

## COMPANIES ACT 71 OF 2008 AND THE “TURQUAND” RULE

The Companies Act 71 of 2008 (“the Act”) had a long and arduous path to come into existence. It started with the Guidelines for Corporate Law Reform published in Notice 1183 in *Government Gazette* 26493 of 2004-06-23, ironically marked “Confidential”. After various Bills, the Act was signed by the President on 2009-04-08 but only to come into operation on a date determined by proclamation, and from the general effective date would then repeal most of the Companies Act 61 of 1973 (“1973 Act”) (s 225 of the Act). The Act starts a new era in South African corporate law and will change the existing law, also the common law, extensively. It appears that the Act follows an eclectic approach in that it borrowed extensively from the corporate laws of other jurisdictions. This is not *per se* an unacceptable *modus operandi*, but careful grafting into the existing common law is necessary, so as not to create problems and uncertainty. A situation where this may be the case, and where the confusion may be exacerbated, is in respect of company capacity and representation.

Capacity and representation of a company are some of the most important principles of company law as this is the interface with the outside world, and certainty for the company and third parties should be a given. However, in practice this has never been the case and the concepts have been confused with

one another and on their own by the courts, academics and students. The confusion was not because of anything else but the extraordinary complexity of these concepts if one were to stray from the most basic principles.

A very basic restatement of the law in respect of representation of a company may be necessary to the extent that it is relevant for the discussion below. A company is a juristic person and as such has “no soul to be saved or body to be kicked” and although this dictum by Greer LJ in *Stephney Corporation v Osofsky* [1937] 3 All ER 289 CA 291 was with reference to the perpetual succession of a company, it is also apposite in respect of representation. A company cannot contract (or for that matter perform any other legal act) on its own and it needs “agents” to do so on its behalf (s 69 of the 1973 Act). Herein starts a whole new micro cosmos as the authority of the agents must be conferred by somebody or something and the rights of the company and third parties contracting with the company must be balanced. This puts the interaction between three company law doctrines in motion, these being, at least, the doctrine of disclosure, the doctrine of constructive notice, and as a logical corollary to the last doctrine, (aspects of) the *Turquand* rule.

The doctrine of disclosure is the most basic of the company law doctrines as it is the flipside of corporate legal personality. For the “privilege” of perpetuity and separate legal personality and liability of, amongst others, the shareholders, the veil of secrecy otherwise applying to a sole proprietorship or partnership is substituted by disclosure. (Sealy “The ‘disclosure’ philosophy and company law reform” 1981 *Company Lawyer* 51 and *Company law and commercial reality* (1984) 21. S 13 of the Act now states that it is a right, not a privilege, to incorporate.) The disclosure applies to the public documents, being those that must be lodged with the Companies and Intellectual Properties Registration Office (“CIPRO”), the most important of which are the memorandum and articles of association (s 63 of the 1973 Act). There are, however, also some advantages for the company to disclose and these are embodied in the doctrine of constructive notice which postulates that a person who deals with the company is deemed to have knowledge of the public documents (Cilliers, Benade, Henning, Du Plessis, Delpont, De Koker and Pretorius *Cilliers and Benade Corporate law* (2000) 190, *Oranje Benefit Society v Central Merchant Bank Ltd* 1976 4 SA 659 (A), Du Plessis *Maatskappyregtelike grondslae van die regsposisie van direkteure en besturende direkteure* (LLD thesis UOFS 1990) 64). It is in these public documents, usually the articles, that the company will, in the first instance, appoint its agents and therefore the model articles for a public company in Table A of Schedule 1 of the 1973 Act for a public company (a 60 of Table B for a private company) provides as follows: “**59.** The business of the company shall be managed by the directors.”

“Directors” here mean the directors collectively acting as a board (Kunst, Delpont and Vorster *Henochsberg on the Companies Act* (1994) 1035). It is accepted that this power is an original and not a delegated power and that the board can delegate its powers to anybody, also to a non-director (Du Plessis *Maatskappyregtelike grondslae* 44, but see *Henochsberg on the Companies Act* 1043). Essentially the same provision is now found in section 66 of the Act, and the significance that it is now a statutory provision and the effect thereof should be noted.

A company is bound by the actions of its “agents” if those agents acted *intra vires* their authority. It is acknowledged that a director is more than an “agent”

but as only the agency principles are discussed, the term “agent” is used (see authorities cited in *Cilliers and Benade Corporate Law* 116). A director’s authority can have different bases. In *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 2 SA 11 (T) 14–15 it was summarised as follows:

- “2. Such authority [to bind the company] may take the usual forms of express, implied or ostensible authority . . .
- (a) Express authority may be given by a company’s articles of association or by resolution of the members or board of directors.
  - (b) Implied authority exists ‘when the official acting on behalf of the company purports to exercise an authority which that type of official usually has even though the official is exceeding his actual authority.’ (Per Claassen J in *Wolpert’s case [Wolpert v Uitzigt Properties (Pty) Ltd* 1961 2 SA 257 (W)] at 266.) . . . Or it may be inferred from the acquiescence of the directors in a course of dealing inside the company itself. (*Dickson v Acrow Engineers (Pty) Ltd* [1954 2 SA 63 (W)] . . .
  - (c) To prove ostensible authority facts raising an estoppel against the company would have to be proved.”

Express and implied authority can also be grouped together under the concept of actual authority (see also Du Plessis *Maatskappyregtelike grondslae* 195). If the agent has express authority, or if the company is estopped from claiming lack of authority, the company is bound. However, a problematic situation may arise in that the company can have the standard articles but a provision is added that if the contract value is above 50% of the issued share capital of the company, prior authority from the general meeting is required but no contracts can be concluded under any circumstances above 100% of the issued share capital. The agents therefore have potential authority for the 50% issued share capital contract but no authority for the 100% share capital contract. If they now purport to conclude the latter, the company will not be bound because it was *ultra vires* the authority and the third party is deemed to have knowledge due to the doctrine of constructive notice. Estoppel can also not work, as the same doctrine precludes a misrepresentation by the company of something that the third party is deemed to know is not true (Oosthuizen “Aanpassing van verteenwoordigingsreg in maatskappyverband” 1979 TSAR 5). The *Turquand* rule, however, comes to the assistance of certain third parties if the 50% issued share capital contract is concluded without authorisation (or ratification) from the general meeting. The *Turquand* rule, created in *Royal British Bank v Turquand* (1856) 6 E & B 327; 119 ER 886 can be summarised as follows:

“This rule mitigates the unrealistic doctrine of constructive notice which deems anyone dealing with a company to know the contents of the company’s memorandum, articles of association, resolutions and other documents recorded on the company’s file with the Registrar of Companies. In its simplest form the *Turquand* rule, or ‘indoor management rule’, entails that if nothing has occurred which is obviously contrary to the provisions of the registered documents of the company, an outsider may assume that all the internal matters of the company are regular. That the rule is applicable in South Africa is apparent from *Mine Workers’ Union v Prinsloo* 1948 (3) SA 831 (A) and numerous other cases. See M J Oosthuizen *Die Turquand-reël in die Suid-Afrikaanse Maatskappyereg* (unpublished LLD thesis, University of South Africa (1976)); and M S Blackman ‘Companies’ in W A Joubert (ed) *The Law of South Africa* 4 Part 2 (1996) 185 (see n2 for authorities) for comprehensive discussions. The effect of the rule is that the company is prevented from resiling from a contract with a *bona fide* third party on the ground that some internal requirement has not been satisfied” (Pretorius, Delport, Havenga and Vermaas *Hahlo’s Company law through the cases* (1999)

361; and see also, *inter alia*, McLennan “The ultra vires doctrine and the *Turquand* rule in company law – A suggested solution” 1979 *SALJ* 329; Benade “Opmerkings oor die *Turquand*-reël” 1962 *THRHR* 194; Oosthuizen “Die *Turquand*-reël as reël van die verenigingsreg” 1977 *TSAR* 210, and “Aanpassing van die verteenwoordigingsreg in maatskappyverband” 1979 *TSAR* 1).

The *Turquand* rule therefore does not operate if the third party is not *bona fide* (has knowledge of non-compliance by the company) or if the third party is aware of facts that would put a reasonable person on enquiry with regard to whether or not there was compliance (“exclusions”) (*Cilliers and Benade Corporate law* 192, Du Plessis *Maatskappyregtelike grondslae* 66, *Henochsberg on the Companies Act* 131). The issue that is important for the present discussion is that the “outsider may assume that all the internal matters of the company are regular” and that “the company is prevented from resiling from a contract” when the *bona fide* third party contracts with the company under a *Turquand* situation. The question is then also who can act for the “company” for *Turquand* to be effective. There have been many opinions and uncertainty, but for the present the following as stated in *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 2 SA 11 (T) 15 is accepted as the correct position:

“[4] . . . In contracting with a company the following categories of person or persons acting or purporting to act on its behalf may be encountered:

- (a) The board of directors;
- (b) The managing director or chairman of the board of directors;
- (c) Any other person or persons such as an ordinary director or branch manager or secretary.

5. Where someone contracts with a company through the medium of the persons referred to in paras 4(a) and (b) above, the company will usually be bound because these persons or bodies will, unless the articles of association decree otherwise, be taken to have authority in one form or another to bind the company in all matters affecting it. Moreover all acts of internal management or organisation on which the exercise of such authority is dependent may, in terms of the *Turquand* rule, be assumed, by a *bona fide* third party, to have been properly and duly performed. Indeed unless some such principle was accepted no one would be safe in contracting with companies.

6. The same does not apply where the company is represented by the category of person referred to in para 4(c) above. Here a third party is not automatically entitled to assume that such person has authority and the company is not precluded from repudiating liability on the ground that he had no authority to bind it. To hold the contrary would deprive a company of the rights which any natural principal would have of denying the allegation that a particular person is his agent. The application of the *Turquand* rule in this sphere is limited. It only comes into operation once the third party has surmounted the initial hurdle not present in cases falling under paras 4(a) or (b) above and proves that the director or other person purporting to represent the company had authority. Once this is proved then, if the actual exercise of such authority is dependent upon some act of internal organisation, such can, by a *bona fide* third party, be assumed to have been completed. But in dealing with the type of person in question the other contracting party cannot use the *Turquand* rule to help him surmount the hurdle mentioned.”

(See also Oosthuizen “*Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 (2) SA 11 (T)” 1978 *TSAR* 173 and *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 3 SA 486 (SCA) 494G.)

If, in the example above, the articles contain the 50% share capital provision, but also provide that the board may delegate their powers to anybody (a single director or anybody else for that matter), the *Turquand* rule will only apply if the

person has been appointed (*Turquand* in the narrow sense). If the appointment was made but the company now disputes the validity of the appointment because, as an example, a quorum was not present at the board meeting where the appointment was effected, the *Turquand* rule (in the wide sense) can also apply and the third party can presume, and the company cannot dispute, that the appointment was “properly and duly performed” (*Sugden v Beaconsfield Dairies (Pty) Ltd* 1963 2 SA 174 (E) 182. S 214 of the 1973 Act could also apply here). It should be noted that the *Turquand* rule does not classify the third party on an institutional basis but rather functionally. Therefore, even if a person is an “insider”, the test should be whether that person is not *bona fide* or if the circumstances were such that they should have investigated the situation and by not doing so were negligent (Du Plessis *Maatskappyregtelike grondslae* 72, McLennan 1979 *SALJ* 329, Oosthuizen LLD thesis 174).

And along comes the Companies Act 71 of 2008. According to the basic principles of hermeneutics, the common law still applies, unless where it is expressly or by necessary implication abolished. The Act so, *inter alia*, abolishes the doctrine of constructive notice expressly and section 19(4) provides:

“Subject to subsection (5)[the “RF” and personal liability company], a person must not be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document—

- (a) has been filed; or
- (b) is accessible for inspection at an office of the company.”

Then, to make matters a little more complicated, section 20(7) of the Act provides:

“A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.”

Section 20(7) is said to codify the *Turquand* rule principles as set out above (Davis, Cassim, Geach, Mongalo, Butler, Loubser, Coetzee and Burdette *Companies and other business structures in South Africa* (2006) 42). This may not be the case, as what is codified is not the whole *Turquand* rule, for the following reasons:

- (a) Section 20(7) applies to a person dealing in good faith with the company, but a director, prescribed officer or shareholder of the company (“insider”) is expressly excluded. Therefore, the possibility that, as in the *Turquand* rule, an insider can also be protected is expressly excluded and an institutional rather than a functional category is established. It is not clear why only these categories are excluded and why the functional category is abandoned. A holder of “securities other than shares” (in ordinary language a debenture holder) can, in terms of section 43(3), be granted voting rights unless the memorandum of incorporation provides otherwise. Such a voting debenture holder will not be an insider *per se* and section 20(7) will apply if the debenture holder is *bona fide*. The logic for this exception is not clear.
- (b) The *bona fide* non-insider is, under certain circumstances, entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements.

Apparently this “presumption” by the non-insider applies to inside actions (“indoor management”) and presumes that all the actions were taken (and presumably properly taken). This is therefore part of the *Turquand* rule (in the wide sense) and also incorporates aspects of section 214 of the 1973 Act. It appears to cover the situation that there was an actual “decision” and that it was properly taken and does not presume that the decision was taken. The question can be posed whether this is that same as the *Turquand* principles which state that an “outsider may assume that all the internal matters of the company are regular” and that “the company is prevented from resiling from a contract” when the *bona fide* third party contracts with the company. It is clear that it covers the “assumption” but it is not so clear that the second part, that the company is prevented from resiling, is included. The position under the *Turquand* rule is “that the necessary acts of internal management are presumed to have been performed and not that a particular person is entitled to assume that they have” (*Mine Workers’ Union v Prinsloo* 1948 3 SA 831 (A) 849). I suppose that in practice the non-insider will be protected by section 158 of the Act. What is curious is that only the restrictions in the Act, the memorandum of incorporation and any rules are a “safe haven” for the non-insider. Formal and procedural requirements in a contract between shareholders and the company and the directors (which is not a shareholders’ agreement as defined in section 15(7) of the Act) or a resolution of shareholders restricting the powers of the directors are not included.

- (c) Section 20(7) is excluded if the non-insider knew or reasonably ought to have known of any failure by the company to comply with any internal requirement. “Knowledge” is defined in section 1 of the Act as:
- “‘knowing’, ‘knowingly’ or ‘knows’, when used with respect to a person, and in relation to a particular matter, means that the person either—
- (a) had actual knowledge of the matter; or
  - (b) was in a position in which the person reasonably ought to have—
    - (i) had actual knowledge;
    - (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
    - (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.”

The word “knew” as defined in section 1 therefore means actual knowledge, but also includes situations where the person reasonably should have acquired the knowledge. However, the duty to reasonably acquire the knowledge (as in s 1) is repeated in section 20(7), which creates interpretational difficulties with a double “reasonableness” test. Also, the requirements in (iii) in respect of the definition in section 1 appears to go much further than the “reasonably ought to have known” in section 20(7) and also the exclusions under *Turquand* and would greatly extend the ambit of statutory exclusions, to the detriment of the non-insider.

To add to the confusion, section 20(8) provides:

“Subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers.”

This expressly retains certain common-law principles, of which the *Turquand* rule is apparently one and creates various alternatives. In the first instance it can

be argued, as section 20(8) (presumably) clearly states, that *Turquand* and section 20(7) apply concurrently. Due to the fact that the ambit of *Turquand* and section 20(7) differs substantially, it could lead to uncertainty and even worse, legal arbitrage. Secondly it could be argued, less convincingly, that due to the fact that there is, as a general principle, no doctrine of constructive notice, *Turquand* cannot apply as it is inextricably linked to the doctrine of constructive notice (see *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 3 SA 486 (SCA) 494B). The problem that may militate against this interpretation is that *Turquand* applies at common law not only if the non-insider is deemed to have knowledge but also if he or she has actual knowledge. Therefore there is no reason why *Turquand* can also apply if, for example, the non-insider knew that there is an additional requirement for a particular act, such as authorisation from the shareholders in general meeting if the directors want to conclude a contract with a value above 50% of the issued share capital of the company. Thirdly it can be argued that *Turquand* will only apply in respect of those companies where the doctrine of constructive notice is expressly retained, being the “RF” and personal liability company (s 19(4) of the Act and to extent provided for in s 13(3) and 19(3) respectively). Unfortunately none of the above alternatives is conducive to certainty and clarity.

The uncertainty caused by sections 20(7) and (8) is disconcerting and maybe the following caution in respect of *ultra vires* in the 1973 Act should have been heeded when the *Turquand* rule was addressed:

“Some doctrines, when they have outlived their usefulness, are easily removed; others are so embedded in the law that force is necessary to pry them loose. A consideration of the new South African Companies Act suggests that the *ultra vires* doctrine was thought to be of the latter kind and that, rather than risk the use of force, the legislature has sought to render it harmless. This appears to be the safer approach. In fact, it is almost certainly the more dangerous. An error in the initial analysis of the doctrine may wreck the entire enterprise. Great skill is needed if the fabric of the law is in truth to remain intact. And then, even if that skill is achieved, the old structure is left standing and the old concepts and principles remain, looking for all the world as they did before, when in fact they are either redundant or, if they still function, do so in a radically different way” (Blackman “The capacity, powers and purposes of companies: The commission and the new Companies Act” 1975 *CILSA* 1).

The position is complicated even further due to the fact that the common-law rules regulating representation of the company were, for some inexplicable reason, also retained, which increases the present uncertainty and risks for the company and third party alike in the application of the *Turquand* rule. Apart from examples in foreign jurisdictions where the issues regarding representation and *Turquand* were successfully and efficiently solved (see s 40 of the British Companies Act 2006 (C 46) and ss 15(1) and 18(a) of the Canada Business Corporation Act RSC 1985 (C 44)), sections 17 and 54 of the Close Corporations Act 69 of 1984 could also have served as a good basis to do the same in South African company law (McLennan “Time for the final abolition of the *ultra vires* and constructive notice doctrines in company law” 1997 *SA Merc LJ* 333). The problems with *Turquand* in the Act may even be an initiative to rather incorporate and operate a close corporation, if at all possible, based on operational requirements.