNET SOURCES

Collins Dictionary 'Purport' available at:

<https://www.collinsdictionary.com/dictionary/english/purport#:~:text=to%20present%20C%20esp.,document%20purporting%20to%20be%20official> (accessed 3 April 2023).

JOURNAL ARTICLES

Benade M 'A survey of the main report of the Commission of Enquiry into the Companies Act' (1970) 3 *The Comparative and International Law Journal of Southern Africa* 277-309.

Cassim FHI 'The Companies Act 2008: An overview of a few of its core provisions' (2010) 22 *South African Mercantile Law Journal* 157-75.

Cassim M 'Some difficult aspects of pre-incorporation contracts in South African law and other jurisdictions' (2012) 13 *Business Law International* 5- 26.

Cassim MF 'Pre-incorporation contracts: The reform of section 35 of the Companies Act' (2007) 124(2) *South African Law Journal* 364-99.

Courtney W 'Failed pre-registration contracts and the statutory remedy' (2007) 25(4) *Company and Securities Law Journal* 226-45.

Easson A and Soberman D 'Pre-incorporation contracts: Common law confusion and statutory complexity' (1992) 17 *Queen's Law Journal* 414-64.

Estey W 'Pre-incorporation contracts: the fog is finally lifting' (2000) 33(1) *Canadian Business Law Journal* 3-37.

Griffiths A 'Agents without principles: pre-incorporation contracts and section 36C of the Companies Act 1985' (1993) 13(2) *The Journal of the Society of Legal Scholars* 241-53.

Gwanyanya M 'The South African Companies Act and the realisation of corporate human rights responsibilities' (2015) 18(1) *Potchefstroom Electronic Law Journal* 3107-31.

Hambrook JP 'Pre-incorporation contracts and the National Companies Code: What does section 81 really mean' (1982) 8(2) *Adelaide Law Review* 119-42.

Isakow L 'The perplexities of section 71 of the Companies Act' (1971) 88(2) *South African Law Journal* 165-69.

Jooste R 'When do pre-incorporation contracts have retrospective effect?' (1989) 106(3) *South African Law Journal* 508-11.

McKerron RG 'The juristic nature of contracts for the benefit of third persons' (1929) 46(4) *The South African Law Journal* 387-95.

MacPherson D 'Law reform in corporate/commercial law in Manitoba' (2012) 35(2) *Manitoba Law Review* 49-84.

Maloney M 'Pre-incorporation transactions: A statutory solution' (1985) 10(4) *Canadian Business Law Journal* 409-39.

Moseneke D 'Transformative Adjudication in Post-Apartheid South Africa- Taking stock after a decade' (2007) *Speculum Juris* 2-12.

Mupangavanhu BM 'Impact of the Constitution's normative framework on the interpretation of provisions of the Companies Act 71 of 2008' (2019) 22 *Potchefstroom Electronic Law Journal* 1-24.

Mupangavanhu BM 'The Lawfulness of a Memorandum of Incorporation Clause that Permits a Company Board to Refuse Transfer of Shares Without Reasons: Analysis of Visser Citrus (Pty) Ltd' 2017 *Speculum Juris* 191-204.

Ncube CB 'Pre-incorporation contracts: Statutory reform' (2009) 126(2) *South African Law Journal* 255-69.

Obayemi O 'Pre-incorporation contracts in Nigeria: The need for progressive, expansive, and less restrictive statutory provisions' (2020) Vol XX *ASPER Review* 123-54.

Omar P 'Crossing time boundaries: A comparative review of legal responses to the pre-incorporation contract' (2005) 1 *Singapore Journal of Legal Studies* 76-92.

Perrel P 'Pre-incorporation contracts and *1394918 Ontario Ltd v 1310210 Ontario Inc* Some answers, some questions' (2002) 37(2) *Canadian Business Law Journal*, 296-305.

Puri P 'The promise of certainty in the law of pre-incorporation contracts' (2001) 80(3) *The Canadian Bar Review*, 1051-1064.

Stanford Intramural Law Review 'Outmoded concepts dominate law of promoters' (1948) 2 *Stanford Law Review*, 119-28.

Tweedle G & Flynn L 'Piercing the corporate veil: Cape industries and multinational corporate liability for a toxic hazard 1950-2004'(2007) 8(2) *Oxford Journals*, 268-96.

Williams RC 'An agent's liability when acting for a non-existent principal' (1990) 107 *South African Law Journal*, 203-06.

REPORTS

Victorian Law Reform Commissioner, Report 8, *Pre-incorporation contracts* (1979).

SOUTH AFRICAN LEGISLATION

Alienation of Land Act 68 of 1981.

Close Corporations Act 69 of 1984.

Companies Act 46 of 1926.

Companies Act 61 of 1973.

Companies Act 71 of 2008.

Companies Amendment Act 23 of 1939.

Companies Amendment Act 46 of 1952.

Corporate Laws Amendment Act 24 of 2006.

THESES

Boonzaier M *Pre-incorporation contracts and the liability of the promoter* (published LLM thesis, University of Pretoria 2010).

De Waal E *The distribution of liability in terms of pre-incorporation contracts* (Doctoral dissertation, University of Pretoria, 2021).

Johnson N *Pre-incorporation contracts in Company Law: A comparative study* (Doctoral thesis, University of the Western Cape. 2000).

Jukes C *A comparison between the Companies Acts of 1973 and 2008 in respect of pre-incorporation contracts in relation to the stipulation alteri* (Doctoral dissertation, University of Pretoria, 2018).

Le Roux L *In the name of the company: An analysis of the provision and effect of section 21 of the Companies Act 71 of 2008* (Doctoral dissertation, University of Pretoria, 2020).

Mangano K *Pre-incorporation contracts: A balancing of the interests of the promoter, the company and third party contractant in South African Company Law* (Doctoral dissertation, University of the Witwaterstrand, Faculty of Commerce, Law and Management, School of Law 2013).

Moreroa P *The constitutionality of deemed ratified pre-incorporation contracts* (published LLM thesis, University of Johannesburg 2019).

Mupangavanhu BM *Directors' Standards of care, skill, diligence, and the Business Judgment Rule in view of South Africa's Companies Act 71 of 2008: Future implications for corporate governance* (published Doctorate thesis, University of Cape Town 2016).

