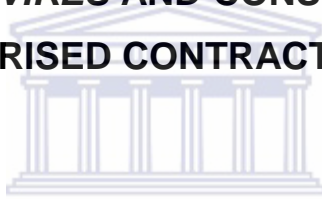




FACULTY OF LAW

**THE IMPACT OF THE COMPANIES ACT 71 OF 2008 ON THE  
DOCTRINES OF *ULTRA VIRES* AND CONSTRUCTIVE NOTICE AS IT  
RELATES TO UNAUTHORISED CONTRACTS**



A mini-dissertation submitted in partial fulfilment of the requirements for  
the degree of LLM in the Faculty of Law at the University of the Western  
Cape

By

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Supervisor: Adv. GF Kotze

December 2015

## DECLARATION

I, Etienne Aubrey Olivier, declare that *The Impact of the Companies Act 71 of 2008 on the Doctrines of Ultra Vires and Constructive Notice as it relates to Unauthorised Contracts* is my own work, that it has not been submitted before for any degree or examination at any other university, and that all the sources that I have used or quoted have been indicated and acknowledged as complete references.

Signed: \_\_\_\_\_

**Etienne Aubrey Olivier**

Signed: \_\_\_\_\_

**Adv GF Kotze**



December 2015

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I must express my overwhelming gratitude to my parents, Gerald and Ria Olivier. Their sacrifices and determination paved the way for me to receive an excellent education. The drive that I have seen displayed by my mother continues to inspire me to work that little bit harder every day. My brothers, Grant and Réan, have also played an important role in my development as a student and as a person.

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## DEDICATION

*To Lonique, for saving my life.*

*And to Sisqo, for teaching me how to live it.*



## KEY WORDS AND PHRASES

Company

Representative/Agent

Outsider/Third party

Director

Shareholder

Insiders

Contract

Agency

Authority

*Ultra vires* doctrine

Doctrine of constructive notice

*Ultra vires* contract

Pure unauthorised contract

“RF” company

Non-“RF” company

Validity

Liability



## ABBREVIATIONS

**AOA** – Articles of Association

**CIPC** – Companies and Intellectual Property Commission

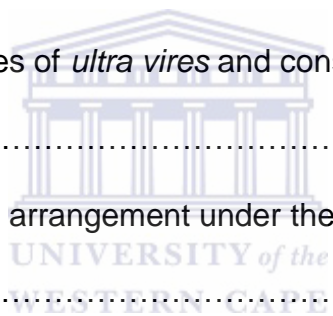
**MOA** – Memorandum of Association

**MOI** – Memorandum of Incorporation

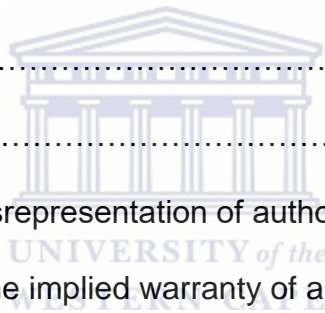
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## CHAPTER ONE

### INTRODUCTION

#### 1.1 Introduction

The law of agency facilitates commercial transactions. It allows a person to conclude a contract without himself<sup>1</sup> signing it, or even being present at the time of its conclusion.<sup>2</sup>

Company law is a confusing and often dangerous beast, replete with archaic and menacing rules such as the *ultra vires* doctrine and the doctrine of constructive notice. It is trite that efficient rules of company law are vital for the stability of the economy, and that any uncertainty would detract from that stability. The concepts of a company's capacity and the authority of its representatives demand the highest degree of certainty achievable, as these matters regulate a company's interaction with the outside world.<sup>3</sup> Unfortunately, the common-law doctrines of company law have evolved to frustrate rather than to facilitate commercial dealings with companies. While no doubt born of the best intentions, the doctrines of *ultra vires* and constructive notice have served only to prejudice third parties dealing with companies, thereby hampering commercial activity.

This chapter will introduce the topic of this thesis by identifying the aims of the dissertation and setting out the relevant research problem, questions, and limitations. Chapter One will also provide a brief background on the issues to be discussed herein.

#### 1.2 Abstract

An agent acting in excess of his authority creates several legal problems, particularly in company law. In South African law, like in many other legal systems around the world, the interplay between the doctrines of *ultra vires* and constructive notice has, historically, played a profound role in governing the relationship between a company, its representatives, and outsiders. For decades, the contractual capacity and consequent liability of companies have been guided by thorny and intricate legal principles.

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<sup>1</sup> Reference to the masculine gender should be interpreted to also refer to the feminine.

<sup>2</sup> Provided, of course, that the person has the necessary capacity to do so.

<sup>3</sup> Delpont P 'Companies Act 71 of 2008 and the "Turquand Rule"' (2011) *THRHR* 74 132 at 132.

This issue has become especially intriguing in light of the changes to the company law regime introduced by the new legislation. The relevant sections of the Companies Act 71 of 2008 (the 2008 Act) that allow for the restriction of a company's powers, require close scrutiny and thoughtful consideration. To that end, this thesis shall examine some of the legal consequences arising from the conclusion by a company's agent of an "unauthorised contract".<sup>4</sup>

### 1.3 Research problem

If P authorises A to conclude a contract with a third party on P's behalf, P is A's principal and A is P's agent. Provided A acts within the scope and extent of his authority, the contract entered into will be valid and binding between P and the third party.<sup>5</sup> However, a quagmire of problems may arise if A contracts with a third party in excess of A's given authority. What is P's obligation, if any, towards the third party? What is A's obligation, if any, towards the third party? And will the position be different if P is a company? The answers to these questions are of critical importance as unauthorised agency is an almost inevitable occurrence in commercial dealings.<sup>6</sup>

The position of outsiders contracting with companies has historically been affected by two key common-law doctrines: the doctrine of *ultra vires* and the doctrine of constructive notice. After years of the *ultra vires* doctrine frustrating commercial dealings and prejudicing outsiders, Parliament saw fit to effectively abolish it by enacting s 36 of the Companies Act 61 of 1973 (the 1973 Act). Section 20(1) of the 2008 Act has reinforced this approach to the contractual capacity of companies. However, ss 19(4) and 19(5) of the 2008 Act bring something new to the table: these provisions effectively abolish the doctrine of constructive notice while simultaneously retaining a watered-down version of it applicable to companies that elect to restrict their own capacity. In so doing, the 2008 Act creates two categories of companies, which in this thesis shall be termed "RF" companies and non-"RF" companies.

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<sup>4</sup> Authority being an essential requirement of agency, and consensus *ad idem* being a requirement of a valid contract, it is of course oxymoronic to speak of "unauthorised agency" or an "unauthorised contract". However, for brevity's sake, this thesis will make use of such terms.

<sup>5</sup> See Dendy M 'Agency and Representation' in De Wet JC (founding ed) *LAWSA vol1 Third Reissue* (2014) para 126.

<sup>6</sup> See Busch D & MacGregor L (eds) *et al The Unauthorised Agent; Perspectives on European and Comparative Law* (2009) 2.

By providing an option for a company to restrict its own contractual capacity, it would seem that the Legislature has reintroduced a slightly modified form of the *ultra vires* doctrine. In addition, the 2008 Act has created a statutory reformulation of the doctrine of constructive notice. If an “RF” company complies with the formal requirements stipulated by s 19(5)(a) of the 2008 Act, aspects of the *ultra vires* doctrine and the doctrine of constructive notice will influence every contract it concludes.<sup>7</sup>

The impact of the 2008 Act on the contractual capacity of companies, the doctrine of constructive notice, and the authority of a company’s agents, is of paramount importance when determining the validity of unauthorised company contracts. Unfortunately, the “RF” provisions are not entirely unambiguous, and definitely open to interpretation. In 2012, the Companies and Intellectual Property Commission (the CIPC) issued Practice Note 4 of 2012, in an attempt to clarify certain issues for practitioners. However, the meaning and effect of the “RF” provisions remain largely unaddressed in academic literature.

#### 1.4 Aims of the research

The 2008 Act has brought profound changes to company law in South Africa, particularly in the area of corporate capacity. The new legislation has partially abolished the doctrine of constructive notice and effectively established two categories of companies, one of which will “enjoy” certain consequences of the *ultra vires* doctrine. These changes are of great importance to the issue of a company’s liability for unauthorised contracts, and are therefore deserving of academic attention. Practitioners and students of company law require a comprehensive and detailed understanding of the “RF” provisions. To that end, this thesis will analyse the relevant sections of the 2008 Act and some of their implications for a company, its agent, and an outsider, in the event that a situation of unauthorised agency arises.

Shortly after the 2008 Act came into effect, a call was made for thought and comment on certain of the “RF” provisions.<sup>8</sup> It is hoped that this thesis will serve as a suitable (partial) response to that call.

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<sup>7</sup> In this regard, see 3.5.3 herein.

<sup>8</sup> Jooste R ‘Observations on the impact of the 2008 Companies Act on the Doctrine of Constructive Notice and the *Turquand* rule’ (2013) 130 SALJ 130 467.

## 1.5 Research questions

This thesis will investigate two pressing issues which an outsider will be confronted with when he learns that he has concluded an unauthorised contract with an agent of a company:

- 1) Is the contract valid and enforceable?
- 2) If the contract is not enforceable, can the purported agent be held liable to compensate the outsider for loss suffered as a result of the unauthorised contract?

## 1.6 Background to the study

The law of agency permits one person (the principal) to authorise another person (the agent) to represent the principal for the purpose of concluding contracts with third parties. The common intention of all the parties in this legal phenomenon is to bring about a contract between the principal and the third party. The agent is generally not a party to the contract and incurs no liability thereunder.<sup>9</sup>

Unauthorised agency is a course of events that creates considerable legal uncertainty. This oxymoronic phenomenon arises where one person (the purported agent) purports to represent another person (the professed principal) in concluding a contract with a third party, while lacking the necessary authority to bind the professed principal to the juristic act. The respective legal positions of the professed principal, the purported agent, and of the third party, are issues of great legal and commercial significance, and will depend largely upon the facts of each particular case.

### 1.6.1 Liability of the principal

An essential requirement of agency is that the agent must have been duly authorised by the principal before he can effectively conclude juristic acts on the principal's be-

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<sup>9</sup> '[A]n agent is now regarded as one to whom no contractual liability in respect of agreements, entered into in the name of his principal, can possibly attach. He is simply and solely the representative of another. This view of the position of the modern agent is now so firmly established, and so generally recognised, that no person dealing with an agent, as such, can be held to have intended to contract with him personally *unless the terms of the contract itself make it clear that he did*'. Per Innes CJ in *Blower v Van Noorden* 1909 890 TS 899 [Emphasis added].

half. Whether an agent has indeed been authorised to represent his principal will always be a question of fact.<sup>10</sup>

When acting on behalf of his principal, the agent is restricted to performing those acts which he has been authorised to perform. Since authority is required for valid representation, a principal cannot be bound to a contract outside the scope of the agent's given authority. Put differently, an agent purporting to contract with a third party, in excess of his authority, cannot bind the principal to that contract. In fact, the purported contract would be void *ab initio* for lack of consensus. This rule goes to the foundations of the South African law of agency.<sup>11</sup>

However, an unauthorised contract may yet be saved. It may be validated by the principal's subsequent ratification. A second exception to the general rule exists in the doctrine of agency by *estoppel*, more commonly referred to as "ostensible authority", or "apparent authority".<sup>12</sup> Ratification and agency by *estoppel* were traditionally the only two recognised ways in which a professed principal could incur liability on, and reap the benefits of, an unauthorised contract.<sup>13</sup>

#### 1.6.2 Personal liability of the purported agent towards the third party<sup>14</sup>

As a general rule, an agent will incur no liability in respect of a contract between his principal and a third party.<sup>15</sup> However, a purported agent may in two ways incur personal liability as a result of his misrepresentation of authority: by agreement, or by operation of law.

A purported agent and a third party may agree that the former will incur personal liability in certain circumstances. For example, they may agree that the purported agent warrants the existence of his authority, and will incur liability if he has acted in ex-

<sup>10</sup> See Dendy M 'Agency and Representation' (2014) para 133.

<sup>11</sup> See Dendy M 'Agency and Representation' (2014) para 137.

<sup>12</sup> See *NBS Bank Ltd v Cape Produce Company Ltd and Others* 2002 (2) SA 262 (A), *South African Broadcasting Corporation v Coop* 2006 (2) SA 217 (SCA), and *Northern Metropolitan Local Council v Company Unique Finance* 2012 (5) SA 323 (SCA). Kerr prefers the term "apparent" over "ostensible" in this context, as the word "apparent" is used generally in the law of contract. See Kerr AJ *The Law of Agency* 4 ed (2006) 25.

<sup>13</sup> See Dendy M 'Agency and Representation' (2014) para 137.

<sup>14</sup> There is still uncertainty in South African law about a purported agent's liability towards third parties in the context of an unauthorised contract, particularly regarding the basis and extent of such liability. See Dendy M 'Agency and Representation' (2014) para 163 and Chapter Four herein.

<sup>15</sup> This position has been confirmed on numerous occasions by South African courts. See in this regard, *Marais v Perks* 1963 (4) SA 802 (E) 806 F-G, and *Nordis Construction Co (Pty) Ltd v Theron, Burke and Isaacs* 1972 (2) SA 535 544-5H.

cess thereof. This warranty of authority would be a distinct contract from the one between the principal and the third party.<sup>16</sup> If it is revealed that the purported agent lacked the authority he claimed to have had, he will have breached the contract between himself and the third party.<sup>17</sup> The nature and extent of the purported agent's liability in the event of a breach of a warranty of authority will be governed by the terms of that contract.<sup>18</sup> It should be noted that a purported agent may expressly or tacitly bind himself to the third party in this way.

In the absence of an agreement to that effect, South African law can impose liability on a purported agent for damages in respect of loss caused to the third party as a result of the conclusion of an unauthorised contract. Such liability would be based either on delictual principles,<sup>19</sup> or on the breach of a fictional contract (the "implied warranty of authority").<sup>20</sup>

### 1.6.3 Agency principles in company law

It is trite that a company is a fictitious person. As such, it cannot perform acts by and for itself. A company can only conclude contracts through duly authorised representatives acting on its behalf. Therefore, the principles of the law of agency impact greatly on company law.<sup>21</sup>

The relationship between a company and its representatives is generally a principal-agent relationship, albeit one with special characteristics.<sup>22</sup> Therefore, the same general rule of agency will apply in company law: a company's representative contracting in excess of his authority cannot bind the company to that contract.

<sup>16</sup> Dendy M 'Agency and Representation' (2014) para 166.

<sup>17</sup> Dendy M 'Agency and Representation' (2014) para 165.

<sup>18</sup> Dendy M 'Agency and Representation' (2014) para 166. If the contract makes no provision for the nature and extent of the purported agent's liability, and none can be implied, the "implied warranty of authority" may be applied. See Kerr AJ *The Law of Agency* (2006) at 245. This remedy will be discussed in Chapter Four.

<sup>19</sup> See Dendy M 'Agency and Representation' (2014) para 165.

<sup>20</sup> A rule of law developed by Innes CJ in *Blower v Van Noorden* at 900-901.

<sup>21</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 187.

<sup>22</sup> See Cassim R 'Governance and the Board of Directors' in Cassim FHI (man.ed.) *Contemporary Company Law* 2 ed (2012) at 412.

## 1.6.4 The impact of company law doctrines on the validity of unauthorised company contracts

### 1.6.4.1 The doctrine of *ultra vires*

For many years, companies did not enjoy the same contractual capacity as natural persons. A company's business was, in the past, required to be stipulated in a "main objects" clause contained in the company's Memorandum of Association (MOA). The company's contractual capacity would be limited to concluding contracts related to or reasonably incidental to that main object.<sup>23</sup> In fact, companies were regarded in law to exist only for the purpose of concluding those contracts related to or in furtherance of their main object.<sup>24</sup> Any contract concluded outside of that limited sphere was void *ab initio*, and was incapable of ratification by the shareholders of the company.<sup>25</sup> This became known as the *ultra vires* doctrine.

Ostensibly, the purpose of the *ultra vires* doctrine was the protection of a company's shareholders, potential investors, and its creditors. In theory, the "main objects" clause was intended to place these parties in a position to better evaluate the risk of investing in or dealing with a company. However commendable the initial aim of the *ultra vires* doctrine may have been, the doctrine would always operate to protect a company at the expense of outsiders. Eventually, its application and its very legitimacy became questionable as a result of the abuse of the "main objects" clause.<sup>26</sup>

The *ultra vires* doctrine was in large part abolished by the Companies Act 61 of 1973 (the 1973 Act). According to s 36 of that Act, an *ultra vires* contract concluded by a director was not void only as a consequence of the company's lack of capacity, or the director's lack of authority arising from such lack of capacity. Such a contract would be valid and enforceable. However, the internal consequences of the *ultra vires* doctrine survived: the responsible directors incurred liability to the company for breaching a fiduciary duty, and the shareholders of the company could still have been entitled to restrain the directors from rendering performance in terms of the

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<sup>23</sup> See *In Re Horsley & Weight Ltd* [1982] 3 ALL ER 1045 (CA) 1050-1.

<sup>24</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 163.

<sup>25</sup> *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653. See also Cassim FHI 'The Rise, Fall and Reform of the Ultra Vires Doctrine' (1998) 10 SA Merc LJ 293.

<sup>26</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 166-7. The problems and failures of the *ultra vires* doctrine will be discussed in Chapter Three.

contract.<sup>27</sup> The relaxed approach of the 1973 Act to the *ultra vires* doctrine continues to apply in the new company law dispensation.<sup>28</sup> In fact, the 2008 Act further distances South African company law from the *ultra vires* doctrine by expressly stating that a company has the same contractual capacity and powers as a natural person.<sup>29</sup>

#### 1.6.4.2 The doctrine of constructive notice

The doctrine of constructive notice is a rule of company law that has traditionally been available to a company to protect itself from being bound to *ultra vires* contracts entered into by the company's directors and other agents. Under the application of this doctrine, third parties dealing with a company were effectively deemed to be aware of the contents of the public documents of the company, whether they had read those documents or not.<sup>30</sup> The doctrine of constructive notice has attracted severe criticism over the years for its harsh effects on outsiders dealing with companies.<sup>31</sup>

The 2008 Act has to a large extent abolished the doctrine of constructive notice.<sup>32</sup> However, it has made provision for the resurrection of the doctrine in two specific instances. In the first instance, outsiders are deemed to have knowledge of the joint and several liability of directors of personal liability companies.<sup>33</sup> Secondly, s 19(5)(a) of the Act stipulates that all persons must be regarded as having notice and knowledge of any restrictive condition in a company's MOI, provided the company's name includes the term "RF" at the end of its name, and the Notice of Incorporation or a subsequent Notice of Amendment draws proper attention to the relevant provision.<sup>34</sup> The expression "RF" is intended to alert outsiders dealing with a company to

<sup>27</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 170 and 172.

<sup>28</sup> In terms of s 20(1)(a)(i) of the 2008 Act.

<sup>29</sup> In terms of s 19(1)(b) of the 2008 Act. See 3.5.1 herein. This is an approach long adopted in respect of close corporations. See s 2(4) of the Close Corporation Act 69 of 1984.

<sup>30</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 179.

<sup>31</sup> Particularly, by Professor JS McLennan. See McLennan JS 'Time for the Final Abolition of the Ultra Vires and Constructive Notice Doctrines in Company Law' (1997) 9 *SA Merc LJ* 333.

<sup>32</sup> Section 19(4) of the 2008 Act expressly states that subject to s 19(5), a person must *not* be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document has been filed or is accessible for inspection at an office of the company.

<sup>33</sup> See s 19(3) read with s 19(5)(b) of the 2008 Act. FHI Cassim comments that the rationale for this provision is not completely clear. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 181.

<sup>34</sup> Section 11(3) read with ss 13(3), 15(2)(b), and 19(5)(a) of the 2008 Act.



the fact that the company's powers are restricted in some way, thereby encouraging them to examine the company's MOI to determine precisely what the limitation is.

Unfortunately, the phrase 'restrictive conditions applicable to the company' contained in s 15(2)(b) of the Act remains undefined.<sup>35</sup> To dispel the growing confusion, the CIPC issued Practice Note 4 of 2012, which aimed to clear up the uncertainty regarding precisely under which circumstances the expression should be affixed to a company's name.

### 1.7 Theoretical assumptions and delimitation of study area

Due to the constraints of the word limit of this mini-thesis, a comprehensive exposition of unauthorised agency in company law will not be possible. Certain areas of this problem are simply impossible to address here.

It shall be assumed that the company was named and in existence at the time of conclusion of the unauthorised contract, and that the agent's lack of authority is not due to non-compliance with an internal formality of the company for the validity of such a contract.<sup>36</sup> This thesis will only cursorily discuss the liability of the agent towards the company for acting in excess of his authority.<sup>37</sup>

### 1.8 Research methodology

This thesis will not take the form of an empirical study. Instead, this thesis will be a strictly desktop study. It is hoped that an analysis of relevant primary sources such as the provisions of the 1973 Act and of the 2008 Act, as well as of relevant foreign and domestic case law, will serve to lay a proper foundation for identifying the intricate legal principles at play. To add depth to this thesis, the views on this topic of leading South African academics will also be consulted and critically discussed.

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<sup>35</sup> MF Cassim rightly raises concern about the lack of certainty in this regard. See Cassim MF 'Formation of Companies and the Company Constitution' in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 130.

<sup>36</sup> In such a case, s 20(7) of the 2008 Act and the common-law *Turquand* rule provide protection to *bona fide* third parties. See ss 20(7) and 20(8) of the 2008 Act. While the legal position created where the purported agent's lack of authority arose from the company's non-compliance with an internal formality for the existence of the agent's authority is without doubt a matter of great practical importance and academic interest, it can unfortunately not be addressed in this thesis.

<sup>37</sup> The 2008 Act, in ss 75-77, codifies certain of the common-law fiduciary duties of directors, and stipulates the consequences of their breach.

## CHAPTER TWO

### AUTHORITY, AGENCY BY *ESTOPPEL*, AND RATIFICATION

#### 2.1 Introduction

Chapter Two will discuss the concept of authority and analyse the important role it plays in the phenomenon of representation. It is trite that the legal principles regulating the relationship between a company and its representatives are primarily those of the law of agency. However, company law rules (both statutory<sup>38</sup> and those arising from the common law<sup>39</sup>) create an agency relationship with special characteristics. Yet, the fundamental principle remains that a person purporting to represent a company must have been duly authorised to do so, in order to effectively 'create, alter or extinguish legal obligations' on the company's behalf.<sup>40</sup> Therefore, it seems appropriate to commence the body of this thesis with an analysis of the concept of authority.

Consideration will be given to the two manifestations of actual authority, express authority and implied authority. Thereafter, this chapter will discuss the various sources of authority, to illustrate how one person may come to have the power to represent another.<sup>41</sup> Finally, a reflection on the principles of ratification and agency by *estoppel* will illustrate the circumstances under which a person may be held liable, as principal, on an unauthorised contract.

#### 2.2 Authority required for successful representation

Central to the principles of agency law in South Africa, is the requirement of the representative's authority to act on his principal's behalf. In order for a representative to conclude a valid contract on behalf of another person, he must have the necessary authority to do so.<sup>42</sup> A contract entered into by an agent, in excess of his actual au-

<sup>38</sup> In terms of s 66(1) of the 2008 Act.

<sup>39</sup> Like the doctrines of *ultra vires* and constructive notice.

<sup>40</sup> See Dendy M 'Agency and Representation' in De Wet JC (founding ed) *LAWSA* vol1 Third Reissue (2014) para 126.

<sup>41</sup> For the purpose of concluding juristic acts.

<sup>42</sup> Ratification and agency by *estoppel* being the exceptions. See Dendy M 'Agency and Representation' (2014) para 137.

thority, is void. FHI Cassim's description of authority as 'the nub of agency' is therefore quite an appropriate one.<sup>43</sup>

### 2.3 Types of authority

Lord Denning's exposition of the two distinct forms of actual authority in *Hely-Hutchinson v Brayhead Ltd & another*<sup>44</sup> has been relied upon and approved by South African courts on multiple occasions.<sup>45</sup> There is only one type of authority recognised in South African law: actual authority. Actual authority can manifest in one of two ways: express authority or implied authority. Express authority is that authority explicitly given by the principal to the agent, either verbally or in writing. The conferring of authority may also be implied from the conduct of the parties and other surrounding circumstances.<sup>46</sup> In conjunction with his express authority, an agent may have the implied authority to do whatever is reasonably necessary for, or incidental to, the performance of the obligation/s with which the express authority is coupled.<sup>47</sup>

### 2.4 Sources of authority

It is necessary, at the outset, to state that the juristic nature of the various sources of authority remains in doubt. The two academic heavyweights of contract and agency law in South Africa, Professors JC De Wet and AJ Kerr, grappled with opposing ends of this proverbial stick.<sup>48</sup> Dendy attempts to resolve the dispute in the latest re-issue

<sup>43</sup> Cassim FHI 'Corporate Capacity, Agency, and the Turquand Rule' in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 187.

<sup>44</sup> [1968] 1 QB 549 (CA); [1967] 3 All ER 98.

<sup>45</sup> See *NBS Bank Ltd v Cape Produce Co (Pty) Ltd and Others* 2002 (1) SA 396 (SCA) [2002] 2 All SA 262 para 24; *Northern Metropolitan Local Council v Company Unique Finance* (36/11) [2012] ZASCA 66 (21 May 2012) para 24. In *Hely-Hutchinson*, Lord Denning stated: '[Actual authority] is *express* when it is given by express words, such as when a board of directors pass a resolution which authorises two of their number to sign cheques. It is *implied* when it is inferred from the conduct of the parties and the circumstances of the case, such as when the board of directors appoint one of their number to be managing director. They thereby impliedly authorise him to do all such things as fall within the usual scope of that office. Actual authority, express or implied, is binding as between the company and the agent, and also as between the company and others, whether they are within the company or outside it'.

<sup>46</sup> It could thus be argued that there are in fact *three* manifestations of actual authority: authority expressly given, authority tacitly "given", and authority implied by virtue of the task/s needing to be performed on the principal's behalf. See Dendy M 'Agency and Representation' (2014) para 142 for a concise and thoughtful discussion of the concept of actual authority.

<sup>47</sup> Provided that the agent cannot have the implied authority to do something which is clearly beyond his express authority, for example where an express limitation is placed on his authority. See Dendy M 'Agency and Representation' (2014) 142.

<sup>48</sup> See Dendy M 'Agency and Representation' (2014) para 139 for a succinct analysis of the debate.

of 'Agency & Representation'.<sup>49</sup> What can be regarded as certain and accepted law regarding the creation of authority will be set out below.

In the usual course of events, an agent will derive his authority from authorisation by his principal. The authorisation consists of an expression of the principal's will, by words or by conduct, that the agent be empowered to conclude a juristic act on the principal's behalf.<sup>50</sup> The authorisation will more often than not be obligated by or incidental to, and evidenced by, a contract.<sup>51</sup> This contract between the principal and his agent will usually be one of mandate.<sup>52</sup>

However, representative capacity may also be established through operation of law. The following examples are illustrative of this point:

- (i) A parent or guardian of a minor child is authorised to act on the minor's behalf; and
- (ii) Mentally ill persons and prodigals are represented by curators with *ex lege* authority to act on their behalf.<sup>53</sup>

Immediately noticeable in the above scenarios, is the absence of the principal's wish to enter into an agency relationship.<sup>54</sup> It is submitted that a further distinction between authority conferred by authorisation and authority arising from operation of law lies in the ease with which the principal can revoke the authority. If authority has been conferred on an agent by way of authorisation, the principal is generally free to

<sup>49</sup> Dendy M 'Agency and Representation' (2014) para 139.

<sup>50</sup> Dendy M 'Agency and Representation' (2014) para 142.

<sup>51</sup> See Corbett JA's *dictum* in *Joel Melamed and Hurwitz v Cleveland Estates (Pty) Ltd; Joel Melamed and Hurwitz v Vornor Investments (Pty) Ltd* 1984 (3) SA 155 (A). At para 121 the learned judge of appeal writes: 'An act of representation needs to be authorised by the principal. Such authorisation is usually contained in a contract.' Whether authorisation in such circumstances is a unilateral or bilateral juristic act is, it is respectfully submitted, far from settled. See Dendy M 'Agency and Representation' (2014) para 139.

<sup>52</sup> Indeed, '[a]gency has always been associated with mandate for unstated but obvious reasons'. See Joubert DJ 'Agency and *Stipulatio Alteri*' in Zimmermann R & Visser D (eds) *et al Southern Cross: Civil Law and Common Law in South Africa* (1996) 352. A typical example would be the relationship between an attorney and his client. Before proceeding to act on the client's behalf, the attorney should have the client sign a "power of attorney" as evidence of the attorney's authority. Included in this "power of attorney" however, will be an instruction to the attorney to perform certain acts (factual and/or juristic) on the client's behalf. In such a case, the attorney's instruction, embodied in the "power of attorney", constitutes a mandate. See also *Benson and Another v Walters and Others* [1984] 1 ALL SA 283 (A), where Van Heerden JA at 287 remarked that '[i]t is clear that the relationship of an attorney and his client is based on *mandatum*'. Kerr correctly points out that the contract need not *necessarily* be one of mandate; authority can also be conferred as a result of the conclusion of an employment contract, for example. See Kerr AJ *The Law of Agency* 4 ed (2006) 33.

<sup>53</sup> These examples should by no means be considered to be a closed list.

<sup>54</sup> As a general rule.

unilaterally revoke the agent's authority at any time.<sup>55</sup> In contrast, the authority of a parent, guardian or curator cannot unilaterally be revoked by his ward; nothing but a court order can remove such authority.<sup>56</sup>

## 2.5 Agency by *estoppel*

One often hears it said that an agent is clothed with "ostensible authority".<sup>57</sup> However, "ostensible authority" is no authority at all. This phrase is merely used to describe a situation where it *appears* to third parties that a purported agent has been properly authorised to contract on behalf of a professed principal. In certain circumstances, *estoppel* may become available to hold a professed principal liable on an unauthorised contract. In simple terms, *estoppel* is a remedy aimed at preventing a person from benefitting from his own misrepresentation, however honest it may have been.<sup>58</sup> It operates in an agency context as follows: a prejudiced third party who was induced into contracting with an unauthorised agent by some conduct of a professed principal, may rely in legal proceedings on the equitable remedy of agency by *estoppel* to hold the professed principal to the contract, provided certain requirements have been met. The Supreme Court of Appeal has in a number of decisions restated the requirements for reliance on agency by *estoppel*.<sup>59</sup> In order for a third party to enforce a claim against a professed principal based on the "ostensible authority" of a purported agent, the following elements must be present:

- (i) A representation by words or conduct;
- (ii) The representation was made by the professed principal that the purported agent was authorised to act as he had done;
- (iii) The representation was of such a form that the professed principal should reasonably have expected outsiders to act on the strength of it;

<sup>55</sup> The existence of a truly irrevocable authority in South African law remains doubtful. See Dendy M 'Agency and Representation' (2014) para 149. Indeed, the jurisprudential recognition of "irrevocable authority" found in, *inter alia*, *Natal Bank v Natorp* 1908 TS 1016, *Ward v Barret* 1962 (4) SA 732 (N), and *Mattioda Construction (Pty) Ltd v Ritchie Bros Auctioneers* 2007JOL 20858 (D), postulates a reasoning which is capable of criticism. See Kotze GF *Die Leerstuk van Onherroeplike Volmag in die Suid-Afrikaanse Verteenwoordigingsreg* (unpublished LLM thesis, Stellenbosch University, 1985).

<sup>56</sup> At least during the period in which the authority is intended to exist. When a minor attains the age of majority, for example, the authority of his parent or guardian lapses without the need for the minor to revoke it.

<sup>57</sup> See *Northern Metropolitan* para 3.

<sup>58</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 189.

<sup>59</sup> *NBS Bank Ltd v Cape Produce (Pty) Ltd and Others* 2002 (1) SA 396 (SCA) para 26; *Glofinco v Absa Bank t/a United Bank* [2002] ZASCA 91 para 12, *South African Broadcasting Corporation v Cop and Others* [2005] ZASCA 118 para 66; *Northern Metropolitan* para 28.

- (iv) The third party was induced by the representation into concluding the unauthorised contract;<sup>60</sup>
- (v) The third party's reliance was reasonable in the circumstances; and
- (vi) The third party suffered prejudice as a result.

If the above factual requirements have been met, the professed principal will be *estopped* (prevented) from denying the existence of the purported agent's authority. Consequently, the professed principal will be bound to the unauthorised contract as if the purported agent *had* been duly authorised to conclude it.

Since "apparent authority" is no authority at all, in the interest of accurate terminology, it is submitted that the description "agency by *estoppel*" should be preferred.<sup>61</sup>

## 2.6 Ratification

It often happens that, despite the professed principal's ire at his agent for contracting beyond his authority, he nevertheless wishes to accept the rights and obligations which would have arisen had the would-be agent been properly authorised. In such circumstances, the professed principal may elect to abide by an unauthorised contract through ratification.

Ratification is the subsequent validation of a previously unauthorised contract concluded by a purported agent on a professed principal's behalf. Ratification is a unilateral juristic act by the professed principal, entailing an expression of his will that he shall assume the liabilities under the unauthorised contract. The effect of ratification is to have the unauthorised contract be regarded as if it had been authorised at the time of its conclusion.<sup>62</sup>

## 2.7 Conclusion

The common-law principles regarding authority, ratification and agency by *estoppel* are of fundamental importance in commercial dealings, no less so where the principal is a company. Since the existence of a director's authority now flows directly from

<sup>60</sup> See *Strachan v Blackbeard and Son* 1910 AD 282 at 288-9.

<sup>61</sup> Cf Kerr AJ *The Law of Agency* (2006) 25-31. Unfortunately, Mpati P in *Northern Metropolitan's* case referred to the "ostensible authority" of the appellant throughout.

<sup>62</sup> See Dendy M 'Agency and Representation' (2014) paras 150-1.

the 2008 Act,<sup>63</sup> a proper understanding of the law of agency is vital when determining the extent to which a company can be bound to unauthorised contracts.

Chapter Three will analyse the validity of unauthorised company contracts in light of the provisions of the 2008 Act.



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<sup>63</sup> In terms of s 66(1) of the 2008 Act. See 4.2 below.

## CHAPTER THREE

### THE VALIDITY OF UNAUTHORISED COMPANY CONTRACTS

#### 3.1 Introduction

A company is a fictitious person. As such, it is unable to speak or act for itself. Therefore, representatives must be appointed to speak and act on a company's behalf.<sup>64</sup> The archaic notion that a company's contractual capacity is limited to achieving its main object as set out in the company's public documents has presented great difficulties in commerce. These antiquated ideas arose in the early days of company law, at a time when no corporate veil separated a company from its members. Besides restricting commercial activity, the idea of a company possessing only limited contractual capacity was also the cause of a considerable amount of complexity in company law jurisprudence as a whole.<sup>65</sup>

Despite legislative reform aimed at simplifying the company law regime and providing greater protection for third parties,<sup>66</sup> it remains the case that no straightforward answer exists to the question of what the legal position is if a company's agent concludes an unauthorised contract with an outsider. This state of affairs is far from ideal, as company law has a particularly important role to play in any economy, and therefore needs to be clear and certain.<sup>67</sup>

In order to appreciate the contemporary approach to corporate capacity, regard must be had to the historical operation of the common-law doctrines of *ultra vires* and constructive notice, in conjunction with the effect of relevant provisions of the 1973

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<sup>64</sup> These representatives include the company's authorised directors and agents. Section 69 of the Companies Act 61 of 1973 (the 1973 Act) rather superfluously restated the common law in this regard by requiring company contracts to be concluded by persons authorised to contract on behalf of the company in order for them to be valid. Section 66(1) of the Companies Act 71 of 2008 (the 2008 Act) stipulates that a company's business and affairs must be managed by or under the direction of the board of directors, and confers on the board the authority to 'exercise all of the powers and perform any of the functions of the company' (within the limits of the company's MOI and of the Act itself). The authority to perform the functions of the company should include the authority to bind the company to contracts. See 4.2 herein.

<sup>65</sup> On the *ultra vires* doctrine, Professor McLennan writes: '[T]his topic has perhaps received more judicial and academic attention than any of the numerous other controversial topics in the field of company law'. See McLennan JS 'The Ultra Vires Doctrine and the Turquand Rule in company law – A Suggested Solution' (1979) 96 SALJ 329 at 329. FHI Cassim agrees that the *ultra vires* doctrine has had a profound impact on corporate law thinking. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 163.

<sup>66</sup> In the forms of first the 1973 Act and its amendments, followed by the 2008 Act, as amended.

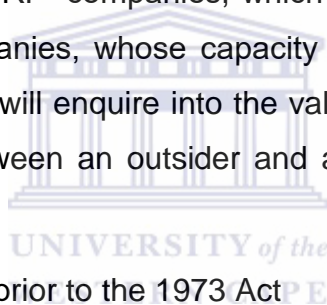
<sup>67</sup> See Baiketile L *Corporate Capacity and Authority of Agents under the Botswana Companies Act 2003* (unpublished LLM thesis, University of Cape Town, 2014) at 10.



Act.<sup>68</sup> To that end, this chapter will reflect on the commercial and legal problems encountered as a result of these two antiquated doctrines, as well as on the legislative measures taken to halt their ever-increasing abuse.

For the purpose of this thesis, two “types” of unauthorised company contracts must be distinguished: the first is a purported company contract which exceeds the contractual capacity of the company (an *ultra vires* contract), and the second is a purported company contract entered into by an agent acting beyond the limits of his actual authority (a pure unauthorised contract). In this chapter, the effect of the relevant provisions of the 2008 Act on the validity of both of these types of unauthorised contracts will be discussed.

The 2008 Act has radically altered the South African company law approach to the issue of a company’s contractual capacity. In short, two categories of companies have now been created: non-“RF” companies, which have nearly unlimited contractual capacity, and “RF” companies, whose capacity is limited in some way by the company’s MOI. This chapter will enquire into the validity of both types of unauthorised contracts concluded between an outsider and an agent of both categories of companies.



### 3.2 The common-law position prior to the 1973 Act

#### 3.2.1 The doctrine of *ultra vires*

Historically,<sup>69</sup> in order to create a legally valid contract between a company and another person, it was necessary to comply with two key requirements:<sup>70</sup> the company had to have had the contractual capacity to enter into the agreement, and the company’s representative had to have had the necessary authority to bind the company.<sup>71</sup> If either of these two requirements were lacking, the purported contract would be a nullity.<sup>72</sup>

<sup>68</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 163.

<sup>69</sup> Before 1 January 1974, the commencement date of the 1973 Act.

<sup>70</sup> In addition to the common-law requirements for validity of a contract. See Naudé SJ ‘Company Contracts: The Effect of Section 36 of the New Act’ (1974) 91 *SALJ* 315 at 315; Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 163.

<sup>71</sup> Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 163; Naudé SJ (1974) 315. The second requirement is an established common-law rule of agency. See 2.2 above.

<sup>72</sup> For either one or both of two reasons: lack of capacity on the part of the company, and/or lack of authority on the part of the representative.

For many years, the contractual capacity of South African companies was restricted. A company's main business was, in the past, required to be stipulated in a "main objects" clause contained in the company's MOA. The stated main object of a company was the cornerstone upon which all the company's business dealings were done, as the main object of the company determined its contractual capacity. The company would be limited to concluding contracts related to or reasonably incidental to that main object.<sup>73</sup> Any contract concluded outside of that limited scope was void *ab initio*, and was incapable of ratification by the shareholders of the company.<sup>74</sup> This became known as the *ultra vires* doctrine.<sup>75</sup>

The foundation of the *ultra vires* doctrine rested on the fact that companies were regarded to exist only for the purpose of concluding contracts related to or aimed at achieving their main object.<sup>76</sup> A company's legal existence was thought to be limited to concluding only those contracts that furthered the company's main object, or at the very least contracts which were ancillary or reasonably incidental to the company's main object.<sup>77</sup> Contracts aimed at achieving a purpose unrelated to the company's main object simply *could* not be valid.<sup>78</sup>

It should be borne in mind that a company's contractual capacity and the authority of its agents to act on the company's behalf are inextricably linked – if a company's main object limited its contractual capacity to achieving purpose X, the representatives of the company could never have the authority to conclude a contract aimed at achieving purpose Y.<sup>79</sup> Therefore, an *ultra vires* contract is also an unauthorised contract.

For more than a hundred years, the *ultra vires* doctrine has plagued South African company law, complicating transactions between companies and outsiders. In simple terms, the *ultra vires* doctrine prohibits a company from entering into an agreement beyond its legitimate powers. Any purported contract concluded on behalf of a

<sup>73</sup> See *In Re Horsley & Weight Ltd* [1982] 3 ALL ER 1045 (CA) 1050-1.

<sup>74</sup> A principle established in *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653. See Cassim FHI 'The Rise, Fall and Reform of the Ultra Vires Doctrine' (1998) 293.

<sup>75</sup> The literal translation of the phrase '*ultra vires*' is 'beyond the powers'. See <http://legal-dictionary.thefreedictionary.com/ultra+vires> (accessed on 13 August 2015).

<sup>76</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 163 and 165.

<sup>77</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 163 note 3.

<sup>78</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 163. See also McLennan JS (1979), where the learned author at 330 note 11 cites *Hompes v Beaumont Estate Co Ltd* 1903 TS 227 as an early example of the *ultra vires* doctrine being applied in South African law.

<sup>79</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 165.

company dealing with matters outside of the limited scope of the company's main object as stated in its MOA, was void *ab initio* due to the company's lack of capacity. Consequently, no party to an *ultra vires* company contract could enforce performance according to its terms.<sup>80</sup>

FHI Cassim distinguishes between the external and the internal consequences of an *ultra vires* contract.<sup>81</sup> Externally, i.e. between the company and the third party, the *ultra vires* doctrine renders the purported contract void and unenforceable. In any subsequent dispute that may arise, either party may rely on the fact that the contract is beyond the capacity of the company and therefore void and unenforceable. The internal consequence of an *ultra vires* contract was twofold: the shareholders were entitled to prohibit the company from concluding or performing in terms of an *ultra vires* contract,<sup>82</sup> and the company would have been entitled to hold the responsible director liable for any loss sustained by the company as a result of the unauthorised action, on the basis of a breach of the director's fiduciary duty not to act in excess of his actual authority.<sup>83</sup>

The *ultra vires* doctrine was codified in the first legislative attempt to regulate South African company law. Section 6 of the Companies Act 46 of 1926 stipulated that a company that acted beyond the limits of the objects contained in its MOA acted *ultra vires*, and confirmed that such acts were void *ab initio* and incapable of ratification. In the event that an *ultra vires* contract was concluded between a company and a third party, the invalidity of the contract would preclude either party from enforcing its terms, and any performance made in terms of the void contract was to be returned.

The traditional justification put forth for the *ultra vires* doctrine was that it served the important purpose of protecting the interests of a company's creditors and shareholders.<sup>84</sup> It was argued that the *ultra vires* doctrine served as a guarantee to both current and prospective shareholders that 'an investor in a gold mining company did

<sup>80</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 165.

<sup>81</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 165-6.

<sup>82</sup> In practice, the shareholders were entitled to apply for an interdict restraining the company from acting *ultra vires*. See McLennan JS (1979) 330; Naudé SJ (1974) 316.

<sup>83</sup> See *Cullerne v London and Suburban General Permanent Building Society* (1890) 25 QBD 485. See also McLennan JS (1979) 331.

<sup>84</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 164; McLennan JS (1979) 331; Blackman MS 'The capacity, powers and purposes of companies: the Commission and the new Companies Act' (1975) 8 CILSA 1 at 2.

not find himself holding shares in a fried-fish shop'.<sup>85</sup> In addition, the *ultra vires* doctrine ostensibly safeguarded the interest of creditors to have the company's capital remain within the realms of the company's main object.<sup>86</sup> It should be noted that these grounds of justification have not found much support among contemporary company law academics.<sup>87</sup> But however advantageous the *ultra vires* doctrine may have been for the company and its insiders, it would always operate to the detriment of third parties wishing to contract with the company. Indeed, the possibility of causing prejudice to outsiders is an almost inevitable consequence of the *ultra vires* doctrine. This risk was thought to be justified by the fact that a company's public documents were available for inspection by outsiders wishing to contract with it; it was argued that outsiders were therefore in a position to protect themselves by determining a company's contractual capacity before contracting with it.<sup>88</sup> This argument *prima facie* has merit, until one considers how well-equipped outsiders actually would have been to read and understand a company's public documents. A company's MOA and AOA would often have been voluminous documents filled with company management jargon and, as will be discussed below,<sup>89</sup> could quite easily not even have reflected the true contractual capacity of the company.

Therefore, the traditional *ultra vires* doctrine, coupled with the company's main object, effectively operated as a guarantee for insiders that the company's finances would not be used for a purpose other than the purpose for which the company had been formed.<sup>90</sup> In this regard, the *ultra vires* doctrine was tremendously successful. However, it cannot be denied that restrictions on a company's contractual capacity would always place third parties at great risk. Indeed, ensuring greater protection for outsiders transacting with companies was among the chief reasons for the Legislature's introduction of s 36 of the 1973 Act.<sup>91</sup>

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<sup>85</sup> See Gower *et al* *Gower's Principles of Modern Company Law* 4 ed (1979) 165; Cassim FHI (1998) 295.

<sup>86</sup> Cassim FHI (1998) 295.

<sup>87</sup> See McLennan JS (1979) 331. Blackman suggests that the practical usefulness of the *ultra vires* doctrine may have been exaggerated because of its important role in corporate theory. See Blackman MS (1975) 1.

<sup>88</sup> See Blackman MS (1975) 2.

<sup>89</sup> At 3.3.1.

<sup>90</sup> McLennan JS (1979) 331.

<sup>91</sup> McLennan JS (1979) 334.

### 3.2.2 The doctrine of constructive notice

The doctrine of constructive notice is a company law rule that supplemented the *ultra vires* doctrine and greatly impacted on the potential liability of companies for unauthorised contracts concluded on their behalf. Under the application of this doctrine, all outsiders dealing with a company were effectively deemed to be aware of the contents of that company's public documents lying open for public inspection at the office of the Registrar of Companies,<sup>92</sup> whether they had read them or not.<sup>93</sup> These public documents included the MOA and the AOA, as well as any special resolutions passed by the company.

However, to say that the doctrine of constructive notice deemed outsiders to have knowledge of the contents of a company's public documents is a potentially misleading statement, as it would imply that an outsider contracting with a company could rely on a provision in the company's public documents despite not knowing about the provision at the relevant time.<sup>94</sup> This was never the position. Professor McLennan correctly summarises the effect of the constructive notice doctrine as follows:

'[T]he doctrine is more accurately expressed by saying that a person dealing with a company cannot rely on his ignorance of the contents of the public documents than by saying that he is *deemed to have knowledge* of them'.<sup>95</sup>

This judge-made rule operated to prevent outsiders dealing with a company from asserting that they did not have knowledge of the contents of the company's public documents. The legal fiction created by the doctrine of constructive notice has always been justified by the argument that the public documents of the company have been made available for inspection by the public, who should guide themselves by their contents.<sup>96</sup> Of course, this publicity of a company's documents was required by

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<sup>92</sup> Now the Companies and Intellectual Property Commission.

<sup>93</sup> A rule laid down in *Ernest v Nicholls* (1857) 6 HL CAS 401.

<sup>94</sup> McLennan JS (1979) 342.

<sup>95</sup> McLennan JS (1979) 343.

<sup>96</sup> Thus, Professor McLennan writes: 'This publicity is the underlying basis of the doctrine of constructive notice.' McLennan JS (1979) 342. The publication of the MOA and the AOA was required by the doctrine of disclosure. See Delport P 'Companies Act 71 of 2008 and the "Turquand Rule"' (2011) *THRHR* 74 132 at 133.

the doctrine of disclosure, which ran like a golden thread throughout company law prior to the 2008 Act.<sup>97</sup>

The doctrine of constructive notice was never intended to benefit any other party except the company, and would always operate against outsiders. This much-criticised company law rule was fashioned solely for the protection of a company's interests, and could only be utilised by a company to defend itself; it was never intended to be available to insiders to protect themselves.<sup>98</sup> The doctrine of constructive notice was a rule allowing companies to defend themselves from unwanted liability, not one imputing knowledge upon others where none had previously existed. In this regard, Slade J in *Rama Corporation Ltd v Proved Tin & General Investments Ltd*<sup>99</sup> put forth a concise summation of the true position:

'[T]he doctrine of constructive notice of a company's registered documents...does not operate against a company, but only in its favour. Put in the converse way, the doctrine of constructive notice operates against the person who fails to inquire, but does not operate in his favour. There is no positive doctrine of constructive notice, only a negative one'.<sup>100</sup>

The fact that all outsiders were prohibited from claiming ignorance of the contents of a company's public documents was capable of having important and far-reaching consequences.<sup>101</sup> Since a company's objects clause was contained in a public document, outsiders dealing with that company were effectively deemed to have knowledge of the extent of the company's contractual capacity. Therefore, if a company's representative concluded an *ultra vires* contract on the company's behalf, the third party would in any subsequent legal proceedings be prevented from alleging that he was unaware that the company had been acting in excess of its powers. This illustrates how the doctrine of constructive notice supplemented the *ultra vires* doctrine. No outsider could have relied on his ignorance of a company's lack of capacity

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<sup>97</sup> The doctrine of disclosure was regarded as a necessary corollary of a company's separate legal personality. See Delpont P (2011) 133.

<sup>98</sup> See Naudé SJ (1974) 317; McLennan JS (1979) 342-3. Unfortunately, the Appellate Division in *Smuts v Booyens, Markplaas (Edms) en 'n Ander v Markplaas* (2001) 3 All SA 536 (A) refrained from discussing the appropriateness of an insider's reliance on the doctrine of constructive notice, choosing instead to decide the particular matter on a different basis. See *Smuts v Booyens* para 21.

<sup>99</sup> [1952] 1 All ER 554.

<sup>100</sup> At 556. See also Du Plessis JJ 'Maatskappygebondenheid vir die Optrede van Ongemagtigde Maatskappyfunktionalisse' (1991) 3 SA Merc LJ 281 at 300.

<sup>101</sup> Cassim MF 'Formation of Companies and the Company Constitution' in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 129.

to enforce an *ultra vires* contract, as the doctrine of constructive notice would have prevented him from doing so.<sup>102</sup> Even a *bona fide* third party with no prior knowledge that a particular contract was beyond the stated powers of the company, would not have been able to rely on his ignorance to validate the *ultra vires* contract. Therefore, to protect themselves, outsiders dealing with companies would have had to read the company's public documents in order to determine the company's main object, and thereby its contractual capacity. The doctrine of constructive notice has been severely criticised for placing this burden on third parties, in that outsiders dealing with companies would have been forced to read that company's public documents to ensure that no problematic capacity or authority issues would arise after the conclusion of the transaction.<sup>103</sup> The doctrine failed to take into consideration the fact that even if every outsider would take the time to read a company's public documents, such reading would not guarantee that the outsider fully understood them.<sup>104</sup>

Constructive notice of a company's public documents had a further adverse impact on outsiders. While it is evident that the doctrine of constructive notice mainly served as an excellent enforcer of the *ultra vires* doctrine, it also impacted greatly on the validity of pure unauthorised contracts.<sup>105</sup> As discussed above,<sup>106</sup> the principles of agency law regulate the relationship between a company and its representatives. To provide a more specific structure to the general agency relationship, the authority of a company's representatives would usually have been set out (and often limited) in that company's AOA. Therefore, the doctrine of constructive notice would deem an outsider dealing with a company to know the scope of the company representative's authority when dealing with him, if the extent of that authority was reflected in a public document of the company. The consequence of this is that the third party would not have been able to rely on agency by *estoppel* to enforce the agreement, even if the company had held the purported agent out as having the necessary authority. If, for example, a company in its AOA expressly excluded or limited the authority of one of its representatives, and that representative then concluded a pure unauthorised

<sup>102</sup> See Naudé SJ (1974) 316.

<sup>103</sup> However, the *Turquand* rule served to ameliorate some of the harsh effects of the doctrine of constructive notice. See McLennan JS (1979) 342; Jooste R 'Observations on the impact of the 2008 Companies Act on the Doctrine of Constructive Notice and the *Turquand* rule' (2013) 130 SALJ 464 at 465.

<sup>104</sup> Not to mention the fact that under the 1973 Act, no outsider could be certain that a company's public documents truly reflected the company's contractual capacity. See 3.4.1 herein.

<sup>105</sup> Naudé SJ (1974) 325; McLennan JS (1979) 343.

<sup>106</sup> At 2.1.

contract, the fact that the outsider was prevented from claiming ignorance of the limitation in the AOA would have created an insurmountable difficulty for him to hold the company to the contract on the basis of agency by *estoppel*. FHI Cassim correctly points out that the doctrine of constructive notice ‘could destroy the third party’s prospects of relying on the ostensible authority of the directors’.<sup>107</sup> This is so because the third party cannot be said to have been guided or misled by a company’s representation that an agent had the necessary authority to bind the company, if the third party “knows” that such representation is false.<sup>108</sup> The doctrine of constructive notice would preclude the third party from even *asserting* in legal proceedings that he was ignorant of the purported agent’s lack of authority. If the third party was not induced by the company’s representation of authority (if any existed), then agency by *estoppel* could not have been available to him.<sup>109</sup> In this regard, it has been argued that the doctrine of constructive notice went too far in protecting the company at the expense of outsiders.<sup>110</sup> The risk of a contract failing due to the representative’s lack of authority,<sup>111</sup> coupled with the prohibition on asserting ignorance of such lack of authority, effectively compelled outsiders (if they were prudent) to examine a company’s public documents each time before they entered into an agreement with it – a rather onerous burden.<sup>112</sup>

Despite the criticism of the doctrine of constructive notice and the repeated calls for its abolishment,<sup>113</sup> this archaic company law rule continued to apply under the 1973 Act. South African company law seemed unwilling to rid itself of the malicious doctrine of constructive notice.

### 3.2.3 The failure of the doctrines of *ultra vires* and constructive notice

The failings of the problematic company law doctrines of *ultra vires* and constructive notice are well documented, and therefore need only briefly be summarised here.

<sup>107</sup> See Cassim MF ‘Formation of Companies and the Company Constitution’ (2012) at 129; Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 180 and 190; see also McLennan JS (1979) 343-4.

<sup>108</sup> See Du Plessis JJ (1991) 290.

<sup>109</sup> Thus, Slade J in *Rama Corporation* remarks: ‘[A] person cannot set up an ostensible or apparent authority unless he relied on it in making the contract or the supposed contract’. See *Rama Corporation* at 556; see further Du Plessis JJ (1991) 300.

<sup>110</sup> McLennan JS ‘Time for the Final Abolition of the Ultra Vires and Constructive Notice Doctrines in Company Law’ (1997) 9 *SA Merc LJ* 333 at 333.

<sup>111</sup> In addition to the danger of a contract being *ultra vires* the company.

<sup>112</sup> See Blackman MS (1975) 2.

<sup>113</sup> In particular, by Professor McLennan. See McLennan JS (1979) 357.



The theoretical justification of the *ultra vires* doctrine has often been questioned and criticised for lacking a sound basis. Blackman argues that the doctrine was wholly unpractical as it placed an undesirable restriction on the profitability of companies.<sup>114</sup> Shareholders were prevented from adopting potentially profitable contracts merely because they were *ultra vires* the company. Furthermore, a company's creditors were just as likely to be prejudiced by the *ultra vires* doctrine as they were to be protected by it.<sup>115</sup> It should therefore have come as no surprise that companies would look to use any available means to release themselves from the shackles of the *ultra vires* doctrine.

It is by now notorious how the *ultra vires* doctrine was effectively nullified by the abuse of the objects clause. For various reasons, including business efficacy and commercial freedom, the traditional *ultra vires* doctrine was circumvented by crafty drafting techniques aimed at bestowing on a company any and every conceivable business it could possibly pursue.<sup>116</sup> Drafters of company memoranda began to draft their objects clauses as widely as possible, in an effort to include all potential business activities.<sup>117</sup> The result of this practice was that companies would enjoy the capacity to pursue practically any lawful business and conclude any type of contract.<sup>118</sup> Academics have long noted how the *ultra vires* doctrine 'led to a prolixity of objects and powers in the typical company's memorandum'.<sup>119</sup> However, such widely-drafted objects clauses would always present a potential pitfall for unwary and ignorant outsiders, while providing only superficial protection for the company's members.<sup>120</sup>

As a result of the judicial recognition of "subjective objects" clauses<sup>121</sup> and the broad "ancillary powers" granted by s 33(2) of the 1973 Act, it had become apparent that the classical *ultra vires* doctrine no longer existed. It was therefore of great disap-

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<sup>114</sup> The learned author argues that '[b]usinessmen were unlikely to seek a protection that placed such a burden upon the very persons with whom they wished to transact'. See Blackman MS (1975) 2.

<sup>115</sup> Blackman writes further that 'the creditor was as likely to suffer as to benefit, for the doctrine was as likely to condemn a company to an unprofitable line of business as it was to prevent it from forsaking a profitable one'. See Blackman MS (1975) 2.

<sup>116</sup> Cassim FHI (1998) 295.

<sup>117</sup> McLennan JS (1979) 332; Cassim FHI (1998) 295.

<sup>118</sup> Except, of course, those contracts which juristic persons are unable to enter into, like marriage.

<sup>119</sup> Naudé SJ (1974) 316.

<sup>120</sup> See Naudé SJ (1974) 316; Blackman MS (1975) 2; McLennan JS (1979) 332; and Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 166-7.

<sup>121</sup> In the case that broke the back of the *ultra vires* doctrine, *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 ALL ER 674 (CA). See Beuthin RC 'The *Ultra Vires* Doctrine – An Obituary Notice?' (1966) SALJ 83 461 at 461; Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 166.

pointment to some that the doctrine of constructive notice remained a part of South African company law.<sup>122</sup> Despite the reformulation of the *ultra vires* doctrine by the 1973 Act, the doctrine of constructive notice continued to operate in respect of limitations imposed on the authority of a company's representatives in the company's public documents.<sup>123</sup> Therefore, under the 1973 Act, an outsider's claim against a company in respect of a pure unauthorised contract could still have been negated by the harmful impact of the constructive notice doctrine.<sup>124</sup>

Together, the *ultra vires* doctrine and the doctrine of constructive notice have proven to be an excellent shield for companies against unwanted liability. However, this protection would always be at the expense of outsiders dealing with the company. The inherent risk for outsiders contracting with a company's representatives surely contributed to the frustration of commercial dealings. Fortunately, the confusion and frustration caused by these old-fashioned rules of company law eventually provided the impetus for change, both in South Africa and abroad.

### 3.3 The 1973 Act

A revolutionary change to the South African company law regime came with the introduction of the 1973 Act. This Act completely reformulated the *ultra vires* doctrine and, as a consequence, drastically limited the application of the doctrine of constructive notice.

In furtherance of the doctrine of disclosure, s 63 of the 1973 Act required companies to lodge both an MOA and an AOA with the Registrar of Companies.<sup>125</sup> Section 52(1) of the 1973 Act obligated companies to state in their MOA the main object for which they were incorporated, and to describe the main business for which the company had been formed. Section 33 stipulated that a company's contractual capacity would be limited to the stated main object and would include 'unlimited objects ancillary to the said main object except such specific ancillary objects as are expressly excluded

<sup>122</sup> McLennan JS (1997) 336.

<sup>123</sup> See Naudé SJ (1974) 317 and 332.

<sup>124</sup> The *Turquand* rule traditionally operated side by side with the doctrine of constructive notice, providing a measure of protection to outsiders who conclude pure unauthorised company contracts which are unauthorised due to non-compliance with an internal formality of the company. However, the *Turquand* rule could never find application where a contract was beyond the capacity of a company as determined by the company's main object; such a contract, being void for lack of contractual capacity, was incapable of being validated by reliance on the "indoor management rule". See Naudé SJ (1974) 317.

<sup>125</sup> Delport P (2011) 133.

in its memorandum'. Section 34 of the 1973 Act further consolidated this position by bestowing "plenary powers" on companies to enable them to realise both their main and ancillary objects, provided such powers were not expressly excluded or qualified in the company's MOA. These sections of the 1973 Act were specifically aimed at halting the abuse of the *ultra vires* doctrine by unreasonably wide objects clauses in the MOAs of companies.<sup>126</sup> By bestowing such broad powers on companies, the 1973 Act also greatly reduced the impact of the *ultra vires* doctrine.

In short, the effect of s 36 of the 1973 Act was to have all *ultra vires* company contracts concluded by directors be regarded as valid.<sup>127</sup> Section 36 provided that no act of a company would be void only because the company lacked the capacity to conclude it, or because the directors had no authority to conclude the transaction as a result of the company's lack of capacity. If s 36 of the 1973 Act found application, the most basic requirement for the validity of company contracts, namely that the contract must be within the powers of the company, fell away.<sup>128</sup>

To solidify the new approach, s 36 prohibited companies and outsiders from relying on the company's lack of capacity in any legal proceedings *inter se*.<sup>129</sup> The idea was that since neither the company nor the third party could present evidence before a court regarding the company's lack of capacity to conclude a certain contract, the court would not have been able to take that fact into consideration when deciding on the contract's validity. Without proof of the company's lack of capacity, the court would have had to resolve the dispute as if the company *did* have the capacity to conclude the contract.<sup>130</sup>

However, s 36 did allow for the company's lack of capacity to be relied on in legal proceedings between the company, its shareholders, and the errant director/s. In so doing, Parliament retained an important internal consequence of the *ultra vires* doctrine, namely the shareholders' right to restrain the company from concluding an *ultra vires* contract. In effect, s 36 of the 1973 Act also created a distinction between company contracts with outsiders and company contracts with insiders; the company's

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<sup>126</sup> Naudé SJ (1974) 320.

<sup>127</sup> The heading to section 36 reads 'Acts *ultra vires* the company not void.'

<sup>128</sup> Naudé SJ (1974) 318 and 330.

<sup>129</sup> What FHI Cassim calls a 'statutory estoppel'. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 167.

<sup>130</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 167.

capacity and the modified *ultra vires* doctrine would continue to affect the latter.<sup>131</sup> However, an important change brought about by s 36 was that once an *ultra vires* contract had been concluded, shareholders no longer had the right to restrain the company from performing according to its terms; the shareholders' restraining action under the 1973 Act seemed to be limited to prohibiting the *conclusion* of *ultra vires* contracts, but not their *performance*.<sup>132</sup>

Section 36 of the 1973 Act would only find application where the directors of the company lacked the authority to conclude a company contract *only* because the company did not have the capacity to do so. The wording of s 36 made it clear that an *ultra vires* company contract would be valid only where the director that concluded it lacked authority as a direct result of the company's lack of capacity. If a purported company contract was unauthorised for a reason other than the company's lack of capacity, the contract remained void in accordance with the principles of the law of agency as discussed above.<sup>133</sup> Therefore, for example, if a non-executive director purported to conclude a company contract where the AOA of the company stipulated that only the managing director could bind the company, s 36 could not have found application; such a contract would have been void not because it exceeded the company's capacity, but because the director did not have the authority to conclude it.

Before the commencement date of the 1973 Act, both an *ultra vires* contract and a pure unauthorised contract were void *ab initio* and unenforceable. However, while a pure unauthorised contract was always capable of ratification by the company,<sup>134</sup> an *ultra vires* contract, being an absolute nullity, could never be ratified even if all the shareholders of the company consented to it.<sup>135</sup> Furthermore, agency by *estoppel* and the *Turquand* rule were available to enforce a pure unauthorised contract, but could never find application where a company had acted beyond its powers.<sup>136</sup>

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<sup>131</sup> A company would have been entitled to raise its own lack of capacity to argue that a contract concluded with a director or a shareholder of the company was invalid. This would not have been possible had the company concluded an *ultra vires* contract with an outsider. See Naudé SJ (1974) 324.

<sup>132</sup> Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 167-8.

<sup>133</sup> See 2.2.

<sup>134</sup> In terms of the common law. See 2.6 above.

<sup>135</sup> The second half of this statement reflects the thrust of the *ultra vires* doctrine as set out in *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 163.

<sup>136</sup> See Cassim FHI (1998) 294.

Therefore, the most significant impact of the relevant sections of the 1973 Act on the validity of unauthorised company contracts, is that between 1 January 1974<sup>137</sup> and 1 May 2011, all *ultra vires* contracts concluded by directors were valid.

### 3.3.1 Academic criticism of the arrangement under the 1973 Act

Because s 20(1) of the 2008 Act is clearly intended to replace s 36 of the 1973 Act, and because the wording remains quite similar, it seems appropriate to briefly discuss the difficulties and inconsistencies encountered in the interpretation of the previous legislative arrangement.

Despite Parliament's best intentions, s 36 of the 1973 Act was not a model of legislative clarity.<sup>138</sup> The changes to the issue of corporate capacity brought about by s 36 were subjected to concerned academic criticism since the enactment of the 1973 Act. The provisions regulating the concepts of main objects, main business, and plenary powers, were criticised for being too vague.<sup>139</sup> In particular, s 33(2) was criticised for having the odd effect of creating the legislative space for a situation where the main object as stated in a company's MOA could quite materially differ from the actual capacity of the company.<sup>140</sup> Incongruously, the impact of these sections was to allow the contractual capacity of a company to change without notice, thereby entirely negating the purpose of having a "main objects" clause.<sup>141</sup>

A much-criticised limitation of s 36 was that it could only find application if it was a director that concluded the *ultra vires* contract.<sup>142</sup> As Naudé notes, the wording of s 36 of the 1973 Act could only be interpreted to mean that its protection would become available only if it was a director, and not any other authorised representative, that concluded the *ultra vires* contract. Section 36 could only operate to validate an *ultra vires* contract if it was the directors of the company that had concluded it, there-

<sup>137</sup> The commencement date of the 1973 Act.

<sup>138</sup> Section 36 of the 1973 Act reads as follows: 'No act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact and, except as between the company and its members or directors, or as between its members and its directors, neither the company nor any other person may in any legal proceedings assert or rely upon any such lack of capacity or power or authority.'

<sup>139</sup> McLennan JS (1997) 334.

<sup>140</sup> Naudé SJ (1974) 320; McLennan JS (1997) 334.

<sup>141</sup> McLennan JS (1997) 334.

<sup>142</sup> See Naudé SJ (1974) 332 and McLennan JS (1979) 336. Fortunately, s 1 of the 1973 Act provided a broad enough definition of "director" so as to include 'any person occupying the position of director or alternate director of a company, by whatever name he may be designated'.

by excluding from its ambit *ultra vires* company contracts concluded by duly authorised persons who were *not* directors, for example employees, mandataries, independent contractors, or regular agents. Section 36 was therefore criticised for unduly limiting its own application.<sup>143</sup>

As Naudé correctly points out, authority to represent a company need not necessarily be conferred on directors alone; indeed, it is often the case that a company delegates power to non-directors, for example employees and *ad hoc* mandataries, to act on its behalf.<sup>144</sup> Naudé and McLennan were therefore particularly critical of the formulation of s 36 for the following reason: it left the door open for the full force of the *ultra vires* doctrine to find application where a non-director company representative concluded an *ultra vires* contract. This position was certainly capable of being exploited by companies to the detriment of third parties, as it allowed a back-door escape from liability for *ultra vires* company contracts.<sup>145</sup> Despite s 36 not being applicable to *ultra vires* company contracts concluded by authorised persons who were not directors, the principles of agency law would naturally remain applicable to the transaction. As discussed above,<sup>146</sup> the capacity of a company and the authority of its representatives were always regarded as inseparable, in the sense that a company's representative could never have the authority to perform acts which were beyond the capacity of the company. Therefore, if a non-director representative concluded an *ultra vires* contract under the 1973 Act, the company would have been entitled to argue that the representative could not have been authorised to bind the company to a contract which exceeded the company's capacity. Since s 36 would probably not have found application, the common law would have prevailed to render the purported contract void. To make matters worse for the third party, the doctrine of constructive notice would have prevented him from asserting that he had had no knowledge of the company's main object as it appeared in the MOA. Since the shareholders could not have ratified the agreement, the outsider would have been left with a void contract. The potential for abuse of this loophole is clear: unscrupulous companies could empower non-director representatives to conclude *ultra vires*

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<sup>143</sup> See Naudé SJ (1974) 332; McLennan JS (1979) 336.

<sup>144</sup> See Naudé SJ (1974) 332-3.

<sup>145</sup> Naudé SJ (1974) 332-3. However, it also remained the case that the outsider could refuse to perform on the ground that the contract was *ultra vires* the company.

<sup>146</sup> At 3.2.1.

contracts, which the company could then legitimately back out of at a later stage.<sup>147</sup> Whether this type of abuse actually took place, however, is not known. Still, it is hardly desirable that such a *lacuna* existed.<sup>148</sup>

Nothing in the wording of s 36 prohibited a third party who actually *knew* that he was contracting with a company in excess of the company's capacity, from holding the company to that contract anyway. Section 36 regarded as irrelevant the outsider's motives or knowledge that the company was acting *ultra vires*, leaving the door open for outsiders to enforce company contracts which they knew were outside of the company's capacity at the time of their conclusion.<sup>149</sup> Worse still, *ultra vires* company contracts were valid even if both the directors and the third party who concluded it were fully aware of the company's lack of capacity.<sup>150</sup> However, this type of abuse likely seldom occurred, or was even of any relevance, as the vague concepts of "main business" and "plenary powers" introduced by the 1973 Act served only to extend a company's powers further, making it nearly impossible for anyone to prove that a particular contract was beyond a company's capacity.<sup>151</sup> In this regard, the 1973 Act made great strides in eliminating the harsh effects of the *ultra vires* doctrine on outsiders.<sup>152</sup>

The fact that the 1973 Act allowed for the company's lack of capacity to be relied on in legal proceedings between the company and its shareholders has also been subjected to concerned criticism. Naudé argues that placing the directors on par with shareholders in this context may lead to inequitable results. He writes:

'[I]t creates a situation where the validity of important contracts between companies may depend upon the insignificant shareholding of the one in the other for investment purposes. It is even conceivable that an abuse may take place: the holding of shares for the devious purpose of escaping from a contract at a later stage if the need to do so should arise'.<sup>153</sup>

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<sup>147</sup> Naudé SJ (1974) 332-3.

<sup>148</sup> See McLennan JS (1979) 337.

<sup>149</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 167.

<sup>150</sup> Naudé SJ (1974) 324.

<sup>151</sup> See McLennan JS (1997) 334. Furthermore, it would also be unlikely that a company's director would knowingly conclude an *ultra vires* contract, as he would be liable to the company for any loss caused thereby.

<sup>152</sup> See McLennan JS (1979) 335.

<sup>153</sup> Naudé SJ (1974) 329.

A company's directors are entrusted with the management of the company, and should therefore be expected to have greater knowledge of the company's capacity than the shareholders would have. In addition, one of the fiduciary duties of directors is the duty not to exceed their authority. Therefore, directors should have no cause for complaint if a company raised its own lack of capacity to avoid liability under an *ultra vires* contract between the company and a director, or to sue the directors for breaching their fiduciary duty not to exceed their authority. But perhaps potential investors guide themselves by other indicators than merely the company's constitutive documents. Yet, s 36 could have been invoked to invalidate a company contract merely because the outsider happened to be a shareholder of the company.<sup>154</sup> Naudé's argument is not without merit: it may have been unfair and unreasonable to punish a company's shareholders for ignorance of the company's stated main object, which in any event under the 1973 Act may not even have reflected the true capacity of the company.

Since a company's capacity under the 1973 Act had for the most part become a non-issue, outsiders would rarely have had cause or opportunity to argue ignorance of the company's capacity as set out in the main objects clause. By rendering the contractual capacity of a company a largely irrelevant concept, s 36 considerably limited the application of the doctrine of constructive notice. Unfortunately for outsiders however, the doctrine of constructive notice was not completely abolished by the 1973 Act. The outsider's deemed knowledge of the contents of a company's public documents continued to affect the validity of company contracts, at least in respect of the authority of a company's representatives as set out in the company's public documents.<sup>155</sup> As was the case before the 1973 Act, outsiders dealing with a company would not have been able to claim ignorance of the provisions in a company's AOA regulating the authority of the company's representatives. Therefore, the doctrine of constructive notice continued to bar outsiders from relying on agency by *estoppel* to validate a pure unauthorised company contract concluded by an agent whose authority was curtailed in a public document of the company. In this regard, s 36 was criticised for not going far enough.<sup>156</sup>

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<sup>154</sup> See Naudé SJ (1974) 329.

<sup>155</sup> Naudé SJ (1974) 325.

<sup>156</sup> McLennan JS (1979) 357.



Another concern raised by Naudé was the possibility of s 36 being misused in a manner that would yet give effect to the traditional *ultra vires* doctrine. He noted that it was possible that a limitation on a company's contractual capacity could be enforced on outsiders by way of a carefully-worded curtailment of the authority of the company's directors. A company's AOA could, for example, state that the directors of the company were not authorised to conclude contracts beyond the company's capacity as determined by the main objects clause in the MOA. An *ultra vires* contract concluded by a director on that company's behalf would also have been a pure unauthorised contract. Such a contract would arguably have been void despite s 36, for the director's lack of authority arose not only from the company's lack of capacity, but from the fact that his authority was expressly limited to concluding *intra vires* contracts. Because the doctrine of constructive notice was not abolished by the 1973 Act, the outsider would not have been able to claim ignorance of the limitation and enforce the contract by way of agency by *estoppel*. Such a clause in a company's AOA would effectively have enforced a company's contractual capacity against outsiders, thereby defeating the purpose of s 36.

Whatever its defects, it must be acknowledged that s 36 of the 1973 Act successfully removed most of the prejudicial impact of the *ultra vires* doctrine. Despite the criticism of the arrangement under the 1973 Act, and the uncertainty regarding the interpretation of s 36, no notable litigation arose on the subject. Therefore, the Legislature may have been forgiven for thinking that the legislation had achieved its aim, and for resisting the impulse to fix what was, by all appearances, working.<sup>157</sup> As it transpired, however, Parliament saw fit to completely alter the legal position when it enacted the 2008 Act.

### 3.4 The present position

#### 3.4.1 The contractual capacity of companies

Parliament has, seemingly, through the enactment of s 19(1)(b) of the 2008 Act, completely abandoned the notion of the main object of a company (contained in a public document) determining the company's contractual capacity. Section 19(1)(b) boldly proclaims that a company now has:

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<sup>157</sup> McLennan JS (1997) 334-5.

'[A]ll the legal powers and capacity of an individual, except to the extent that –

- (i) a juristic person is incapable of exercising any such power, or having any such capacity; or
- (ii) the company's Memorandum of Incorporation provides otherwise'.

The effect of s 19(1)(b) is to bestow upon all companies practically the same contractual capacity as natural persons, allowing them to conclude all types of contracts in connection with any lawful business that they choose to pursue.<sup>158</sup> The second proviso to s 19(1)(b), which allows a company to derogate in its MOI from the broad contractual capacity provided to companies by the 2008 Act, provides the basis for the retention of certain aspects of the problematic *ultra vires* doctrine in South African company law, in conjunction with a statutory reformulation of the common-law doctrine of constructive notice.

#### 3.4.2 The Memorandum of Incorporation

To comply with the registration requirements under the 1973 Act,<sup>159</sup> companies were required to lodge both their MOAs and AOA's with the Registrar of Companies. The 2008 Act has altered this position: the MOI has replaced both the MOA and the AOA, and is now the sole governing document of South African companies.<sup>160</sup> Both an MOI and a Notice of Incorporation must be lodged with the CIPC when incorporating a company.<sup>161</sup> The MOI is intended to be the one document in which the rights, duties and responsibilities of shareholders, directors, and all other relevant persons, are set out.<sup>162</sup>

In contrast to the previous arrangement, a company's MOI will generally not be regarded as a public document, as there no longer seems to be a doctrine of constructive notice.<sup>163</sup> In fact, companies will no longer be required to have an objects clause in their MOIs at all. This should be welcomed, as it eliminates the unnecessary com-

<sup>158</sup> The South African approach to the contractual capacity of companies is now in accord with company law legislation in, *inter alia*, Australia, New Zealand, Canada, and the United Kingdom. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 169.

<sup>159</sup> Which were informed by the doctrine of disclosure.

<sup>160</sup> See the definition of "Memorandum of Incorporation" in s 1 of the 2008 Act. See further Cassim FHI 'Introduction to the New Companies Act' in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 9.

<sup>161</sup> In terms of ss 13(1) and (2) of the 2008 Act.

<sup>162</sup> The fundamental restriction of the MOI is that its contents must be consistent with all the provisions of the 2008 Act. See s 15(1)(a) of the 2008 Act.

<sup>163</sup> As a result of s 19(4) of the 2008 Act.

plexity surrounding a company's contractual capacity that existed under the 1973 Act.<sup>164</sup> There is no longer any need for a company to set out its intended business activities in an objects clause, since companies are now free to pursue practically any business activity. However, a company's MOI may stipulate which business activities the company intends *not* to pursue, by way of a restrictive condition limiting the powers of the company. Section 19(5)(a) of the 2008 Act states that all persons *must* be regarded as having received notice and knowledge of such provisions.<sup>165</sup> To indicate to outsiders that the powers of the company are limited in some way, such a company must include the suffix "RF" behind its name.<sup>166</sup>

Therefore, once a company has fulfilled the requirements stipulated by s19(5)(a) of the 2008 Act, thereby becoming an "RF" company, the provisions of its MOI in respect of which the ring-fencing has been effected, must be regarded as "public provisions". Importantly, the statutory doctrine of constructive notice will apply to their contents.<sup>167</sup> In an effort to create the necessary publicity for the doctrine to operate effectively, s 13(3) of the 2008 Act requires the "RF" company's Notice of Incorporation to 'include a prominent statement drawing attention to each such provision, and its location in the Memorandum of Incorporation'.

The 2008 Act provides for certain "alterable" provisions, which apply automatically to a company unless excluded or amended in the company's MOI. An example of such an "alterable" provision is the required majority to adopt shareholder resolutions. In terms of s 65(10) of the 2008 Act, a provision in a company's MOI may require a different percentage of voting rights to the prescribed 75 per cent for the adoption of special resolutions.<sup>168</sup> The possibility of opting-out of the standard 75 per cent is relevant to the validity of both types of unauthorised contracts concluded on behalf of an "RF" company, as only a special resolution adopted by the company's shareholders may ratify 'actions by the company or directors in excess of their authority'.<sup>169</sup>

The approach of the 2008 Act to the contents of a company's governing document is designed to promote flexibility regarding a company's internal rules; it allows a com-

<sup>164</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 169. See also 3.3.1 herein.

<sup>165</sup> Subject to compliance with certain procedural requirements. See 3.4.3 below.

<sup>166</sup> The abbreviation "RF" means ring-fence. See Item 2 of Practice Note 4 of 2012.

<sup>167</sup> Out of necessity, the *Turquand* rule has also been retained. See ss 20(7) and (8) of the 2008 Act.

<sup>168</sup> Section 65(9) of the 2008 Act.

<sup>169</sup> For the purpose of s 20(2) of the 2008 Act. See s 65(11)(c) of the 2008 Act.

pany to better control its own operation through the inclusion of appropriate clauses in the MOI.<sup>170</sup> An example of a clause which a company may insert in its MOI, which is of particular relevance to this thesis, is a provision that amounts to a “restrictive condition” for the purposes of s 15(2)(b) of the 2008 Act.

### 3.4.3 The statutory doctrine of constructive notice

Section 19(4) of the 2008 Act, at first glance, has finally abolished the doctrine of constructive notice in South African company law. It states:

‘Subject to subs (5), a person must not be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document has been filed or is accessible for inspection at an office of the company.’

This section has important implications for all companies in South Africa. By virtue of s 19(4), the very concept of a company’s “public documents” has lost much of its legal effect. For the most part, companies will no longer be able to raise against an outsider the outsider’s deemed knowledge of the contents of the company’s constitutive documents. The new position will have vital consequences for all companies, particularly in the context of unauthorised agency. It means that an outsider will no longer be prevented from making use of agency by *estoppel* to enforce a pure unauthorised company contract.<sup>171</sup>

However, s 19(5)(a) of the 2008 Act proceeds to reintroduce a modified version of the troublesome doctrine of constructive notice by stipulating that ‘[a] person *must be regarded as having notice and knowledge of-*

any provision of a company’s Memorandum of Incorporation contemplated in s 15(2)(b) or (c) if the company’s name includes the element “RF” as contemplated in s 11(3)(b), and the company’s Notice of Incorporation or a subsequent Notice of Amendment has drawn attention to the relevant provision, as contemplated in s 13(3).’<sup>172</sup>

The provisions contemplated by s 15(2)(b) and (c) are:

<sup>170</sup> See Cassim FHI ‘Introduction to the New Companies Act’ (2012) at 13.

<sup>171</sup> Subject to s 19(5), of course.

<sup>172</sup> Emphasis added. According to s 19(5)(b), persons must also be regarded as having notice and knowledge of the joint and several liability of past and present directors of a personal liability company. The purpose of this paragraph is not clear. See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 181.

- restrictive conditions applicable to the company;
- impositions of a higher degree or more onerous standard than the degree or standard envisioned by s 16 of the 2008 Act for the amendment of a restrictive condition; and
- provisions prohibiting the amendment of any clause in the MOI.

It is therefore apparent that the statutory doctrine of constructive notice will apply only in very limited circumstances.<sup>173</sup> If a company's MOI purports to restrict the company's powers in a manner envisioned by s 15(2)(b) and (c), but the company fails to comply with the prescribed formalities stipulated by s 19(5)(a),<sup>174</sup> the statutory doctrine of constructive notice cannot find application. However, if a provision in a company's MOI limits the powers of the company and the formal requirements prescribed by s 19(5)(a) have been complied with, third parties dealing with that company *must* be deemed to have notice and knowledge of such limitation on the company's powers.

Immediately noticeable is the slightly different wording of the statutory doctrine of constructive notice versus its formulation at common law.<sup>175</sup> Professor Jooste notes that the wording of s 19(5) could suggest that a positive doctrine of constructive notice has been created, enabling persons other than the company to take advantage of the imputed 'notice and knowledge'.<sup>176</sup> The correctness of such an interpretation, and the implications thereof, will be more fully discussed in Chapter Four.

#### 3.4.4 "RF" companies

Read together, ss 11(3), 13(3), 15(2)(b), 19(1)(b)(ii), 19(5)(a) and 20(1) of the 2008 Act, provide the option for a company to restrict its own powers by way of a "restrictive condition" in the company's MOI, by placing a greater restriction on the amendment of a restrictive condition, or by way of a prohibition on the amendment of any

<sup>173</sup> Cassim MF 'Formation of Companies and the Company Constitution' (2012) at 129.

<sup>174</sup> If a company's MOI includes a provision contemplated in s 15(2)(b), s 13(3) prescribes that the Notice of Incorporation filed by the company 'must include a prominent statement drawing attention to each such provision, and its location in the Memorandum of Incorporation'. In addition, s 11(3)(b) requires the name of such a company to be immediately followed by the expression "(RF)".

<sup>175</sup> In terms of the common-law doctrine of constructive notice, third parties were prevented from alleging that they were ignorant of the contents of a company's public documents. Alternatively, it was often said that the doctrine deemed persons dealing with a company to be aware of the contents of that company's public documents. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 179; see also 3.2.2 herein.

<sup>176</sup> Jooste R (2013) 469.

provision in the MOI. If a company limits its own powers in this way, it has chosen to become an “RF” company, a new category of company created by the 2008 Act. For these companies, certain of the consequences of the traditional *ultra vires* doctrine, as well as a codified doctrine of constructive notice, may affect their dealings with outsiders.

The phrase ‘restrictive conditions applicable to the company’ is not defined anywhere in the 2008 Act. In an effort to clear up the uncertainty regarding the use of “RF” in the name of a company, the CIPC released Practice Note 4 of 2012, which provided much-needed guidelines in that regard. Item 5 of the Practice Note is reproduced here in full:

‘Inconsiderate use of the expression “RF” in the name of a company could lead to unnecessary confusion and in the circumstances it is submitted that the expression “(RF)” be used only in cases where it is evident that-

1. the purpose or objectives of the company are restricted or limited in the MOI of the company;
2. the powers of the company are restricted or limited in its MOI;
3. any other pertinent restricting condition is applicable to the company;
4. any requirement in addition to those set out in s 16, for the amendment of any of the abovementioned restrictions or limitations as contained in the MOI; or
5. the MOI of a company contains a prohibition on the amendment of any particular provision of the MOI.’

Practice Note 4 of 2012 by implication suggests that the phrase “restrictive condition” means a restriction placed on the company’s powers or on its MOI. While Item 5.3 may be open to interpretation, it is submitted that the phrase ‘restrictive condition applicable to the company’ should not be interpreted so as to include limitations on the authority of a company’s agents, even if such restriction is reflected in the company’s MOI. If all companies were required to include the suffix “RF” behind its name merely because the authority of the company’s agents are restricted in some way, the result would be a considerable number of “RF” companies.<sup>177</sup> The suffix would become commonplace, and could thus fail to alert outsiders in the manner it was intended to do. In addition, it is submitted that the entire ethos of the “RF” provisions,

<sup>177</sup> Particularly in light of the fact that s 66(1) of the 2008 Act authorises the entire board of directors to act on a company’s behalf. Consequently, there may often be the need to impose limitations on the authority of a company’s directors.

and of s 36 of the 1973 Act, is centered around the powers and capacity of *companies*, and not of their agents. The fact that both s 36 of the 1973 Act and s 20(1) of the 2008 Act were drafted to impact only on a situation where a director's lack of authority is brought about solely by the company's lack of capacity, indicates that "restrictive condition" should not be interpreted to refer to limitations on the authority of a company's agents, where such limitation of authority is separate from a restriction on the company's capacity. Therefore, it is submitted that only where the MOI of a company limits the powers of the *company* in at least one of the three ways envisioned by s 15(2)(b) or (c), should that company make use of the suffix "RF". If a company merely imposes limitations on the authority of its agents in its MOI, it need not (and should not) call itself an "RF" company.

In the event that a company elects to restrict its own capacity by inserting in its MOI a restrictive condition, it will subject itself to more or less the same arrangement in respect of capacity that existed for all companies under the 1973 Act. By making provision for "RF" companies, the Legislature has apparently intended to create a legislative "best of both worlds" in the South African company law landscape, wherein aspects of the doctrines of *ultra vires* and constructive notice will remain available for those persons wishing to incorporate and invest in a company over which greater control can be imposed. It remains to be seen whether these types of companies will gain popularity in South Africa.<sup>178</sup>

#### 3.4.4.1 The validity of "RF"-company contracts

Section 20(1) of the 2008 Act is clearly intended to replace s 36 of the 1973 Act. Section 20(1) reads as follows:

'If a company's Memorandum of Incorporation limits, restricts or qualifies the purposes, powers or activities of that company, as contemplated in s 19(1)(b)(ii)-

(a) No action of the company is void by reason only that-

- (i) the action was prohibited by that limitation, restriction or qualification; or
- (ii) as a consequence of that limitation, restriction or qualification, the directors had no authority to authorise the action by the company; and

(b) in any legal proceeding, other than proceedings between-

- (i) the company and its shareholders, directors or prescribed officers; or

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<sup>178</sup> As of 28 October 2015, the number of registered "RF" companies in South Africa stood at 1814. See CIPC 'RF Companies' (2015) available on request from the CIPC.

- (ii) the shareholders and directors or prescribed officers of the company, no person may rely on such limitation, restriction or qualification to assert that an action contemplated in paragraph (a) is void.’

Immediately noticeable is the fact that this section will not apply to *all* “RF” companies. If a company’s MOI contains a provision prohibiting the amendment of any other provision in the MOI, it must call itself an “RF” company. However, if the company merely includes such a clause in its MOI without imposing a restrictive condition on the ‘purposes, powers or activities’ of the company as envisioned by ss 20(1) and 15(2)(b), it would enjoy the same contractual capacity as non-“RF” companies. In such a case, no aspect of the reformulated *ultra vires* doctrine should impact on the validity of any contract that the “RF” company concludes.

However, if a company’s MOI does restrict the ‘purposes, powers or activities’ of the company, it thereby limits the company’s contractual capacity. As was the case under the 1973 Act, contracts concluded in excess of that capacity will not automatically be void. Just like its predecessor, s 20(1)(a) of the 2008 Act negates the external consequences of the *ultra vires* doctrine by proclaiming that *ultra vires* contracts are valid despite being beyond the capacity of the company. Section 20(1)(b) solidifies the position by prohibiting both the company and the third party from raising, in any legal proceedings between themselves, the company’s lack of capacity to argue that the contract is void. However, the approach adopted by the 1973 Act regarding the internal consequences of an *ultra vires* contract has also been retained. The internal consequences of *ultra vires* contracts, namely that the company’s lack of capacity may be raised by the shareholders, directors, and prescribed officers to restrain the company from acting *ultra vires*,<sup>179</sup> and the responsible directors’<sup>180</sup> liability to the company for breach of their fiduciary duty not to exceed their authority, have been preserved by the 2008 Act.<sup>181</sup> Therefore, the internal operation of the *ultra vires* doctrine has been retained under the 2008 Act to continue to ‘as a form of shareholder protection and protection for the company’.<sup>182</sup>

<sup>179</sup> This remedy is provided for by s 20(5) of the 2008 Act.

<sup>180</sup> Section 1 of the 2008 Act defines a “director” as ‘a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated’.

<sup>181</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 170-1.

<sup>182</sup> Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 170.



The ability to restrain the company from acting *ultra vires* enables a company's shareholders to exercise a degree of control over the contracts entered into on the company's behalf. This security and control could encourage investment. Arguably, the option to control the activities of directors represents one of the chief purposes of the Legislature's retention of the *ultra vires* doctrine through the "RF" provisions. However, it must be said that the measure of control provided to shareholders of "RF" companies over the actions of the directors remains somewhat limited, and may in fact prove to be no more than illusory, for in the ordinary course of events a company's shareholders would learn of an unauthorised contract only after the transaction had already been concluded.<sup>183</sup> The damage, as they say, will usually already have been done.<sup>184</sup> Be that as it may, s 20(1) of the 2008 Act is commendable in that it aims to provide for this shareholder control, while at the same time protecting outsiders from the worst effects of the *ultra vires* doctrine.

Where s 20(1) of the 2008 Act differs markedly from its predecessor, is in the phrase 'the directors had no authority *to authorise* the action by the company'.<sup>185</sup> Two arguments, both with some merit, can be made in respect of the meaning of this phrase. Either s 20(1) can operate where any authorised representative concludes an *ultra vires* contract, or the legislation requires a director personally to conclude the contract.

Arguably, the wording of s 20(1)(a)(ii) removes the gap in the law that existed under the 1973 Act. It is common knowledge that boards of directors rarely involve themselves with the day to day business of the company, instead delegating authority to the managing director, senior employees, and other agents, to enter into contracts on the company's behalf.<sup>186</sup> Perhaps the drafters of s 20(1) intended for the "RF" provisions to apply to *ultra vires* contracts concluded by *all* authorised company representatives, and deliberately drafted the section to be construed in that way. The wording of s 20(1) would hardly be strained if called upon to support that interpreta-

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<sup>183</sup> Similar restrictions on the right to restrain were noted in respect of s 35 of the UK Companies Act 1985, as amended by the UK Companies Act 1989, upon which the "RF" provisions were largely modelled. See Cassim FHI (1998) 301 and Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 173.

<sup>184</sup> However, the company may recover from the responsible directors any loss suffered by the company as a result of the *ultra vires* contract.

<sup>185</sup> Emphasis added.

<sup>186</sup> See McLennan JS (1979) 336; Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 187.

tion, for if a company lacks the capacity to enter into a certain contract, a director cannot have the authority to empower another to conclude it; this is merely an extension of a well-understood principle. Instead of demanding that the directors themselves concluded the *ultra vires* contract, (which is what the wording of s 36 arguably did), s 20(1) could be interpreted so as to merely require the directors to have had no authority to *authorise* the contract. If that is the correct interpretation, s 20(1) completely closes the avenue of abuse highlighted by Naudé and McLennan. Perhaps the Legislature contemplated that in order to completely secure the release of company law from the grip of the worst effects of the *ultra vires* doctrine, the legislative solution must make provision for *ultra vires* company contracts concluded by *all* authorised company representatives, regardless of their title. Indeed, if one adopts the view of Naudé and McLennan, one would be compelled to reject an interpretation of s 20(1) that would require a director personally to have concluded the *ultra vires* contract. It could be argued that such an approach would frustrate much of the intended impact of the legislation, as it would allow the full force of the traditional *ultra vires* doctrine to affect contracts between outsiders and non-director representatives of those “RF” companies with restrictive conditions in their MOIs.

In contrast, it could be argued that the Legislature purposefully restricted the application of s 36 of the 1973 Act to *ultra vires* company contracts concluded by directors in order to protect shareholders, and intends for the same approach to apply in respect of “RF” companies under the 2008 Act. It could be that Parliament was influenced by the important purpose of safeguarding the interests of shareholders. In order to provide greater protection to a company’s shareholders, s 20(1) would have to be construed so as only to validate *ultra vires* contracts concluded by directors, and not those concluded by other agents. Directors are generally appointed in terms of a voting procedure involving the company’s shareholders. A company’s shareholders to some degree control the composition of the board of directors, but have less direct control over the appointment of senior employees and other agents. Therefore, Parliament may have been wary of unfairly prejudicing shareholders, and thereby discouraging investment, if it were to enact legislation that would hold an “RF” company liable to *ultra vires* contracts concluded by non-directors.

It is rather unfortunate that s 20(1)(a) of the 2008 Act is phrased in this way, as it creates needless uncertainty in this regard. It could be that the insertion of the

phrase 'directors had no authority to authorise' was merely an oversight. Until a competent court pronounces on this issue, or the CIPC clarifies the position, the question of whether s 20(1) can find application where a non-director representative of an "RF" company concludes an *ultra vires* contract, will remain a matter for debate.

A slightly simpler solution exists to the question of what the position would be if a representative of an "RF" company concludes a pure unauthorised contract with an outsider.<sup>187</sup> Since s 20(1) of the 2008 Act cannot affect pure unauthorised contracts, the common law would have to be reverted to: because an agent cannot bind his principal to an unauthorised contract,<sup>188</sup> no valid contract can come into being. The failed contract cannot be rescued by s 20(1) but will be capable of ratification by the company's shareholders. If the shareholders refuse to ratify the agreement, the third party's only remaining means to bind the company to the contract would be agency by *estoppel*. This is where the 2008 Act may prove to provide greater protection to outsiders than its predecessor did. It has already been submitted that the statutory doctrine of constructive notice should not apply to provisions in an MOI of an "RF" company that merely limit the authority of the company's agents. The wording of s 19(5)(a) and the guidelines of Practice Note 4 of 2012 suggest that the statutory doctrine of constructive notice cannot apply to such a provision. As discussed above, s 19(5)(a) will operate in respect of three types of "public provisions" contained in the MOI of an "RF" company.<sup>189</sup> The CIPC has not suggested that s 19(5)(a) is intended to apply to provisions in a company's MOI that restrict the authority of the company's agents. Therefore, under the circumstances set out above, the third party should be free to assert his ignorance of the representative's lack of authority. The consequence of this is that the third party will not be barred from relying on agency by *estoppel* to validate the contract. This approach would constitute a welcome change to the position that prevailed for outsiders under the 1973 Act, as it provides greater protection to third parties in the context of pure unauthorised company contracts.

However, it would seem that the concern expressed by Naudé, that a company may yet enforce the *ultra vires* doctrine against outsiders, remains valid under the 2008

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<sup>187</sup> For example, if the representative who concluded the unauthorised contract lacked authority because his authority to act on behalf of the company was expressly excluded in the company's MOI.

<sup>188</sup> See 2.2.

<sup>189</sup> See 3.4.3.

Act. It may be that an “RF” company could achieve the effect created by the traditional doctrines of *ultra vires* and constructive notice by way of, for example, the insertion of the following clause in its MOI: “The directors and other representatives of the company shall have no authority to bind the company to transactions which conflict with the restrictive condition/s to the company’s powers, purpose and activities.” If an *ultra vires* contract is concluded by a director of that company, s 20(1) may not be able to find application.<sup>190</sup> What is relatively certain is that the statutory doctrine of constructive notice will not apply to the clause limiting the authority of the company’s representatives, but that it *will* operate in respect of the restrictive condition limiting the company’s capacity. The third party will be deemed to have received notice and knowledge of the company’s lack of capacity, but not of the separate limitation placed on the authority of the company’s agents. Unfortunately for the third party, this is the point where the statutory doctrine of constructive notice may begin to show its teeth. As discussed above,<sup>191</sup> one of the consequences of the common-law doctrine of constructive notice was that it would prevent an outsider from relying on agency by *estoppel* to hold a company liable to a pure unauthorised contract where the agent’s authority was limited in a public document. Although the wording of the statutory doctrine of constructive notice differs somewhat from its formulation at common law, it is reasonable to assume that it is intended to have a similar impact against third parties dealing with companies. If the outsider must be regarded as having received notice of a restrictive condition in an “RF” company’s MOI, he may find it difficult to assert that the company had held the director out as having the necessary authority to conclude a contract in excess of the limits of the company’s capacity. In fact, the effect of the statutory doctrine of constructive notice could be to prevent any discussion being had at all about the company’s misrepresentation and the outsider’s reliance thereon. Just like the common-law doctrine of constructive notice under the 1973 Act, the statutory doctrine of constructive notice will arguably eliminate the possibility of an outsider holding an “RF” company liable on a pure unauthorised contract by way of agency by *estoppel*, *in such an instance*. If that is the true position, then failing ratification of the contract by the company’s shareholders,

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<sup>190</sup> This is due to the fact that the contract would be unauthorised due to a limitation placed on the authority of the company’s representatives, meaning that the director’s lack of authority arose not only from the company’s lack of capacity, but also from an express limitation on his authority in the company’s MOI. See 3.4.1 above.

<sup>191</sup> At 3.2.2.

the third party can look only to the purported agent to recover any loss suffered as a consequence of the failed contract.<sup>192</sup> Since the number of companies that have elected to make use of the “RF” provisions remains relatively miniscule,<sup>193</sup> this is not likely to be an issue that will arise too often. Yet, it remains undesirable for such a potential loophole to exist.

As was the position under the 1973 Act, s 20(1) does not require the outsider to act in good faith. Nothing in the wording of s 20(1) prevents a third party dealing with a company from enforcing an *ultra vires* contract despite knowing full well that the purported contract was *ultra vires* at the time of its conclusion. As discussed above,<sup>194</sup> the absence of a requirement of good faith on the part of the outsider was rendered mostly insignificant by the broad powers which companies enjoyed under the previous framework. Therefore, the possibility of outsiders abusing the legislation in such a manner was minimal. Under the 2008 Act, “RF” companies enjoy as wide a contractual capacity as their MOI permits, without the legislative addition of “ancillary powers” and “plenary powers”. Therefore, even a *mala fide* outsider contracting with an “RF” company, in full knowledge that the purported agreement is prohibited by a restrictive condition in the company’s MOI, would be entitled to rely on s 20(1) to enforce the contract. One can easily imagine how an outsider could take advantage of this loophole by conspiring with a director to hold an “RF” company liable to *ultra vires* contracts.<sup>195</sup> In light of the concerns expressed on this point regarding s 36 of the 1973 Act, it could be argued that the Legislature erred in failing to close this avenue of abuse when enacting the 2008 Act. However, if one considers the historical operation of the *ultra vires* doctrine,<sup>196</sup> one should realise that the third party’s knowledge and motives have never been of any consequence to the question of the company’s capacity to conclude a contract, and nor should they have been.<sup>197</sup> The traditional *ultra vires* doctrine could never be negated by the fact that one party to the contract

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<sup>192</sup> See *Blower v Van Noorden* 1909 890 TS 897. The legal basis and extent of the purported agent’s liability will be discussed in Chapter Four.

<sup>193</sup> Compare the figure quoted by the CIPC in their 2013/2014 annual report of 240 781 registered companies in South Africa with the 1814 registered “RF” companies as at 28 October 2015. See ‘Companies and Intellectual Property Commission Annual Report 2013/14’ available at [http://www.cipc.co.za/files/5214/3143/3874/CIPC\\_ANNUAL\\_REPORT\\_2014\\_FINAL.pdf](http://www.cipc.co.za/files/5214/3143/3874/CIPC_ANNUAL_REPORT_2014_FINAL.pdf) (accessed on 17 November 2015) and note 185 herein.

<sup>194</sup> See 3.4.1 herein.

<sup>195</sup> However, the director will have breached a fiduciary duty in doing so.

<sup>196</sup> Before and after the enactment of the 1973 Act.

<sup>197</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 176.

had been acting in good faith. Therefore, the good or bad faith of a party to an *ultra vires* contract concluded with an agent of an “RF” company should likewise have no effect on the operation of s 20(1). Even in the context of a restraining application in terms of s 20(5) of the 2008 Act, the good or bad faith of the parties to an *ultra vires* contract should be irrelevant to the issues of the company’s capacity and the contract’s validity.<sup>198</sup>

#### 3.4.4.2 Ratification in terms of s 20(2) of the 2008 Act

According to s 20(2) of the 2008 Act:

‘If a company’s Memorandum of Incorporation limits, restricts, or qualifies the purposes, powers or activities of that company, or limits the authority of directors to perform an act on behalf of the company, the shareholders, by special resolution, may ratify any action by the company or the directors that is inconsistent with any such limit, restriction or qualification, subject to subs (3).’<sup>199</sup>

This section stipulates that if an “RF” company restricts its capacity in its MOI, and a director of the company contracts beyond that capacity, the shareholders will be entitled to ratify the *ultra vires* contract by way of a special resolution.<sup>200</sup> Section 20(2) of the 2008 Act therefore introduces a new internal consequence of the traditional *ultra vires* doctrine. Traditionally, *ultra vires* contracts were completely void and incapable of ratification, even with the unanimous approval of all of the company’s members. Section 20(2) overrules this position by allowing for the ratification of *ultra vires* contracts concluded by directors, provided such ratification is done by way of a shareholders’ special resolution. At first glance, this section may be slightly confusing, as s 20(1) declares *ultra vires* contracts to be valid. It raises the question of the purpose of allowing for ratification of valid contracts. It is submitted that the purpose of making provision for ratification of *ultra vires* contracts concluded by directors of “RF”

<sup>198</sup> Where the third party’s good faith does become relevant, however, is in respect of any claim for damages he may have in the event that the shareholders restrain the company from performing in terms of the *ultra vires* contract. See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) 176-8. See also 3.5.4.3 herein.

<sup>199</sup> Section 20(3) simply provides that an action for the purposes of subsection (2) cannot be ratified if it conflicts with any other provision of the 2008 Act. Section 20(2) of the 2008 Act draws its inspiration from s 35(3) of the UK Companies Act 1985 (as amended by s 108 of the UK Companies Act 1989). See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 173.

<sup>200</sup> A “special resolution” is defined by s 1 of the 2008 Act as ‘a resolution adopted with the support of at least 75% of the voting rights exercised on the resolution, or a different percentage as contemplated in section 65(10)’.

companies stems from the effect of s 20(5) of the 2008 Act.<sup>201</sup> In addition, formal ratification of an *ultra vires* contract would provide greater certainty for all the parties. If, for example, an outsider refuses to perform upon discovering that his agreement with an “RF” company was beyond its powers, ratification of the contract could put his mind at ease.

Once an *ultra vires* contract has been ratified, it is arguable whether the remaining internal consequences should still apply.<sup>202</sup> While the responsible directors would still, strictly speaking, have breached a fiduciary duty, they would likely incur no liability to the company for it, for one or both of two reasons: either the special resolution ratifying the *ultra vires* contract also serves to ratify the directors’ breach of fiduciary duty,<sup>203</sup> or the directors would not be liable for damages as the company will have suffered no loss.

The suggestion the ratification of an *ultra vires* contract retroactively authorises the responsible directors, and thereby erases the breach of the fiduciary duty, is not a particularly persuasive one.<sup>204</sup> While such an explanation would be convenient, it fails to appreciate the basic limitation of ratification, namely that it is generally not capable of affecting personal rights acquired by third parties in the interim period between the unauthorised act and its subsequent ratification.<sup>205</sup> If a director concludes an unauthorised contract on a company’s behalf, the company becomes entitled to hold that director personally liable for any loss sustained by the company as a result of the unauthorised contract, on the basis of a breach of the director’s fiduciary duty. In South Africa it has been accepted that while ratification by a fiction of law creates a contractual relationship between a professed principal and a third party as if the purported agent had been properly authorised, it certainly does not prevent the prin-

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<sup>201</sup> The interaction between these two sections will be discussed below, at 3.4.4.3. In the context of the comparable (and now repealed) sections of the UK Companies Act 1985, FHI Cassim suggested that ratification of an *ultra vires* contract was required before the company would be able to sue on the agreement. See Cassim FHI (1998) 301. With respect, it is submitted that the non-ratification of a *val-id* agreement should have no effect on either of the parties’ rights to enforce the contract through legal proceedings.

<sup>202</sup> Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 173.

<sup>203</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 174.

<sup>204</sup> If a company ratifies an unauthorised contract entered into by an employee of the company, will the company lose the right to institute disciplinary proceedings against the employee? One would think not.

<sup>205</sup> See *Jagersfontein Garage & Transport Co. v Secretary, State Advances Recoveries Office* 1939 OPD 37 at 41.

principal from suing the unauthorised agent for breach of contract.<sup>206</sup> In *Mine Workers' Union v Broderick*<sup>207</sup> the Appellate Division stated:

'A principal may for a variety of reasons choose to ratify an unauthorised contract entered into by his agent but this does not mean that he has abandoned, as against the agent, any rights that he has against the latter for his breach of the terms of his agency.'<sup>208</sup>

It is accepted law that in the context of ratification, the relationship between the principal and the third party is separate from the one between the principal and the agent. While an action based on the breach of a fiduciary duty is distinct from one based on breach of contract, should the same principle regarding ratification not prevail? It is submitted that a special resolution ratifying an *ultra vires* contract, on its own, does not serve to retroactively authorise the directors to conclude the agreement. Although the wording of s 20(2) refers to the ratification of 'any act of the company or the directors', and could thus be interpreted to refer to ratification of a breach of the directors' fiduciary duty, such an approach should be avoided as it would be inconsistent with the principles of ratification at common law. It is submitted that in the absence of a second, separate special resolution ratifying the responsible director's conduct and absolving him of liability,<sup>209</sup> the director should remain liable to the company for breaching his fiduciary duty.

It may be that the company's action against the director will become meaningless, as the company will in the usual course of events not have suffered any loss. Be that as it may, the mere fact that the shareholders choose to ratify an agreement should not automatically mean that they forgive the director and absolve him of all liability. It may be that the "RF" company has somehow suffered loss in the interim period between the moment the shareholders learn of the *ultra vires* contract and the moment they pass a special resolution ratifying it. Potential prejudice could be caused to the shareholders if, by their ratification of an *ultra vires* contract, they will be regarded as having ratified the responsible director's breach of his fiduciary duty. The conse-

<sup>206</sup> For the simple reason that '[t]he principal may ratify and approve of what his agent has done or he may ratify and disapprove'. See Kerr AJ *The Law of Agency* 4 ed (2006) 81.

<sup>207</sup> 1948 4 SA 959 (AD).

<sup>208</sup> At 979.

<sup>209</sup> Which was the position under the now-repealed UK Companies Act 1985.



quence of this would be that the company would be deprived of a basis to sue the responsible director for loss caused to the company by the *ultra vires* contract.<sup>210</sup>

Furthermore, once the shareholders have adopted a special resolution ratifying the *ultra vires* contract, the company's insiders should lose their right to apply for an interdict restraining the company from acting *ultra vires*.<sup>211</sup>

It is submitted that the phrase 'or limits the authority of directors to perform an act on behalf of a company' is likely only to cause confusion. At common law, a professed principal, whether a natural or a juristic person, was always entitled to ratify an unauthorised contract entered into by his or its representative.<sup>212</sup> The members of a company would in the past have shown their acceptance of the terms of an unauthorised contract by way of compliance with the company's internal requirements for the ratification of pure unauthorised contracts, which would usually have been set out in the company's AOA. What is troubling is the fact that s 20(2) seems to refer not only to limitations on a director's authority flowing from the company's lack of capacity, but also to a director's lack of authority resulting from restrictions placed on his authority in the company's MOI.<sup>213</sup> The 2008 Act does not *expressly* repeal or amend the common-law principles of ratification with respect to pure unauthorised contracts entered into by a company's directors. Therefore, s 20(2) poses several interesting and important questions, which may be worthy of academic attention.<sup>214</sup>

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<sup>210</sup> It is notable that s 35(3) of the UK Companies Act 1985 (as amended), upon which s 20(2) of the 2008 Act is modelled, expressly stated that a special resolution ratifying an *ultra vires* contract would not affect the liability incurred by the directors. Since the "RF" provisions have no comparable clause, a counterargument could be that the Legislature clearly intended for the *ultra vires* contract and the director's breach of his fiduciary duty to be ratified by a single special resolution. Yet, English law now allows for the directors' breach of fiduciary duty to be ratified by an ordinary resolution, by virtue of s 239 (2) of the UK Companies Act 2006. These are the types of inconsistencies that are likely to present themselves when one attempts to interpret new legislation that is based on outdated foreign law. See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' at 174.

<sup>211</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 177.

<sup>212</sup> Provided that the contract was not prohibited by statute.

<sup>213</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 173.

<sup>214</sup> For example, s 20(2) fails to impose a time limit on the potential ratification. Furthermore, the legislation fails to address the interim position between the moment the shareholders learn of the unauthorised contract and the moment the shareholders adopt a special resolution ratifying it. It is also not made clear whether ratification at common law supersedes or should operate concurrently with ratification in terms of s 20(2).

### 3.4.4.3 The insiders' right to restrain

The right to apply for an interdict restraining a company or its directors from entering into or performing in terms of an *ultra vires* contract, was a remedy available to shareholders before the enactment of the 1973 Act. Under s 36 of that Act, however, it was thought that a company's shareholders could only restrain the company from *concluding* an *ultra vires* contract, but could not restrain the *performance* of an *ultra vires* contract once it had been properly concluded.<sup>215</sup>

Section 20(5) of the 2008 Act slightly alters the position and now leaves little room for doubt, by broadly stating:

'One or more shareholders, directors or prescribed officers of a company may apply to the High Court for an appropriate order to restrain the company or the directors from doing anything inconsistent with any limitation, restriction or qualification contemplated in subs (2)'.

Section 20(5) presents certain interpretational challenges, most notably those regarding the intended interaction between the insiders' right to restrain and ratification in terms of s 20(2). However, a more practical issue is the scope of the right to restrain. Unlike under the 1973 Act, where a company's shareholders could only rely on the restraining action to prevent the company from *performing* in terms of the *ultra vires* contract, s 20(5) of the 2008 Act appears to permit a restraining application to prevent both the conclusion *and* the performance of an *ultra vires* contract. It is submitted that the words 'doing anything inconsistent with any limitation, restriction or qualification' are broad enough to refer to both the conclusion *and* the performance of an *ultra vires* contract. Arguably, a wide interpretation to this phrase would provide a better balance between the insiders' right to restrain and the outsider's right to enforce an *ultra vires* company contract.

It is clear that an *ultra vires* contract concluded by a director of an "RF" company is only *provisionally* valid and enforceable, as s 20(5) of the 2008 Act allows for the insiders of an "RF" company to enforce against outsiders the restrictive conditions contained in the company's MOI. By making provision for an application to restrain a company from acting *ultra vires*, s 20(5) merely codifies the remedy that had traditionally been available to shareholders. However, s 20(5) includes the directors and

<sup>215</sup> See Cassim FHI 'Corporate Capacity, Agency and the Turquand Rule' (2012) at 167-8.

prescribed officers<sup>216</sup> as beneficiaries of this right. The legislation allows these parties to make an application to the High Court for an order declaring an *ultra vires* contract void, and/or prohibiting the company from performing in terms of the agreement. FHI Cassim suggests that the purpose of s 20(5) is ‘to draw a proper balance between the interests of the company and the rights of the third party’ where an *ultra vires* contract is concluded.<sup>217</sup> However, allowing the insiders of an “RF” company to restrain the company from acting *ultra vires* will always have the potential to cause prejudice to third parties.<sup>218</sup> The effect of s 20(5) is to limit an “RF” company’s contractual capacity in a manner similar to the traditional *ultra vires* doctrine.<sup>219</sup>

What, then, is the intended relationship between ss 20(2) and 20(5) in the context of *ultra vires* contracts? At the outset, it must be remembered that since *ultra vires* contracts concluded by “RF” companies will not automatically be void, there is no real legal need for the shareholders to ratify such contracts. The need to do so may arise, however, if one of the insiders declares his intention to invoke s 20(5) of the 2008 Act.

If the shareholders of an “RF” company adopt a special resolution ratifying an *ultra vires* contract, the contract should become unquestionably valid. In order to maintain a logically consistent legal framework, a subsequent restraining application under such circumstances should not be possible. Ratification of an *ultra vires* contract under s 20(2) should prevent any person relying on s 20(5) to restrain the company from performing in terms of the *ultra vires* contract.<sup>220</sup> Therefore, once the *ultra vires* contract has been ratified by the company by way of a special resolution of the shareholders, the company’s insiders should lose their right to apply for a court order preventing the company from acting *ultra vires*. If ratification in terms of s 20(2) truly trumps a subsequent restraining application in terms of s 20(5), then it is tentatively submitted that the option to ratify *ultra vires* contracts was primarily made available to serve as a means for a company’s shareholders to preemptively prevent a restraining application being instituted by a single director, shareholder or prescribed

<sup>216</sup> A “prescribed officer” is defined by s 1 of the 2008 Act as ‘the holder of an office, within a company, that has been designated by the Minister in terms of section 66(11)’.

<sup>217</sup> Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 177.

<sup>218</sup> See Claasen M ‘Third party protection under the current application of the ultra vires doctrine’ (2014) available at <http://thewritecandidate.co.za/third-party-protection/> (accessed on 31 March 2015).

<sup>219</sup> Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 177.

<sup>220</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ (2012) at 177.

officer. Ultimately, s 20(2) grants to shareholders an extra measure of control over the business of an “RF” company.

Conversely, if a shareholder, director, or prescribed officer has successfully relied on s 20(5) to obtain a court order restraining an “RF” company from entering into or performing in terms of an *ultra vires* contract, the company’s shareholders should not be able to ratify it. To hold otherwise would conflict with the most basic limitation of ratification at common law, namely that it is not ‘a legal miracle which renders non-existent everything which transpired between the inception of the inchoate juristic act and its validation’.<sup>221</sup> The legal fiction of ratification can generally not affect rights acquired and duties imposed between the moment of conclusion of a purported contract and the moment of its ratification.<sup>222</sup> For the above reasons it is submitted that it should not be possible for the shareholders of an “RF” company to ratify an *ultra vires* contract that has been declared void or unenforceable by a court order. Once the restraining application has been granted, the shareholders should not be able to validly ratify the agreement unless and until that court order is overturned.

It should also be borne in mind that a court, if approached in terms of s 20(5) of the 2008 Act, would be under no obligation to grant the restraining application. Furthermore, there does not seem to be a reason why the remaining directors, shareholders and prescribed officers, or even the third party for that matter, could not oppose the application to restrain the company from acting *ultra vires*. Indeed, opposing the application may in certain circumstances be a more effective means of ensuring that the contract remains binding than securing ratification by way of a special resolution.

If one considers the wording of s 20(2), it would seem that s 20(5) also grants insiders of either category of company the right to restrain the directors from acting in excess of their authority as curtailed in the company’s MOI. Section 20(5) appears to make provision for a restraining application where a proposed company contract is not *ultra vires*, but merely beyond the authority of the director that concluded it. It is submitted that making the right to restrain applicable to pure unauthorised company contracts concluded by directors is not only wholly unnecessary, but also likely to cause confusion in the same way that s 20(2) muddies the waters of ratification of pure unauthorised contracts concluded by directors. A pure unauthorised contract is

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<sup>221</sup> *Jagersfontein* at 46.

<sup>222</sup> *Jagersfontein* at 41.

void *ab initio*;<sup>223</sup> no performance can be made in terms of a void contract as no valid obligations can arise. These common-law principles of agency and contract are well established. Therefore, the purpose of providing to insiders a statutory right to apply for an order prohibiting a company or its directors from doing anything inconsistent with a clause in the company's MOI which limits the authority of the company's directors, is difficult to understand.

One final question regards the potential impact of the statutory doctrine of constructive notice in the context of a restraining application in terms of s 20(5). It is submitted that if a restraining application is instituted by an insider of an "RF" company, and such application is opposed by a third party,<sup>224</sup> the third party, who will be arguing that the company should remain bound to the agreement, will be prevented by the statutory doctrine of constructive notice from asserting that he was unaware of any restrictive conditions in the company's MOI. Whether this prohibition will assist or hinder him with his claim will depend on the facts of the particular case.

### 3.5 A company's liability for unauthorised contracts

It is at this point that the first of the two research questions posed by this thesis will be addressed. If an outsider concludes an unauthorised contract with an agent of a company, with the intention of creating a contract between the company and the outsider, what is the legal status of the contract? The answer is, unfortunately, not a straightforward one. Broadly speaking,<sup>225</sup> the framework of the 2008 Act requires a proper appreciation of the effect of the following two criteria when assessing the validity of unauthorised company contracts:

- (i) what category of company one is dealing with; and
- (ii) which type of unauthorised contract one is speaking of.

#### 3.5.1 A non-"RF" company's liability for an *ultra vires* contract

Since a non-"RF" company by its very nature has no restrictions placed on its powers, no contract its agent concludes *can* be *ultra vires*. In fact, the very concepts of

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<sup>223</sup> See 2.2 herein.

<sup>224</sup> For the purpose of this statement, a "third party" could be any party with *locus standi*, and would include the other insiders of the company as well as the outsider with whom the *ultra vires* contract was concluded.

<sup>225</sup> As will be shown below, the invalidity of unauthorised company contracts will always be subject to their possible ratification by the company.

capacity and powers have been (mostly) removed from the company law landscape as a result of s 19(1)(b) of the 2008 Act. No form nor aspect of the *ultra vires* doctrine can affect the validity of contracts concluded on behalf of companies that do not take the steps envisioned by the “RF” provisions. That being the case, the only other potential ground<sup>226</sup> upon which the validity of a non-“RF” company’s contract could be challenged would be the authority of the agent that had concluded it.

Assuming that the representative was properly authorised to enter into the agreement on the company’s behalf, the contract will be valid.<sup>227</sup>

### 3.5.2 A non-“RF” company’s liability for a pure unauthorised contract

The consequences of a company’s agent concluding a contract in excess of his actual authority have never been as straightforward as would be the case if only natural persons were involved in the transaction. In order to address the reality that the internal management of companies brings with it additional complications, company law has had to develop special rules to supplement the more general agency principles.<sup>228</sup> Two significant rules in this regard are the doctrine of constructive notice and the *Turquand* rule. The *Turquand* rule was introduced to ameliorate the harsh effects of the doctrine of constructive notice, in an effort to provide greater protection for third parties that contract with companies. The two rules therefore usually operated side by side. Since there is no doctrine of constructive notice imputing deemed knowledge on outsiders of the contents of the MOI of a non-“RF” company, the need for the *Turquand* rule (in this context) falls away. Even if the authority of the agent was curtailed by an internal requirement reflected in the company’s MOI, third parties cannot be deemed to know about it.

Therefore, the relationship will be governed purely by agency principles. Because the agent was not authorised to conclude the transaction, the contract will be regarded as void from the moment of its purported conclusion. The contract will be a nullity but, as discussed above,<sup>229</sup> it will be capable of ratification. Should the shareholders refuse to ratify the agreement, agency by *estoppel* will be available to the

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<sup>226</sup> Relevant to this thesis.

<sup>227</sup> Assuming further that all the common law and/or statutory requirements for the validity of the contract had been fulfilled.

<sup>228</sup> Du Plessis JJ (1991) 283.

<sup>229</sup> In Chapter Two.

third party, regardless of whether the exclusion of the agent's authority was reflected in a clause in the MOI.<sup>230</sup>

### 3.5.3 An "RF" company's liability for a pure unauthorised contract

The relationship between a properly incorporated "RF" company and its agents remains subject to the law of agency. Since a pure unauthorised contract is unauthorised not because the contract exceeded the company's capacity, but because the representative that concluded it had acted in excess of his actual authority,<sup>231</sup> s 20(1) of the 2008 Act will not find application. The common law of agency must therefore be reverted to.

In accordance with the law of agency, the pure unauthorised contract will be void *ab initio*.<sup>232</sup> However, the contract may be ratified by the company's shareholders. The third party may also rely on agency by *estoppel* to validate the contract,<sup>233</sup> even if the exclusion of the agent's authority was contained in the company's MOI.<sup>234</sup>

### 3.5.4 An "RF" company's liability for an *ultra vires* contract

The effect of s 20(1) of the 2008 Act is that an "RF" company's lack of capacity will not necessarily invalidate an *ultra vires* contract concluded by a director of the company. It remains to be seen whether s 20(1) will or should find application where the agent that concluded the *ultra vires* contract was not a director. This is an important question that needs answering, as the common law will render *ultra vires* contracts void. It is unfortunate that the precise ambit of s 20(1)(a) of the 2008 Act remains unclear. What is certain is that the section will definitely operate in the event that a director concluded an *ultra vires* contract on behalf of an "RF" company, and where no other reason existed for the director's lack of authority except the company's lack of capacity.

If s 20(1) does find application, the *ultra vires* contract will be valid and provisionally enforceable, subject to a potential restraining application in terms of s 20(5) of the

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<sup>230</sup> This is an important consequence of the repeal of the doctrine of constructive notice. See 3.4.3 above.

<sup>231</sup> For a reason separate from the company's capacity.

<sup>232</sup> See 2.2 herein.

<sup>233</sup> If all the elements of agency by *estoppel* are present.

<sup>234</sup> Since a clause limiting the authority of a representative to act on behalf of the company is not a "public provision", the statutory doctrine of constructive notice should not operate to defeat the third party's reliance on agency by *estoppel*. See 3.4.2 and 3.4.3 herein.

Act. The “RF” company will be obligated to perform in terms of the *ultra vires* contract, unless the High Court orders otherwise.

### 3.6 Conclusion

The existence of an agent’s authority to bind a company will always be a vital consideration when assessing the validity of company contracts. Outsiders dealing with companies should be wary when dealing with purported agents of companies, and should always look to confirm the existence of an agent’s authority before contracting with him. If this precautionary measure is followed, it would rarely be necessary to rely on the company’s ratification or on litigation.

It has been discussed how the traditional *ultra vires* doctrine effectively operated as a guarantee for a company’s shareholders that the company’s finances would not be used for a purpose other than the purpose for which the company had been formed.<sup>235</sup> Indeed, that very justification for the *ultra vires* doctrine is arguably the reason why the Legislature retained remnants of the *ultra vires* doctrine in the 2008 Act: the protection offered by restrictive conditions and the “RF” provisions will provide greater security and control to the shareholders of these companies. It may be that the “RF” provisions are intended to encourage investment by persons wishing to have certainty regarding a company’s business dealings. In addition, the fact that directors of “RF” companies can incur personal liability to the company for breaching their fiduciary duty to act within their authority, should act as an incentive for them not to exceed their authority. It is submitted that “RF” companies and the reformulated *ultra vires* doctrine are designed to promote shareholder control over the business of a company and the actions of its directors. This is evident from the fact that while all insiders of “RF” companies, individually or collectively, are empowered to approach the High Court to restrain an *ultra vires* contract, only the company’s shareholders may validly ratify such agreements.

Unfortunately, the legislative arrangement under the 2008 Act still presents a certain level of risk for outsiders contracting with “RF” companies. If an outsider and a director of an “RF” company conclude an *ultra vires* contract, the enforceability of the agreement will depend on whether the company’s insiders wish to abide by it. Just one dissenting insider may frustrate the contract by exercising his right to apply for

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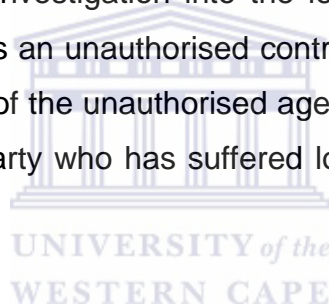
<sup>235</sup> See 3.2.1.



an interdict restraining the company from performing in terms of the agreement. This is hardly a desirable position for the outsider to be in. Also, the question of whether s 20(1) of the 2008 Act applies to *ultra vires* contracts entered into by non-directors, remains unanswered.

The conclusion that can be drawn from this chapter is that outsiders should exercise caution when dealing with all purported agents of companies, especially agents of “RF” companies. Before dealing with an “RF” company, outsiders should take the time to examine the company’s MOI to determine whether it contains any restrictive conditions limiting the company’s contractual capacity. In the event that a person has already concluded an *ultra vires* contract with an “RF” company, the only way for him to completely secure his position would be to request that the shareholders of the company adopt a special resolution ratifying the agreement.

In the following chapter, the investigation into the legal position created where an agent of a company concludes an unauthorised contract will be broadened. Chapter Four will analyse the position of the unauthorised agent and discuss his potential liability to compensate a third party who has suffered loss as a result of an unauthorised contract.



## CHAPTER FOUR

### THE AGENT'S LIABILITY TOWARDS THE THIRD PARTY

#### 4.1 Introduction

The crux of the law of agency lies in the intention to create a juristic act between a represented person and a third party.<sup>236</sup> In order to create such a juristic act, the representative must have been authorised to conclude it on his principal's behalf. If the representative lacks the necessary authority, he cannot bind the principal to the juristic act. The same principle applies to the relationship between a company and its agents.

Yet, directors are different from regular agents in many respects. Just one such difference is the fact that the conduct of directors is regulated by both the common law and the Companies Act 71 of 2008 (the 2008 Act). In keeping with the theme of this thesis, Chapter Four will analyse the impact of the 2008 Act on the liability of the agent to a third party for loss caused by an unauthorised contract. This issue is particularly important because in a world where many contracts are concluded on a daily basis, the law of averages suggests that unauthorised agency is bound to occur.<sup>237</sup>

Obviously, if an unauthorised contract is validated by ratification, agency by *estoppel*, or by s 20(1) of the 2008 Act, there will usually be no discussion of holding the agent liable for the third party's consequential losses. If the contract is adopted by the company, the third party can generally have no cause for complaint: he has gotten exactly what he has bargained for. Therefore, this chapter will focus on the liability of the agent in the event that an unauthorised company contract is "absolutely" void, in the sense that s 20(1) is not applicable or the contract has been restrained by a court order, the company refuses or is unable to ratify the agreement, and the elements of agency by *estoppel* are not present. Unfortunately for the third party in such a scenario, he is left with an unenforceable contract. Even worse, he may have suffered loss as a result of its purported conclusion. The issues that this chapter will investigate are whether the purported agent with whom the unauthorised contract

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<sup>236</sup> See Dendy M 'Agency and Representation' in De Wet JC (founding ed) *LAWSA* vol1 Third Reissue (2014) para 163.

<sup>237</sup> See Busch D & MacGregor L (eds) *The Unauthorised Agent; Perspectives on European and Comparative Law* (2009) 2.

was concluded can be held liable to compensate the third party for any loss caused thereby, what the extent of the liability would be, and what influence the 2008 Act could have. These issues are significantly important for all outsiders dealing with a company's agents.

#### 4.2 The authority of directors

As mentioned in Chapter One, a director's functions often include those of an agent in the "true" sense: in other words, directors may be called upon to conclude juristic acts on the company's behalf.<sup>238</sup> Naturally, directors need authority to validly bind a company to contracts.

The powers of boards of directors were traditionally derived from authorisation by the company's shareholders.<sup>239</sup> Under the previous dispensation, the authority of a company's directors was usually made provision for in that company's AOA. The 2008 Act has altered the position by replacing the AOA with the MOI, and by conferring statutory authority on all directors of companies.<sup>240</sup>

The MOI will therefore not be the sole source of the authority of a company's directors. Section 66(1) of the 2008 Act confers on all directors the 'authority to exercise all of the powers and perform any of the functions of the company', subject to the company's MOI and the remaining provisions of the Act. It is therefore apparent that the authority of a company's directors is now derived directly from statute, and not from the company's constitutive documents. The wording of s 66(1) is extremely broad: the phrase 'exercise all of the powers and perform any of the functions of the company' certainly envisages the conclusion of contracts, as one of the functions of a company is to conclude business transactions.<sup>241</sup> Section 66(1) effectively confers on each and every director of a company the authority to make decisions, including contractual ones, on the company's behalf.<sup>242</sup> Therefore, directors will automatically be empowered to conclude any company contract. However, directors are not free to

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<sup>238</sup> R Cassim argues that the similarity between directors and other agents is less obvious than it was under the previous dispensation, as the powers of directors are now derived directly from s 66(1) of the 2008 Act. See Cassim R 'Governance and the Board of Directors' in Cassim FHI (man.ed.) *et al Contemporary Company Law* 2 ed (2012) at 412.

<sup>239</sup> See Van der Heever QS *The powers of Directors and Limitations* (unpublished LLM thesis, University of Pretoria, 2013) at 6.

<sup>240</sup> Van der Heever QS (2013) at 6.

<sup>241</sup> Van der Heever QS (2013) at 10.

<sup>242</sup> Van der Heever QS (2013) at 6.

do as they please. The conduct of directors will remain subject to their common-law fiduciary duties and the remaining provisions of the 2008 Act, the most important of which is s 76.<sup>243</sup> In addition, a company's MOI may include provisions limiting a director's authority, and/or provisions rendering the authority of directors subject to the fulfillment of an internal requirement.

#### 4.3 The warranty of authority

As a general rule, company's agent will incur no liability whatsoever in respect of a contract between the company and a third party.<sup>244</sup> However, nothing prevents the outsider from concluding a separate contract with the representative.<sup>245</sup> Either within the principal contract or separately, the agent may promise that his authority is above board, and undertake to assume some measure of liability to the third party if it transpires that he has exceeded his authority.<sup>246</sup> Such an agreement is called a warranty of authority.<sup>247</sup>

The warranty of authority is a separate contract from the one between the company and the outsider, even though the two may be reflected in the same document.<sup>248</sup> In the event that the company repudiates a purported contract because the agent who concluded it had acted in excess of his authority, the agent will be in breach of the warranty.<sup>249</sup> The nature and extent of the purported agent's liability to the third party for breach of a warranty of authority will be determined by the terms of that contract.<sup>250</sup> Contractual liability in this context is without doubt the simplest form of a purported agent's liability towards a third party for an unauthorised contract. It would

<sup>243</sup> Section 76 of the 2008 Act codifies many of the fiduciary duties of directors. See Cassim FHI 'The Duties and the Liability of the Directors' in Cassim FHI (man.ed.) *Contemporary Company Law* 2 ed (2012) 507.

<sup>244</sup> See Joubert DJ 'Agency and *Stipulatio Alteri*' in Zimmermann R & Visser D (eds) *et al Southern Cross: Civil Law and Common Law in South Africa* (1996) at 350; Kerr AJ *The Law of Agency* 4 ed (2006) 243.

<sup>245</sup> For example, a representative may bind himself as surety and co-principal debtor in respect of his principal's contractual obligations. See Joubert DJ 'Agency and *Stipulatio Alteri*' (1996) at 351.

<sup>246</sup> The purported agent may expressly or tacitly bind himself in this way.

<sup>247</sup> See Dendy M 'Agency and Representation' (2014) para 166; Kerr AJ *The Law of Agency* (2006) 243.

<sup>248</sup> Dendy M 'Agency and Representation' (2014) para 166; Kerr AJ *The Law of Agency* (2006) 243.

<sup>249</sup> Dendy M 'Agency and Representation' (2014) para 165.

<sup>250</sup> See Dendy M 'Agency and Representation' (2014) para 166. If the contract makes no provision for the nature and extent of the purported agent's liability, and none can be implied, the terms of the "implied warranty of authority" may be applied. See Kerr AJ *The Law of Agency* (2006) at 245. This remedy will be more thoroughly discussed below.

merely require the contract to be properly interpreted to ascertain the extent of the purported agent's liability.

However, in the absence of a warranty of authority between the agent and the third party, the third party may yet have a claim against the agent. South African private law recognises the right of a third party to sue a purported agent for damages arising from the conclusion of an unauthorised contract. Such liability would be based either on delictual principles,<sup>251</sup> or on the breach of a fictional contract (the "implied warranty of authority").<sup>252</sup>

#### 4.4 The common-law liability of the unauthorised agent towards the third party

Where a purported agent causes loss to a third party as a result of an unauthorised contract, and no express or tacit warranty of authority had been concluded, the third party does have a claim against the purported agent to make good such loss. However, a preliminary *caveat* is necessary. It must be noted that a great deal of uncertainty remains in South African law regarding the legal basis and extent of the purported agent's liability towards a third party in such circumstances.<sup>253</sup> It is clear that the measure of calculating the awardable damages will depend on the legal basis of the claim. Unfortunately, there are divergent views on this point among academics.<sup>254</sup> What is certain, is that South African law does allow for a claim by a third party to hold a "false" agent personally liable for the third party's loss arising from an unauthorised contract. According to Innes CJ in *Blower v Van Noorden*, equity demands that the purported agent be liable to make good the third party's loss in such an instance.<sup>255</sup> But the legal basis of such a claim, as well as the nature and extent of the purported agent's liability, remains a matter for debate.

<sup>251</sup> See Dendy M 'Agency and Representation' (2014) para 168.

<sup>252</sup> A rule formulated by Innes CJ in *Blower v Van Noorden* 1909 890 TS at 900-901.

<sup>253</sup> Dendy M 'Agency and Representation' (2014) para 168. In *Claude Neon Lights (SA) Ltd v Daniel* [1976] 4 All SA 387 (A) at 391, the Appellate Division expressed doubt regarding whether the final word had been spoken in this regard.

<sup>254</sup> Again, the most notable proponents of the opposing views are the writers of 'Agency and Representation', on the one hand, and Professor AJ Kerr, on the other.

<sup>255</sup> At 897 the chief justice remarked as follows: '[U]pon general grounds, it would seem that the ostensible agent, however *bona fide*, who induced another to contract with him as such, *ought* to be answerable for any damages sustained by that other in consequence of the alleged principal refusing to be bound by the contract; because acting upon the profession of authority on the part of the agent, the third party concluded a contract the obligations of which he would have been bound to perform...[h]e *ought*, therefore, to be indemnified for the loss of the corresponding rights which the contract purported to give him; and the only person to whom he could possibly look for such indemnity would be the ostensible agent'. [Emphasis added].

What can also be regarded as relatively certain is that an order of specific performance cannot be granted against the purported agent, *unless such a result was intended by the parties in a contractual provision to that effect*. South African law has firmly moved away from Voet's rule that the purported agent in such a situation automatically becomes liable on the contract itself.<sup>256</sup> The logic of the rejection of Voet's view seems to be irrefutable: since an agent is a mere representative, holding him liable to the contract would effectively create a new contract which neither the third party nor the purported agent had intended to create.<sup>257</sup>

Arguably, the nature of the remedy available to the third party will depend on the culpability of the purported agent in misrepresenting his authority. A misrepresentation<sup>258</sup> can be defined as a wrongful and culpable, incorrect or misleading representation to another, who acts on the strength of the representation, to his detriment.<sup>259</sup> South African law certainly recognises delictual liability for negligent misrepresentations that cause pure economic loss,<sup>260</sup> even if the misrepresentation occurred in a contractual context.<sup>261</sup> In principle, there does not seem to be a reason why such liability cannot extend to an intentional misrepresentation. Indeed, provision was made under both Roman and Roman-Dutch law for an action in the event of an intentional misrepresentation.<sup>262</sup> Therefore, if the purported agent intentionally or negligently held himself out as having more authority than he had, or as having authority where he had none, a delictual claim based on the purported agent's misrepresentation may become available.<sup>263</sup>

<sup>256</sup> Voet J *Commentarius ad Pandectas* 14.3.6. See Harker JR 'The Liability of an Agent for Breach of a Warranty of Authority' (1985) 102 *SALJ* 596 at 599; Dendy M 'Agency and Representation' (2014) para 168; Kerr AJ *The Law of Agency* (2006) 251. Indeed, such an approach would conflict with principles long established (in the context of nonexistent principals) in cases like *Nordis Construction and Terblanche v Nothnagel* 1975 (4) SA 405 (C). See McLennan JS 'Some Thoughts on Remedies for an Agent's Breach of Warranty of Authority' (1987) 104 *SALJ* 321 at 322.

<sup>257</sup> Innes CJ feared anomalous and inequitable results would follow if Voet's rule was applied in South African law. See *Blower v Van Noorden* at 899. See also Dendy M 'Agency and Representation' (2014) para 168; Kerr AJ *The Law of Agency* (2006) 251.

<sup>258</sup> In the delictual sense.

<sup>259</sup> See Neethling J, Potgieter JM, and Visser PJ *Law of Delict* 5 ed (2006) 274.

<sup>260</sup> See *Administrateur, Natal v Trust Bank van Afrika* 1979 (3) SA 824 (A).

<sup>261</sup> Such liability was recognised for the first time in *Bayer v Frost* [1991] 2 All SA 444 (A). See Loubser M & Midgley R (eds) *et al The Law of Delict in South Africa* 2 ed (2012) 225; Neethling J *et al Law of Delict* (2006) 274.

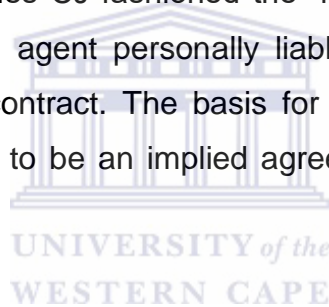
<sup>262</sup> See Neethling J *et al Law of Delict* (2006) 297-299.

<sup>263</sup> The writers of 'Agency and Representation' maintain that in the absence of an agreed warranty of authority, the only real basis of liability can be misrepresentation in the delictual sense. In support of this argument, Professor JC De Wet relied on the views expressed in, *inter alia*, *Peak Lode Gold Mining Co Ltd v Union Government* 1932 TPD 48 and *Nebendahl v Shroeder* 1937 SWA 48, that the pur-

However, if the purported agent had acted without fault, *ie* innocently, he cannot be held liable in delict. The South African law of delict does not recognise a general action based on faultless conduct.<sup>264</sup> If delict was the only available basis for such a claim, an agent who innocently misrepresents the existence of his authority cannot be liable for the third party's damages. At the very least, academics are generally in agreement that a delictual action against the purported agent will be available to the third party only if the purported agent had intentionally or negligently misrepresented the existence of his authority.<sup>265</sup>

Fortunately, a set of facts came before Innes CJ in *Blower v Van Noorden* which required the learned chief justice to determine 'the legal position of a man who enters into a contract as agent of a named and existing principal, in the real, but mistaken, belief that he has authority so to contract'.<sup>266</sup>

In *Blower v Van Noorden*, Innes CJ fashioned the "implied warranty of authority" a basis for holding a purported agent personally liable for a third party's damages caused by an unauthorised contract. The basis for a purported agent's liability in such circumstances was held to be an implied agreement arising from the agent's representation of authority.<sup>267</sup>




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ported agent will not be liable if the third party knew or could determine that the purported agent did not have the requisite authority. Furthermore, the learned authors argue that the Appellate Division's recognition in *Claude Neon Lights* of a causal connection being required between the misstatement of authority and the conclusion of the purported contract indicates that the liability is delictual in nature. See Dendy M 'Agency and Representation' (2014) para 168.

<sup>264</sup> Neethling J *et al Law of Delict* (2006) 329.

<sup>265</sup> Based on the purported agent's intentional or negligent misrepresentation. In fact, the writers of 'Agency and Representation' maintain that 'in the absence of consensus the real basis of liability can only be misrepresentation.' See Dendy M 'Agency and Representation' (2014) para 168. *Cf* Professor Kerr's argument that 'under the residual rules an action lies even if the agent is *bona fide*'. The learned author placed reliance on the following passage from *Collen v Wright* [1857] 120 ER 241 at 245, which influenced the decision in *Blower v Van Noorden*: 'The fact that the professed agent honestly thinks that he has authority affects the moral character of his act; but his moral innocence, so far as the person whom he has induced to contract is concerned, in no way aids such person or alleviates the inconvenience and damage which he sustains'. See Kerr AJ *The Law of Agency* (2006) 248. It is submitted that restricting the claim to the law of delict would be ill-advised as recourse for the third party would not be available where the purported agent had acted without fault.

<sup>266</sup> *Blower v Van Noorden* at 896.

<sup>267</sup> At 900 Innes CJ puts forth the following explanation for the imposition of personal liability on the purported agent: 'What takes place is this: the agent in effect represents to the other contracting party that he has authority to bind his principal; and within the limits of that authority he consents to the terms of the agreement on his principal's behalf. There is a representation by the agent personally, and a contract by him in his capacity as agent. The representation is in respect of a matter which is peculiarly within his knowledge, and of which the other party knows nothing at all. But the latter enters into the contract on the faith of that representation, and the agent intends that he do so; it forms the basis of the whole agreement. Under those circumstances we are surely justified in implying, on the

Considerable uncertainty remains regarding the true legal basis of such an action.<sup>268</sup> All that can safely be said is that the purported agent's personal liability in such circumstances is liability arising from operation of law. However, it is questionable whether this *ex lege* contract can come into being when the purported agent did not have contractual capacity at the relevant time.<sup>269</sup>

It is clear that the purported agent's culpability (or lack thereof) will play an important role with regards to the legal basis or bases of the third party's claim against him. As a result of *Blower v Van Noorden*, which has never been overruled, every time an agent purports to contract with a third party on behalf of a named and existent principal, an *ex lege* contract between the third party and the purported agent comes into being. The content of this agreement is that the purported agent warrants the existence of his authority, and, should it transpire that his authority was lacking, he promises to place the third party in 'as good a position' as if the professed principal had been bound. Breach of the implied warranty of authority will be available to a third party even if the purported agent's conduct was blameless.<sup>270</sup> In addition, where the agent's misrepresentation of authority was intentional or negligent, a delictual action should be available to the third party. At the very least, outsiders can rest assured that the law will not leave them without recourse against a purported agent who misrepresents the existence of his authority, whatever the purported agent's motives may have been.

#### 4.4.1 The extent of the liability

Once it has been established that a purported agent is liable for damages to a third party who has suffered loss as a result of an unauthorised contract, the extent of his liability must be determined. As discussed above, the purported agent cannot be compelled to render specific performance on the contract itself, unless the terms of

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part of the agent, a personal undertaking that his principal shall be bound by the contract, and that, if not, he will place the other party in as good a position as if the principal were bound.' This statement, which contains elements of both delictual and contractual principles, has proven to be the cause of some dissensus in South African law. Indeed, in *Claude Neon Lights* the Appellate Division expressed doubt whether the final word had been spoken in this regard. See *Claude Neon Lights* at 391. See also Dendy M 'Agency and Representation' (2014) para 168 and Kerr AJ *The Law of Agency* (2006) 248-250.

<sup>268</sup> See Dendy M 'Agency and Representation' para 168; Kerr AJ *The Law of Agency* (2006) 248-250.

<sup>269</sup> In the case of an *infans* or a mentally ill person, for example.

<sup>270</sup> Provided that the third party's conduct was blameless as well. In *Blower v Van Noorden* the plaintiff's claim failed because the agent and the third party had *jointly* arrived at the erroneous conclusion that authority had been given.



the agreement make provision for this. What, then, is the precise measure of calculating the damages claimable by a third party against the purported agent in such circumstances? Naturally, the particular cause of action with which the third party is successful will determine the measure of calculating the awardable damages.

#### 4.4.1.1 Delictual liability for misrepresentation of authority

If the basis of the third party's claim is the purported agent's intentional or negligent misrepresentation, the method of calculating damages will be the delictual one of negative interest.<sup>271</sup> This would require the court to have regard to the position the third party would have been in had the delict not occurred, in other words if the purported agent had not misrepresented the existence of his authority. However, this seemingly simple approach may prove to be problematic in a situation of unauthorised agency. Does it require a court to consider the position the third party would have been in had the purported agent been duly authorised, or the position the third party would have been in had the purported contract never been concluded? If the first approach is to be adopted, there would be a need to enquire into the financial position of the professed principal, a party in no way responsible for the situation.<sup>272</sup> If the second approach is preferred, Kerr speculates that the third party may argue that he would have contracted with someone else had he not contracted with the purported agent. Of course, the third party would have to prove that he would have entered into this alternative contract, and what benefits would have accrued to him in terms thereof. Such a case would necessitate the court having to look at the financial position of the person with whom the other contract would have been concluded, and not of the professed principal.<sup>273</sup>

Further important considerations that will arise if the third party's claim was based on delict would be the fact that the principle of contributory fault<sup>274</sup> and the rule on mitigation of loss would apply. Furthermore, the third party will be entitled to claim damages for non-patrimonial loss,<sup>275</sup> which would not be the case if his claim was based on contract.

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<sup>271</sup> This would require the innocent party to be placed in the position he would have occupied had the delict not occurred. See Neethling J *et al Law of Delict* (2006) 217.

<sup>272</sup> See Kerr AJ *The Law of Agency* (2006) 250.

<sup>273</sup> Kerr AJ *The Law of Agency* (2006) 249.

<sup>274</sup> By virtue of the Apportionment of Damages Act 34 of 1956.

<sup>275</sup> See Neethling J *et al Law of Delict* (2006) 197.

Assessing a third party's damages based on a misrepresentation of authority may prove to be a challenging exercise, as it will always be difficult to establish precisely what the third party's position would have been had the purported agent not misrepresented the existence of his authority. However, it should be borne in mind that the assessment of damages has never been a perfect science. All that can be hoped for is that in each particular case, the greatest measure of equity will be found.

#### 4.4.1.2 Liability for breach of the implied warranty of authority

The limits of the so-called implied warranty of authority have never been thoroughly investigated by an appellate level South African court.<sup>276</sup> The rule laid down by Innes CJ in *Blower v Van Noorden* requires the purported agent to place the third party in the position he would have been in if the professed principal was bound to perform in terms of the agreement. This approach accords with the method of calculating contractual damages.<sup>277</sup> The implication of Innes' rule is that regard must be had to the financial position of the professed principal when calculating the damages awardable to the third party.<sup>278</sup> Therefore, if the professed principal is insolvent or a "man of straw" and incapable of performing in terms of the agreement, the purported agent is not liable; the purported agent, by doing nothing, will already have placed the third party in the position he would have been in had the professed principal been bound. However, to ensure some measure of equity in such a circumstance, it is submitted that the purported agent should remain liable for restitutionary damages.

JC De Wet noted several potential stumbling blocks in calculating damages in this way: *inter alia*, the position the third party would have been in had the purported agent had authority may sometimes be difficult to determine. Indeed, the purported contract may be of such a nature that its value to the third party cannot even be as-

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<sup>276</sup> At the very least, the High Court in *Indririe v Du Preez* refused to apply the implied warranty of authority to a situation of a nonexistent principal (a deregistered company *in casu*), as it felt that doing so would extend the fiction too far beyond the limits of the remedy envisioned by Innes CJ in *Blower v Van Noorden*. See *Indririe v Du Preez* [1989] 2 All SA 245 at 261. Kerr suggests that under the implied warranty of authority the following can be claimed by the third party: (i) restitution for any expenses reasonably incurred 'in claiming against the principal', and (ii) 'the amount which he would have received on executing against the purported principal a judgment for damages for breach of the purported contract, had it existed and been breached'. Although this formulation requires further speculation to determine the purported agent's liability, it admirably manages to avoid holding him liable on the contract itself. See Kerr AJ *The Law of Agency* (2006) 249.

<sup>277</sup> Professor De Wet correctly points out that Innes' method of calculating damages is inconsistent with liability based on a misrepresentation, but may be compatible with liability based on a warranty implied by law. See Dendy M 'Agency and Representation' (2014) para 168.

<sup>278</sup> Kerr AJ *The Law of Agency* (2006) 249.

sessed if the contract never comes into existence.<sup>279</sup> Kerr also acknowledges the potential practical difficulties in applying the terms of the “implied warranty of authority”, in particular those arising from the fact that the third party will be required to prove his loss. This would necessarily require an investigation into the professed principal’s ability to perform in terms of the unauthorised contract. Should the professed principal be compelled to disclose his financial position when the entire situation has nothing to do with him? As a means to avoid needlessly inconveniencing and possibly causing harm to an innocent person, Kerr suggests that a court should assume that the professed principal *is* able to meet the relevant obligations in terms of the contract, unless the purported agent can ‘show reasonable grounds for suspecting that he is unable to do so’;<sup>280</sup> and that only if the purported agent can do *that* should the professed principal be subjected to questioning regarding his financial position.<sup>281</sup> While this may seem to be a relatively sensible approach, it is submitted that the appropriateness of enquiring into the financial position of the professed principal must depend upon the facts of the particular case. In addition, requiring the purported agent (who is being sued) to show reasonable grounds for *anything* would conflict with the fundamental principle that the plaintiff in civil proceedings bears the *onus* of proof. If the third party alleges that the professed principal was capable of meeting the relevant contractual obligations, the duty should be on *him* (the third party) to prove it.

#### 4.5 The effect of the statutory doctrine of notice

Section 19(5)(a) of the 2008 Act poses a rather interesting question with regards to an agent’s liability for his unauthorised actions. Professor Jooste notes that ss 19(4) and 19(5)(a) could be construed in a manner that creates a positive doctrine of constructive notice, capable of being relied upon by persons other than the company.<sup>282</sup> The wording of s 19(5)(a) of the Act does not expressly prohibit outsiders, or even insiders for that matter, from relying on the statutory doctrine of constructive notice. Section 19(5)(a) of the Act is unambiguous: all persons *must* be regarded as having

<sup>279</sup> See Dendy M ‘Agency and Representation’ (2014) para 166. Indeed, it could be argued that the calculation of damages for *all* failed contracts will be hampered by this impediment.

<sup>280</sup> Kerr AJ *The Law of Agency* (2006) 250.

<sup>281</sup> Kerr AJ *The Law of Agency* (2006) 249-50.

<sup>282</sup> However, the learned author is of the opinion that such an interpretation could not have been intended by the Legislature. See Jooste R ‘Observations on the impact of the 2008 Companies Act on the Doctrine of Constructive Notice and the *Turquand* rule’ (2013) 130 *SALJ* 464 at 469.

notice and knowledge of all restrictive conditions contained in the MOI of an “RF” company that has complied with the formal requirements for ring-fencing. That being the case, can an agent rely on s 19(5)(a) to escape personal liability to third parties for damage caused by the conclusion of absolutely void *ultra vires* contracts? In the absence of an express or tacit warranty of authority, such liability would either be based on delict or on the implied warranty of authority. Regarding delictual liability, it would seem that the third party’s claim *could* be defeated by s 19(5)(a) if the section creates a positive doctrine of constructive notice. If a third party contracting with a principal through an agent is deemed to know that the agent lacked the requisite authority,<sup>283</sup> he may find it difficult to prove that the agent had misrepresented his authority. If the third party cannot prove that the agent misrepresented the existence of his authority, no delictual liability can be established. Likewise, if the third party was not induced to contract by the agent’s misrepresentation of authority, there can be no discussion of the agent’s liability under the implied warranty of authority.<sup>284</sup> Therefore, can an agent of an “RF” company rely on s 19(5)(a) as a shield to protect himself from being held personally liable to outsiders in such circumstances? The answer to this question will depend on the scope of the statutory doctrine of constructive notice.

It is submitted that s 19(5)(a) should be interpreted with regard to the historical operation of the common-law doctrine of constructive notice. Historically, the constructive notice doctrine was a rule that could only be called upon by a company in order to protect its own interests, and was never available to any other party except the company.<sup>285</sup> The doctrine of constructive notice, being a negative doctrine, could never be relied upon by a company’s agents to escape personal liability for their unauthorised acts. While the wording of s 19(5)(a) of the 2008 Act does not expressly forbid an insider from relying on it, the section does not expressly allow for such reliance either. In the absence of an express legislative indication to the contrary, should the

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<sup>283</sup> Because of the restrictive condition in the company’s MOI.

<sup>284</sup> For the implied warranty of authority to operate, the third party must have been misled by the agent’s misrepresentation of authority, and induced to contract with him as a result thereof: ‘[T]he [third party] enters into the contract on the faith of such representation, and the agent intends that he do so; it forms the basis of the whole agreement’. See *Blower v Van Noorden* at 901. The AD in *Claude Neon Lights* confirmed this position by stating: ‘Whatever the true juridical niche of an action such as this may be, what is clear is that a causal relationship between the ostensible agent’s representation of authority and the conclusion of the contract would necessarily have to be established.’ See *Claude Neon Lights* at 391.

<sup>285</sup> See 3.2.2 herein.

spirit of the common-law doctrine of constructive notice not prevail? A positive doctrine of constructive notice could operate to exclude two key common-law remedies which a third party would ordinarily have had against an agent who caused loss to the third party as a result of a misrepresentation of authority. It is submitted that this could not have been the Legislature's intention.

For these reasons, it is submitted that the statutory doctrine of constructive notice should, just like its formulation under the common law, remain a negative doctrine solely aimed at protecting the interests of "RF" companies. In order to ensure that the interests of third parties dealing with "RF" companies are protected, s 19(5)(a) should not be available to the company's agents to protect themselves from personal liability to the third party.

#### 4.6 Conclusion

In this chapter it was demonstrated that an agent's liability for loss caused to a third party as a result of an unauthorised contract is anything but a straightforward issue.

When contracting with an agent of any company, outsiders would be well advised to bind the agent to an express warranty of authority, because (a) it provides greater security in the event that the company repudiates the agreement due to the agent's lack of authority, and (b) the outsider can better regulate the nature and extent of the agent's liability. This would avoid the complexities involved in placing reliance on the law of delict or on the implied warranty of authority.<sup>286</sup>

Chapter Five will provide a conclusion to this thesis and suggest certain safeguards that outsiders can employ when concluding contracts with companies.

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<sup>286</sup> See Kerr AJ *The Law of Agency* (2006) 249-250.

## CHAPTER FIVE

### CONCLUSION

This thesis commenced with a discussion of the principles of the law of agency, focussing on the concepts of authority, agency by *estoppel*, and ratification. The point of departure was the principle that authority is required for successful representation. However, it was observed that a professed principal may yet incur liability for unauthorised contracts entered into by his agent, by way of the principal's ratification of the unauthorised contract, or by way of the third party's successful reliance on agency by *estoppel*. The rules of agency are of particular importance with regards to the relationship between a company and its representatives, particularly as all directors now have statutory authority to bind a company to contracts.<sup>287</sup>

The concept of a company's capacity, the doctrine of *ultra vires*, and the statutory doctrine of constructive notice, will only be relevant in respect of certain "RF" companies. By virtue of s 19(1)(b) of the Companies Act 71 of 2008 (the 2008 Act), companies that do not take any of the steps envisioned by the "RF" provisions will effectively have the same contractual capacity as natural persons, enabling them to conclude most types of contracts in connection with any lawful enterprise. As a result of s 19(4), outsiders dealing with companies shall no longer be prevented from raising against the company the outsider's ignorance of the contents of the constitutive documents of the company. Therefore, persons dealing with non-"RF" companies will not have to fear the consequences of the doctrines of *ultra vires* and constructive notice. However, they will still be affected by the authority of the agent with whom they are contracting. Under the 2008 Act, the only consideration for outsiders when dealing with non-"RF" companies will be whether the agent with whom they are dealing is in fact authorised to bind the company to the relevant contract. The importance of this factor cannot be overstated, as the scope of an agent's authority greatly impacts on the validity of the company contracts he attempts to conclude. In this regard, the outsider cannot afford to be satisfied with the assurance of the agent himself.<sup>288</sup>

<sup>287</sup> By virtue of s 66(1) of the 2008 Act.

<sup>288</sup> For it is a representation by the professed principal that justifies reliance on agency by *estoppel*. As was stated by the Supreme Court of Appeal in *Glofinco v Absa Bank*, '[a]ssurances by an agent as to the existence or extent of his authority are therefore of no consequence when it comes to the representation of the principal inducing a third party to act to his detriment'. At para 13.

As a result of the enactment of the “RF” provisions, aspects of the *ultra vires* doctrine and a statutory reformulation of the doctrine of constructive notice will influence contracts between certain “RF” companies and outsiders. The real-world impact of the “RF” provisions is far from clear. It has been suggested that the “RF” provisions are intended to operate as shareholder protection, on the one hand, and as an incentive for directors of “RF” companies to act within the limits of their authority,<sup>289</sup> on the other.<sup>290</sup> How effective the “RF” provisions will be at achieving these goals remains to be seen. If the “RF” provisions were indeed intended to allow for the incorporation of a type of “special purpose vehicle”,<sup>291</sup> a company incorporated for a single or limited purpose, one must question how effective such special purpose vehicles would be in light of the fact that *ultra vires* contracts concluded by directors of “RF” companies are not *per se* void.<sup>292</sup>

Whatever the potential benefits for shareholders and investors that the “RF” provisions may bring, it is relatively certain that s 20(1) of the 2008 Act will present a significant amount of risk to outsiders. The vital implication of s 20(1) of the 2008 Act is that if an outsider concludes a contract with a director of an “RF” company which violates a restrictive condition contained in the company’s MOI,<sup>293</sup> the contract will be valid, but voidable upon application to the High Court by an insider of the company. If an outsider concludes an *ultra vires* contract with a director of an “RF” company, his legal position and prospects of enforcing the agreement will be subject to the will of the company’s insiders, and the High Court’s granting or refusal of a potential restraining application in terms of s 20(5) of the 2008 Act. In addition, the statutory doctrine of constructive notice will deem all outsiders to have knowledge of restrictive conditions contained in the MOIs of “RF” companies.

Therefore, outsiders should take great care when dealing with “RF” companies: before the contract is concluded, they need to determine whether a restrictive condition is applicable to the company, and if so, whether and to what extent the company’s

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<sup>289</sup> As directors of “RF” companies run the risk of incurring personal liability to the company for breaching their fiduciary duty to act within their powers.

<sup>290</sup> See Cassim FHI ‘Corporate Capacity, Agency and the Turquand Rule’ in Cassim FHI (man.ed) *et al Contemporary Company Law* 2 ed (2012) at 174-5, where the learned author comments that the *ultra vires* doctrine has now ‘developed into issues of fiduciary duties and shareholder rights’.

<sup>291</sup> See Cassim FHI ‘The Companies Act 2008: An Overview of a Few of its Core Provisions’ (2010) 22 SA Merc LJ 157 at 171.

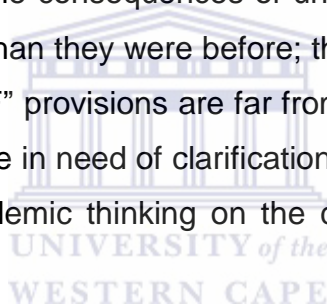
<sup>292</sup> See Cassim FHI (2010) 171.

<sup>293</sup> And all the formal requirements for ring-fencing had been complied with.

contractual capacity is limited. The only way to do this is to examine the “RF” company’s MOI. If an outsider concludes a contract with an “RF” company, and only afterwards discovers that it is *ultra vires*, he should request that the company’s shareholders ratify the agreement in terms of s 20(2) of the 2008 Act in order to ensure that the contract remains valid and enforceable.

In the event that an unauthorised company contract is concluded between an agent of a company and an outsider, the outsider may have a claim against the purported agent to recuperate consequential losses sustained by the third party. The liability of the agent in such an instance may be contractual, delictual, or liability arising from operation of law. In order to avoid unnecessarily complicated and costly litigation, outsiders dealing with companies would be well-advised to bind the representative to an express warranty of authority.

In conclusion, it is clear that the consequences of unauthorised agency in company law are more straightforward than they were before; the 2008 Act is commendable in this respect. However, the “RF” provisions are far from perfect. This thesis has highlighted certain issues which are in need of clarification, and will hopefully serve as an adequate contribution to academic thinking on the complicated issues of capacity and authority in company law.





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