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THE DISTRIBUTION OF LIABILITY IN TERMS OF PRE-INCORPORATION CONTRACTS

By

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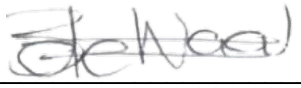
Signature 

ABSTRACT

This dissertation deals with the aspect of pre-incorporation contracts and the uneven distribution of the liability in instances where a pre-incorporation contract is not ratified by the directors, whether partially or fully, or where the company is not incorporated. The legislature went from one extreme to the next in its attempt to correct the disparity regarding who bears the liability in these transactions.

Under the previous Companies Act 61 of 1973, in cases of non-incorporation of a company or non-ratification of a pre-incorporation contract, the third party bore all the risk and liability when these contracts fell through. This position was unfairly skewed in favor of the promoter and the pre-incorporation company, as they were left with the option of contracting with various persons and not having to honor their obligations when the company was indeed incorporated. This left the third party with no sustainability and assurance.

Legislature shifted from a position in law where the third party bore all the liability in these instances to a position to where the promoter bears all the liability, and the company is not even considered regarding bearing some of the liability. This great disparity needs to be addressed in our law.

Under the new Companies Act 71 of 2008, legislature shifted the liability onus completely onto the promoter who now is placed in the position where he would bear the full liability in these instances. This new position again does not promote equality or fairness as the third party and company now bear no responsibility. The promoter is in effect forced to bear the liability for a pre-incorporation company that has mandated him to act on their behalf, and in most cases are not related to the company itself.

There needs to be a proper control mechanism and/or distribution of liability which would require a fact-based inquiry as to who is responsible for the non-incorporation of the company and/or non-ratification of the concluded contract, especially in instances where the promoter is completely independent of the company.

The objective of my research is to conduct an investigation into the essence of a pre-incorporation contract, under the old and the new Companies Act, together with the essential elements thereof to find a workable solution to a variety of the problems we face in the practical aspects of the conclusion of these types of contracts.

There will be a specific concentration on the liability aspects in cases of non-ratification and non-incorporation to equalize the playing field of all the relevant parties. After having ascertained the proper position under South African law, I will turn to comparative research regarding how foreign jurisdictions are addressing the problems that we face, to shape and produce a workable proposal for these instances.

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CHAPTER 1: INTRODUCTION

> *"Generally, a company is formed in order to acquire some business, property or rights, for the exploitation of which it might require accommodation, equipment and such ancillary things, and perhaps also the services of experts of experienced executives. Hence, in order to ensure that it will get those benefits on incorporation, it is usually advisable that the terms of the acquisition of those things and conditions of employment be settled in advance of its incorporation by contracts that will be binding on the contracting parties."*[1]

1.1. Background to the study

Companies are usually formed for a specific purpose such as operating as a restaurant, or to acquire specific assets such as a company being incorporated to purchase an antique home, or companies are formed to even chase specific business opportunities, for example acquiring state tenders. It is logical to firstly investigate or attempt to obtain the specific purpose for which the company is to be formed prior to spending the money and time to have the company registered and to have all the accompanying processes properly completed. It is for this purpose that promoters are often called upon to endeavour to obtain the specific purpose prior to the company being formed to ensure that there would be some form of benefit to lure investors to invest the needed capital to make the company a success.

A good example is when a chef wants to open a restaurant. There are unending lists of things required to make a restaurant work but most importantly, the location. In this instance a promoter may be called upon to acquire prime real estate or conclude a lease agreement prior to the incorporation of the company. If there is no property in the perfect location, then the opening of a restaurant will not be profitable. Thus, the benefit must be acquired prior to the incorporation of the company.

Once the property has been acquired or the necessary lease agreement has been concluded for the benefit of the pre-incorporation company, then the chef can proceed to try and obtain investors for the opening capital into the company. Investors would more likely invest when they have the knowledge that the company will be profitable and that the legal arrangements have been made to acquire the assets and benefits.

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[1] Sentrale Kunsmis Korporasie (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk 1970 (3) SA 367 (A) 396.

In this written piece, we will answer the questions regarding what a pre-incorporation contract is and the legal formalities that surround it with specific reference to the appealed Companies Act 61 of 1973 and the current Companies Act 71 of 2008. This is done in the following two chapters to analyse the legal basis we have, and to this day still follow in South Africa. We will also be concentrating on the areas where the governing law is lacking and the difficulties we will face in our attempt to rectify it. Inspiration will be drawn from the foreign jurisdictions of Canada and Australia regarding ways in which we could proceed to rectify the glaring lacunae in our law in that these foreign jurisdictions are more progressive with their dealings in pre-incorporation contracts. Upon finalizing the analysis of the South African law and pointing out the lacunae and turning to our foreign jurisdictions for solutions, we will then address the aspects that needs to be rectified as well as putting forth the proposed way in which the rectification should occur.

In this current chapter we will investigate the various ways in which a party could conclude a contract to the benefit of a third party, and how the principle of a pre-incorporation contract came to be in our law. We will have a look at the general definition of a pre-incorporation contract and the legal formalities that will have to be complied with by the essential role players.

There are many ways that can be utilised by a person whom intends to contract on behalf of a non-existing company. Under our common law there are 4 (four) distinct manners. These are via the *stipulatio alteri* contract or a cession and delegation contract.[2] [3] Then one can also conclude a nomination[4] or option contract[5] on behalf of the third party.[6]

The legislative manner is by concluding a pre-incorporation contract in terms of the current section 21 of the Companies Act.[7] For the purposes of this study, we would be concentrating on the common law manner of concluding a *stipulatio alteri* and the legislative manner of concluding a pre-incorporation contract. A more in-depth discussion is to follow.

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[2] Delport *New Entrepreneurial Law* (2014) 35.
[3] This means that the promoter concludes a contract in his own name. The contract then contains a specific clause which states that, upon incorporation of the company, the contract will be ceded to the incorporated company.
[4] In this manner of contracting, the promoter contracts with the third party, but the contract contains a specific clause which states that the promoter will have the option to nominate a third party in his place. Upon incorporation the promoter then proceeds to nominate the company.
[5] Here the third party agrees to keep an option made to the promoter open for a certain period. If the offer is then accepted by the promoter, an option contract comes into existence between the parties and the substantive offer can be transferred to the company upon incorporation.
[6] Delport (2014) 36.
[7] The Companies Act 71 of 2008.

Due to the technicality of these contracts, there are certain definitions that need to be addressed prior to proceeding with the study itself. The preliminary definition of a pre-incorporation contract is, a written agreement entered into prior to the incorporation of a company by a person whom purports to act in the name of, or on behalf of, the proposed company, with the intention that the company will be incorporated and thereafter be bound by the agreement.

The person who concludes these contracts would be referred to as the "promoter". This is a person or a group of individuals who are mandated to acquire and conclude a contract on behalf of the proposed company. The third party in these instances is the person whom contracts with the promoter, they usually do some form of service delivery that the proposed company needs.

As part of the study, we will have to investigate when the principle of a pre-incorporation contract would not be applicable in certain situations, as it falls outside the scope of the legislation that governs pre-incorporation contracts and determine how these instances are to be dealt with within our law.

1.2. Contracting to the benefit of a third party

The discussion below deals with the various manners of contracting on behalf of a third party. The first is the common law contract of *stipulatio alteri* and the second is the legislative manner of a pre-incorporation contract, which is currently regulated by section 21 of the Companies Act 71 of 2008.[8] Under this section we are going to discuss both methods, together with the common law hurdles that legislature had to overcome.

1.2.1. *Stipulatio alteri*

As stated above the *stipulatio alteri* is a contract put forth in common law. The translation of *stipulatio alteri* literally means contract for the benefit of a third party.[9] Here two parties contract with each other for the benefit of a third party.[10] In this regard, the promoter contracts under his own name as a principal, and not in his capacity as a promoter, for the benefit of a company that is still to be formed.[11]

[8] The Companies Act 71 of 2008.
[9] Cassim *Contemporary Company Law* (2012) 150.
[10] Cassim (2012) 158.
[11] Cassim (2012) 151.

In the leading case of *McCullogh v Fernwood Estate Ltd (*hereinafter referred to as "*McCullogh*"),[12] it was held that the third party on whose behalf the contract is concluded need to be in existence at the time of the conclusion of the contract. It further stated that the contract may be used to stipulate that it is being concluded in favour of an unformed company that the promoter intends on bringing the company into existence.

Here the promoter, referred to as the *stipulance,* enters a contract with a third party, referred to as the *promisor,* to the benefit of a company that is not yet formed. It is essential that this contract brings about an enforceable obligation in favour of the company. The essential element of a *stipulatio alteri* is that the promoter contracts in his personal capacity as a principal.[13] Once formed the company has an election to accept the benefit under the contract within the time limit as stated in the contract itself, or when the contract is silent on the time frame, it must accept the benefit within a reasonable amount of time.[14]

The promoter must communicate the acceptance of the benefit to the promisor. This can be done expressly or impliedly by virtue of conduct. Upon the communication of the benefit the company formally becomes a party to the contract concluded for its benefit. The company will only become bound by the contract upon accepting the benefit it offers.[15]

This means that the contract is essentially only an offer extended to the company upon its incorporation, and a new contractual relationship would inevitably be created upon the acceptance of the offer by the incorporated company. Until acceptance of the contract, the parties to the contract will remain the promoter and the promisor.[16]

The advantage of the promoter acting in his capacity as a principal, is that the promisor may not unilaterally withdraw from the contract prior to the acceptance by the company. If the promisor still attempts to do so, the promoter is in the legal position to personally apply for an interdict barring the promisor from withdrawing. Another advantage of this is the fact that the promoter may claim for damages when the promisor repudiated the contract.[17]

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[12] McCullogh v Fernwood Estate 1920 AD 204.
[13] Cassim (2012) 159.
[14] Cassim (2012) 159; Sentrale Kunsmis Korporasie (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk 1970 (3) SA 367 (A) 394.
[15] Cassim (2012) 159; McCullogh v Fernwood Estate 1920 AD 204, 205.
[16] Cassim (2012) 159.
[17] Cassim (2012) 159; Bagradi v Cavendish Transport Co (Pty) Ltd 1957 (1) SA 663 (D) 668.

The disadvantage of a *stipulatio alteri* is that prior to the acceptance of the benefit, the promoter and the promisor may mutually cancel the contract, therefore depriving the company of its allotted benefit.[18] This contrasts with the position under the legislative pre-incorporation contracts that will be discussed below.

A party to a *stipulatio alteri* transaction is bound by the contents contained within the contract itself. Unless the contract expressly states that upon non-ratification or non-incorporation the promoter would be held liable, then the promoter would not incur any liability under the contract. The contract would simply lapse.[19]

1.2.2. Pre-incorporation contracts

A pre-incorporation contract is an agreement entered into before the incorporation of a company, by a person who purports to act in the name of, or on behalf of, the company, with the intention or understanding that the company will be incorporated and will thereafter be bound by the agreement.[20] This section creates a form of statutory agency.[21] Its purpose is to put a person, acting in his capacity as an agent, in a position to contract on behalf of the company, even though the company is not yet an existing entity.[22]

To contract on behalf of a non-existing principal has various hurdles in terms of common law that has to be overcome. The first being that a non-existing principal cannot be a party to a contract,[23] and secondly that the company is unable to ratify the contract as the company was not yet in existence upon conclusion thereof.[24] Legislature overcame these hurdles by statutorily providing that one may contract on behalf of a non-existing party, and that the company may ratify the contract upon incorporation.[25]

At this stage, the company cannot enter the transaction itself as it is not yet in existence. To overcome this obstacle, the promoter may enter a contract in terms of which he acquires the benefits and undertakes to cede it to the company upon its incorporation. The second manner is that he could enter a contract with a third party and expressly stipulate in the contract that

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[18] Cassim (2012) 160; see Crookes v Watson 1956 (1) SA 277 (A).
[19] Cassim (2012) 160.
[20] Section 1 of Companies Act 71 of 2008.
[21] Delport (2014) 37.
[22] Cassim (2012) 150.
[23] Cassim *The Law of Business Structure* (2013) 124.
[24] Cassim (2013) 124.
[25] Delport *Henochsberg on the Companies Act 71 of 2008* (2020) 106(8).

upon incorporation the promoter will have the right to cede all his rights and obligations under the contract to the company.[26]

In the English case as heard by the Court of Common Pleas, *Kelner v Baxter (*hereinafter referred to as "*Kelner*")[27], the court held that a company cannot ratify a transaction that was entered into on its behalf prior to its incorporation, due to the fact that the principal can only ratify a transaction if he was in existence at the time the contract was concluded.[28] In these instances there would be no enforceable contract unless it is found to be binding on the person whom signed the contract itself. The court went further to state, that when a person purports to act as an agent of a company not yet formed, then he must be deemed to have undertaken personal liability in terms of the contract itself. This caused the verdict that when a promoter enters into a contract with a clear intention to bind the company, he, the promoter, would have intended to bind himself.[29] In order to have a binding agreement between the company and the third party, there would have to be a new contract that is to be concluded between the parties after its incorporation.

This English rule was incorporated into our legal regime in the matter of *McCullogh,*[30] where the learned judge held that the rule as set forth in the *Kelner* case,[31] that being that there can be no ratification by a principal whom is not yet in existence at the date of the conclusion of the contract, is recognized in our law as it is recognised in English law.[32] The court went further in stating that when a person contracts individually in his capacity as a principal, for the benefit of a third party, a valid contract will result if the company is formed and ratifies the contract.[33] Where the agent acted in his capacity as a promoter then the principle as laid down in *Kelner* will prevail.[34]

Then came the matter of *Nordis Construction Co (Pty) Ltd v Theron, Burke and Isaac (*hereinafter referred to as "*Nordis Construction*"),[35] in which the judge gave a very convincing obiter dictum. This was to the effect that in the case of a pre-incorporation contract, the courts will not simply deem the promoter liable, but will ultimately concentrate on a proper

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[26] Blackman *Commentary on the Companies Act* (2011) 8, 8.
[27] Kelner v Baxter 1866 LR2 CP 174.
[28] Delport (2020) 106(8).
[29] Delport (2020) 106(8).
[30] McCullogh v Fernwood Estate 1920 AD 204.
[31] Kelner v Baxter 1866 LR2 CP 185.
[32] McCullogh v Fernwood Estate 1920 AD 204, 207; Peak Lode GM Co Ltd v Union Government 1932 TPD 48.
[33] Swart *Pre-incorporation contracts* (1977) SACLJ F-39, 39.
[34] Kelner v Baxter 1866 LR2 CP 174.
[35] Nordis Construction Co (Pty) Ltd v Theron, Burke, and Isaac 1972 (2) SA 535.

construction of the agreement to ascertain whether the promoter is to be held liable. The construction of the agreement would shed light on whether the contract was concluded between the parties in their capacities as agents, and not as principals, which would ultimately confirm whether the courts are dealing with a pre-incorporation contract or a *stipulatio alteri.*[36]

Section 35 of the Companies Act 61 of 1973,[37] and section 21 of Companies Act 71 of 2008[38] created a statutory measure to overcome the common law hurdles as discussed above. This is done in that the legislature ensures that it is possible to contract on behalf of a non-existing principal in the capacity as a promoter,[39] while also enabling the company to ratify the contract upon incorporation.[40]

These Acts will be discussed in full in the coming chapters hereunder to see the movement and growth of the principles that enable a promoter to conclude a contract on behalf of a company to be formed.

1.3. The essential role players in a pre-incorporation contract and their essential functions

In the process of the conclusion of a pre-incorporation contract, there are 3 (three) main role players that are involved in the whole process of the agreement.

The first party is the promoter. The term promoter is rather a difficult one to define as it is seen as a business term and not a legal term.[41] The definition of a promoter is not contained in the acts itself.[42] The definition as put forth mostly in pre-incorporation contract articles, and legislation, is that it refers to a person whom has taken part in the formation or promotion of the company.[43] Therefore, a promoter is a person whom undertakes to form a company with given reference to the project which he has been assigned, and has taken all the reasonable steps to accomplish the purpose of the project.[44] The term of a promoter includes a sole proprietor who incorporates his business.[45]

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[36] Blackman (2011) 7.
[37] The Companies Act 61 of 1973.
[38] The Companies Act 71 of 2008.
[39] Section 35 of Companies Act 61 of 1973; section 21(1) Companies Act 71 of 2008.
[40] Section 35 of Companies Act 61 of 1973; section 21(4) Companies Act 71 of 2008.
[41] Delport *Henochsberg on the Companies Act 71 of 2008* (2018) 2-189(8).
[42] Delport (2018) 2-189.
[43] Blackman (2011) 11.
[44] Blackman (2011) 12.
[45] Delport (2020) 106(8).

It therefore seems that to become a promoter, one must have the intention to promote the company, as well as to perform positive acts to make the project a success.[46] A promoter is liable and responsible for all the necessary steps to get the company incorporated until such time as the directors take over the company, only then does he cease to be a promoter.[47]

The general duties of a promoter are that they should never act on behalf of the company in any transaction in which he has an interest, and secondly, he should not derive any secret profit from the transactions in which he is acting as a promoter.[48] Both these general duties stem from the duty of good faith.[49]

For the promoter to act in good faith towards the company, he must only serve the interest of the company, and not his own, therefore there should be no conflict of interest.[50] In the event that the promoter wants and needs to serve his own interests, he will have to remove himself from the contract and the company. He will furthermore only deal with the company at arm's length.[51]

The second party to a pre-incorporation contract is the third party. The main function of the third party is that it has something, a service, goods, or property that the company desires to have prior to its incorporation. The third party is in laymen terms, the party with whom the promoter contracts to the benefit of the company to be incorporated.[52] In the process of the conclusion of a pre-incorporation contract, the promoter and the third party are the contracting parties between whom the contract is concluded.

The third essential party who becomes a party to a pre-incorporation contract is the non-existing company that is to be incorporated. The company obtains all the benefits and obligations under the pre-incorporation contract once the contract is ratified.

Even though there is a statutory manner to contract on behalf of a third party, the legislation enacted for this purpose still has a limited scope of application and certain instances will not be regulated by the legislation at hand. Therefore, we turn to the scope of pre-incorporation contracts.

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[46] Blackman (2011) 12.
[47] Blackman (2011) 13.
[48] Blackman (2011) 14.
[49] Delport (2018) 2-192.
[50] Delport (2018) 2-192.
[51] Delport (2018) 2-192.
[52] Cassim *Pre-Incorporation Contracts: The reform of section 35 of the Companies Act* (2007) SAJL 365, 365.

1.4. The scope of pre-incorporation contracts

If the current contract or agreement does not fall within the scope of the legislation, then the contract will be governed by common law. As already stated, an agent cannot contract on behalf of a non-existent principal and therefore the contract could not be ratified when the company comes into existence.[53] Due to the fact that there is no principal, the agent would be held personally liable as though he acted in his capacity of a principal. Thus, he would be held personally liable upon non-incorporation and non-ratification.

On the flip side of the coin if the court ultimately finds that the contract never intended that the agent will be held personally liable, then the contract would be a nullity and the promoter would not incur any personal liability.[54] Thus the interpretation of the contract is of the utmost importance.

Where the promoter mistakenly believes that the company exists at the time of conclusion of the contract, then it would be inequitable to say and accept that the promoter is acting with the intention or the understanding that the proposed company will be incorporated.[55] This causes the contract to fall outside the scope of the legislation and there would be reliance on the common law principles. This causes the contract to be a nullity and the promoter therefore escapes personal liability.[56] The same situation would be followed in instances where there is an accidental pre-incorporation contract being concluded, where both the agent and the third party are unaware of the company's non-existence.[57]

1.5. Conclusion

The necessary attention has now been given to the different ways in which a person can contract on behalf of a third party with specific attention given to the common law contract of *stipulatio alteri* and how it differs from the principle of a pre-incorporation contract.

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[53] Cassim *Some Difficult Aspects of Pre-Incorporation Contracts in South African Law and Other Jurisdictions* (2012) Business Law International 21, 21.
[54] Kelner v Baxter 1866 LR2 CP 175; Nordis Construction Co (Pty) Ltd v Theron, Burke, and Isaac 1972 (2) SA 545.
[55] Cassim (2012) 23.
[56] Nordis Construction Co (Pty) Ltd v Theron, Burke, and Isaac 1972 (2) SA 545.
[57] Cassim (2012) 23.

The historical and legislative development of a pre-incorporation contract was also delved into to see how the legislature arrived at the statutory agency which they created to govern the necessary instances where a pre-incorporation contract is to be used.

In the following chapter, the focus is on the principles as set forth in section 35 of Companies Act 61 of 1973 and its prerequisite requirements that must be complied with to ensure that a binding pre-incorporation contract comes about.

CHAPTER 2: THE POSITION REGULATING PRE-INCORPORATION CONTRACTS UNDER THE COMPANIES ACT 61 OF 1973

2.1. Introduction

Section 35 of the Companies Act 61 of 1973, must be considered to get the full picture of reform of the principles that regulate pre-incorporation contracts within our law. This section is of utmost importance in that it was the first reformed legal principle that regulated the aspects concerning pre-incorporation contracts to move away from the common law principles that legal practitioners and role players had to rely on.

As discussed in Chapter 1, there were certain common law hurdles that the legislature had to overcome to regulate the use and enforcement of pre-incorporation contracts. They are, that one cannot contract on behalf of a non-existing entity and the fact that ratification only operated retrospectively.

The focus of this chapter would be the examination of the definition extended to a pre-incorporation contract by Section 35, together with the elements that made up the definition and which ultimately stands as the requirements that needed to be complied with to have a valid pre-incorporation contract. Furthermore, there will be a comprehensive analysis regarding whom bears the liability in instances of non-incorporation and non-ratification to ascertain how the reform of Section 35 has impacted the legal position herein.

2.2. The definition of a pre-incorporation contract

The Companies Act 61 of 1973 defined a pre-incorporation contract as follows:

> *"Section 35: Power as to pre-incorporation contracts*
>
> *Any contract made in writing by a person professing to act as agent or trustee for a company not yet incorporated shall be capable of being ratified or adopted by or otherwise made binding upon and enforceable by such company after it has been duly incorporated as if it had been duly incorporated at the time when the contract was made, and such contract had been made without its authority:*

> *Provided that the memorandum of its registration contains as an object of such company the ratification or adoption of or the acquisition of rights and obligations in respect of such contract, and that such contract has been lodged with the Registrar together with the lodgement for registration of the memorandum and articles of the company."*[58]

This section was significant at its time since it created a form of statutory agency. It made it possible for legislature to overcome the first common law hurdle regarding the fact that a party cannot contract on behalf of an entity that is not yet in existence. This section did this by stating that a pre-incorporation contract is an agreement concluded by a person whom professed to act as a promoter of the company that was to be formed and thus further also stated that the contract would be seen as binding and enforceable upon the company after it being duly incorporated.[59]

The definition as portrayed in section 35 clearly indicated that the Act would only be applicable when a promoter professed to act as a promoter, and not as a principal, in the process of concluding a pre-incorporation contract.[60] Where the promoter professed to act as a principal, then the contract would be regulated by the principles of common law as a *stipulatio alteri.*[61]

Now that the definition of a pre-incorporation contract under section 35[62] has been discussed, we can turn our attention to the elements and the requirements that make up a pre-incorporation and that must be complied with to make it a binding agreement between the parties.

2.3. What are the elements that make up a pre-incorporation contract under section 35 of the Companies Act 61 of 1973?

The definition of a pre-incorporation contract as set forth in Section 35 indicates that there were 6 (six) basic elements and requirements that needed to be complied with to make a pre-incorporation contract enforceable. These requirements were that the contract had to be in writing, the contract had to be concluded by a person whom professed to act as an promoter or a trustee on behalf of a company yet to be formed, the contract would be capable of being

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[58] The Companies Act 61 of 1973.
[59] Ncube *Pre-Incorporation Contracts: Statutory Reform* (2009) SAJL 255, 257.
[60] Ncube (2009) 259.
[61] Ncube (2009) 259.
[62] The Companies Act 61 of 1973.

ratified or adopted upon incorporation of the company, the memorandum of registration had to contain the objects of ratification of the contract upon incorporation, the contract had to be lodged with the Registrar, and lastly that the memorandum of registration and articles of association should have been lodged with the Companies and Intellectual Property Commission. The following section will delve deeper into each of the past requirements to broaden the understanding of what a pre-incorporation contract fully entailed.

2.3.1. The contract must be in writing

This requirement was a bit problematic for various legal scholars particularly due to the interpretation of the section. It was however firstly put forth that legislature intended the section to apply in both instances, whether the person was acting in his capacity as a promoter or a trustee.[63] However, the interpretation did not match the intention of the legislature.[64] In the instance where a party acted in his capacity as a trustee, he was in fact acting as a principal and not a promoter. This was clearly indicative of a *stipulatio alteri* and not of a pre-incorporation contract, as fully discussed in chapter 1 hereof.

This line of thought was, however, put to bed in *Ex parte Vickerman and Others* (hereinafter referred to as *"Vickerman*").[65] Which held that that the Companies Act's intention was never to curtail the right of a company to adopt a contract made for its benefit, but rather to extend the right to cases where a person has acted as a promoter entering into a pre-incorporation contract.[66]

The learned judge stated in his judgment that where a promoter had entered a contract which is to the benefit of a third party while not acting as a promoter, then the contract would not be regulated by section 35,[67] and therefore the contract could be adopted even though there was no compliance with the formalities contained in section 35.[68]

As we can note from the above, the capacity in which the person acted would have been decisive regarding what contract and form of agency was ultimately used.[69] That is to say that

[63] Blackman (2011) 8; Delport (2018) 2-186.
[64] Delport (2018) 2-186.
[65] Ex Parte Vickerman and Others 1935 CPD 429.
[66] Ex Parte Vickerman and Others 1935 CPD 429, 430.
[67] The Companies Act 61 of 1973.
[68] Ex Parte Vickerman and Others 1935 CPD 431; Sentrale Kunsmis Korporasie (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk 1970 (3) SA 367 (A) 384.
[69] Blackman (2011) 9.

if all the prerequisites as put forth in section 35 have been complied with, then it would have been irrelevant whether the contract takes the form of a contract concluded by a promoter or a contract concluded for the benefit of a third party. On the other hand, if the requirements of section 35 had not been complied with, then the contract would not be a pre-incorporation contract as far as the company is concerned, and therefore no liability would be forthcoming from the contract itself.[70] However, the contract would still be binding between the concluding parties.

2.3.2. Memorandum of registration contains as an object the ratification of the agreement

This requirement seems to have been the most pertinent requirement, as it served as protection to outsiders who may have wished to invest in the company prior to its incorporation.[71] This requirement brought in the certainty element, in that one of the objects of the company's memorandum of registration had to stipulate that the board of directors would proceed to ratify the pre-incorporation contract within a specified amount of time or a time period which seems reasonable.

Now this posed a question regarding what the legal position would have been, should the unfortunate event occur that the memorandum of registration was silent on the ratification of a pre-incorporation contract. This would ultimately result in the contract not being enforceable.

2.3.3. The pre-incorporation contract had to be lodged with the Registrar

The main purpose of this requirement was yet again to provide the board of directors with the necessary certainty prior to incorporating the company. A cursory reading of the section showed that this requirement was peremptory in nature and therefore had to be complied with.[72]

2.3.4. The contract was to be ratified or adopted

There were various ways in which a company may have ratified a pre-incorporation contract. The drafters of section 35 were rather concerned with the broader concept of ratification and that it should not necessarily have had to involve some form of corporate resolutions being passed.[73]

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[70] Blackman (2011) 9.
[71] Ncube (2009) 260.
[72] Blackman (2011) 10.
[73] Blackman (2011) 10.

Section 35 has displaced a rather important principle in the law of agency, that being that a non-existent person or entity cannot have a promoter, and that any act of a supposed promoter was therefore incapable of ratification.[74] The section therefore overcome this common law hurdle in that it created a form of statutory agency and ratification.

Once formed and incorporated the company could ratify an agreement ostensibly concluded on its behalf prior to its existence.[75] The ratification could have taken the effect of implied actions by any form of manifestation of the principal's intention to be bound or express intentions in unequivocal language that they were to be bound by the agreement concluded by the promoter.[76]

The prerequisite ratification had to be effected within a reasonable time,[77] or the time as agreed upon between the parties,[78] otherwise the agreement would simply lapse and would be unenforceable by the third party, thus causing the company to escape any form of liability.[79]

This provision created some confusion, in that contracts that did not specify a time period for ratification may have found that their rights and obligations were delayed for extended periods of time while having to wait on the company to ratify the contract.[80]

2.3.5. As if the company had been duly incorporated at the time the contract was concluded

In the rather old case of *Peak Lode GM Co Ltd v Union Government* (hereinafter referred to as "*Peak Lode*"),[81] it was held that a contract could only be operational from the date upon which it was ratified and could not be retrospectively binding. This case has gone against the common law principle in that every ratification has a retrospective effect and is equivalent to having a prior mandate.[82]

In effect the section corroborated the common law principle in that it stated that the pre-incorporation contract was capable of being ratified or adopted by the company after its

[74] Blackman (2011) 10-1.
[75] Blackman (2011) 10-1.
[76] Blackman (2011) 10-1.
[77] Peak Lode GM Co Ltd v Union Government 1932 TPD 52.
[78] Sentrale Kunsmis Korporasie (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk 1970 (3) SA 367 (A) 359.
[79] Cassim (2007) 364.
[80] Ncube (2009) 264.
[81] Peak Lode GM Co Ltd v Union Government 1932 TPD 52.
[82] Blackman (2011) 10-2.

incorporation, and would then be bound as if the company had existed when the contract was concluded.[83] This all is a very convoluted way to state that upon ratification the contract was deemed to be binding from the date of its conclusion.

Peak Lode[84] further stated that until a company had ratified the contract it had no binding force. Therefore, the binding force was conditional upon ratification. This suggested that until ratification, no one could acquire any rights or obligations under the contract. If this was accepted as correct, then section 35 would have been completely useless within our law.[85]

Thus, if a promoter purported to act as a promoter for the company and the provisions of this section was not fully complied with, then the company would under no circumstances have acquired any rights and obligations under the contract even if it had been ratified by the company upon incorporation.[86]

From the in-depth look into each of the requirements as put forth by the section itself we can note that the conclusions of pre-incorporation contracts under this section was quite a hefty task to ensure that the contract would inevitably be binding on the company. The following section entails an investigation into the distribution of liability in terms of these pre-incorporation contracts.

2.4. Liability in instances of non-incorporation or non-ratification

Under section 35 of the Companies Act 61 of 1973, it was the unfortunate third party whom bore all the risk and liability when the company was inevitably not incorporated or even when the contract was not ratified by the incorporated company, whether in full or in part.

The section as drafted by the legislature was entirely skewed in the favour of the company and the promoter, which in turn directly operated to the detriment of the third party.[87] Thus, it was clear that the intention of the legislature, whether directly intended or by accident, was to protect the company and the promoter and completely failing to offer any form of protection to the third party.[88] Section 35 has thus been providing the promoter with a legal mechanism to

[83] Blackman (2011) 11; Delport (2018) 2-189.
[84] Peak Lode GM Co Ltd v Union Government 1932 TPD 53.
[85] Delport (2018) 2-189.
[86] Blackman (2011) 11.
[87] Cassim (2012) 5.
[88] Cassim (2007) 365.

avoid any form of liability on a pre-incorporation contract.[89] This would be seen as a statutory mechanism to avoid personal liability.

In these instances, the promoters whom concluded the contract incurred no liability on pre-incorporation contracts as the contracts would simply lapse in instances of non-ratification and thus caused the third party to have no remedy.[90] The main reasoning for this approach was that the third party voluntarily and knowingly undertook the risk to contract with a promoter whom was clearly acting on behalf of a company not yet formed.[91]

In instances of non-incorporation, the third party would simply be left without a remedy since the company could not be held liable as it has not yet been incorporated. The promoter could also not be held liable as he contracted in his capacity as a promoter and not as a principal, which at the time of the conclusion of the contract was to the knowledge of the third party.

Be that as it may, there were counter arguments that the section in fact provided the third party with protection in that there was a requirement upon the promoter to profess that he was acting on behalf of a non-existing company.[92] This was argued by many that the professing by the promoter was to be a warning to third parties. This was however of no value to an unsophisticated third party whom would not know how to negotiate a proper and protective pre-incorporation contract.[93]

Section 35 was an admirable legal provision, but it was in a desperate need for a reform. I will now be turning to the commentary by various legal scholars regarding what was required during the reform.

2.5. Inconsistencies that had to be addressed with the reform of Section 35 of the Companies Act 61 of 1973

During various extensive research there were 4 (four) main aspects and consequences which required a reform in terms of scholarly opinions. The following section will now be looking into each of these aspects.

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[89] Ncube (2009) 257.
[90] Cassim (2012) 6.
[91] Cassim (2007) 365.
[92] Ncube (2009) 258.
[93] Ncube (2009) 258.

2.5.1. Balancing of the liability between the promoter, company and the third party

There have been various articles written regarding proposals for a statutory reform for the obvious problems of Section 35. The main basis regarding the proposed statutory reform was the fact it was inequitable to put all the risk on the third party in instances of non-ratification, while the promoter was in a better position to know whether the contract would in fact be ratified or not.[94]

There was a clear information asymmetry that made it more equitable for the promoter to bear the risk in these instances.[95] A further reasoning for this proposal was the fact that in most instances a promoter later become a director upon incorporation of the company and therefore had greater control over the aspect of ratification as well.

The two main schools of thought that have been put forth were, that either a personal liability approach must be followed or a statutory warranty approach. In terms of the personal liability approach the promoter was personally liable for the damages that sprout forth from breach of a statutory warranty that the company would be incorporated within a reasonable time or that the contract would be ratified.[96] This approach in effect created a new contract between the promoter and the third party. This was problematic in that the main intention of the third party was to contract for the benefit of the company and not the promoter, thus forcing the promoter to step into the shoes of the company.[97] If this approach was followed then it inadvertently meant that the promoter now had all the rights and obligations that was to be endowed upon the company upon incorporation and ratification.[98] Furthermore, the promoter would be held liable in the capacity of a principal and not of a promoter.[99]

This approach was further problematic in that it was at its core still prejudicial to the third party, in that it would still allow the promoter to enforce the contract against the third party but left the third party with little recourse upon non-incorporation and non-ratification.[100]

The second school of thought was called the statutory warranty approach. Following this approach, the promoter would be held liable for the damages that flow from the breach of a

[94] Cassim (2007) 368.
[95] Cassim (2007) 368.
[96] Cassim (2007) 369.
[97] Cassim (2007) 369.
[98] Cassim (2007) 370.
[99] Cassim (2012) 13.
[100] Cassim (2007) 370.

statutorily implied warranty that the company would be incorporated, or the contract would then be ratified within a reasonable time.[101] This warranty should clearly be distinguished from the promoter's authority as they have already professed to act on behalf of a company to be formed.[102]

The warranty is comprised of two elements: firstly, when the company will be incorporated, and secondly, that the company would ratify the contract concluded on its behalf.[103] The liability of the promoter would be triggered if there was a failure in either of these components. As the section was silent on the time periods that the two components were to be complied with, the legal fraternity had resolved and acted according to the fact that it should be complied with within a reasonable time, or as agreed between the parties themselves.[104]

Under this school of thought the promoter would be liable for the amount of damages that would place the third party in the position they would have been had the company in actual fact been incorporated.[105] In this instance, the promoter was not held liable on the contract itself but rather based on a breach of warranty that the company would have been incorporated.[106] The amount recoverable was capped to the amount the third party would have gotten in judgement against the company.[107]

Luckily for the promoter, there was certain limitations on his liability under the second school of thought. These included, firstly, the instances when the contract was not ratified by the company upon incorporation and was rather novated for a contract between the company and the third party on the same or similar terms as was included in the pre-incorporation contract.[108] It would have been highly prejudicial to the promoter to be held liable in these instances as this was not within his control and he should not be held liable for the company's failure to ratify the contract.[109]

The second instance was when the company fails to ratify the contract within the reasonable time as reliant on the facts of the matter.[110] In these instances the courts should be endowed with a discretion to impose secondary liability on the company. The secondary liability would

[101] Cassim (2007) 369.
[102] Cassim (2007) 372.
[103] Cassim (2012) 14.
[104] Cassim (2007) 373.
[105] Cassim (2012) 14.
[106] Cassim (2007) 375.
[107] Cassim (2007) 375.
[108] Cassim (2007) 377.
[109] Cassim (2007) 378.
[110] Cassim (2007) 378.

bring some form of punishment to the company for the fact that it failed to ratify the contract within the time frame it was supposed to. These actions were particularly prevalent where promoters-turned- executive-directors initially had the understanding that the contract would be ratified but later refuse to ratify the contract once they are in the capacity as directors.[111] Here it would be unfair to hold promoters liable whom were not directors once the company has been incorporated. The courts should have adjusted the equities and impose liabilities on the company itself.

There were also instances where there was no discussion needed as to when the promoter was to carry the full risk and liability. The main instance was where the promoter upon becoming aware that the contract was no longer beneficial, or even that if the company was not incorporated, procures a shelf company to ratify the contract to avoid any liability or loss.[112] This is known as fly-by-night companies and the use of them leaves the third party with a meaningless cause of action against a company which has no assets to compensate them.[113]

The trademark case in which this aspect has been addressed is the *Landmark Inns of Canada v Horeak (*hereinafter referred to as "*Landmark Inns"*).[114] In this case the promoter signed a contract to lease a certain property but later elected to lease a different property, thus electing not to ratify the contract with the initial company that was incorporated. Upon realising that he will be held liable for the breach of warranty he procured a shelf company whom then ratified the contract to escape the pending liability. The court however in this instance rejected Horeak's contention that he acted accordingly to the pre-incorporation contract and ordered that he personally will be held liable for the damages suffered.

2.5.2. Ratification of the pre-incorporation contract

The second aspect that was in dire need of a statutory reform was the finer details regarding ratification of the pre-incorporation contract by the company. It was often debated whether there needed to be a form of positive step of ratification or whether the contract was to be automatically binding upon incorporation of the company.

It needed to be said that the contract being automatically binding without any right of rejection extended to the company would in effect have been prejudicial to the company and its board

[111] Cassim (2007) 379.
[112] Cassim (2007) 380.
[113] Cassim (2007) 381.
[114] Landmark Inns of Canada v Horeak (1982) 2 WWR 377 (QB).

of directors as it was completely in favour of the third party as the contract would in these instances always be binding on the company. This was easily detrimental to the company.[115]

There should always be the requirement of positive step having to be taken by the board of directors of the company when incorporated. However, this would not be sufficient within our law. There needed to be a combination of a positive step and an instance when the contract would be automatically binding upon the company.[116]

If it was accepted that ratification needed to entail some form of a positive step, the next question was what will be a positive step in this regard. Section 35 was completely silent on this aspect and therefore there was some ambiguity regarding what will constitute ratification.[117] Within our law it was sufficient to say that the ratification of a pre-incorporation contract must have been done by the board of directors via a special resolution as they were the individuals that were in control of the daily operation of the company.[118] The requirement of a resolution, only requires conduct of the board of directors, whatever that conduct might be construed as, and no conduct on the part of the third party. This created uncertainty insofar as the third party is concerned as to when ratification had occurred.[119]

Lastly, it should have been noted that ratification had retrospective effect that extended to the date the contract was concluded and not the date the company was incorporated despite the date of ratification, although the contract may include a clause that suspends rights and obligations until the date of ratification to create more certainty.[120] This has already been discussed herein.

2.5.3. The interim period between conclusion of the pre-incorporation contract and the incorporation of the company

The interim period, that being the time between the conclusion of the contract and the ratification by the company, was widely unregulated and had no set of rules or consequences. The main issues with that were that there was great uncertainty as to whether a third party may unilaterally withdraw from the contract prior to ratification and whether the parties may cancel the contract by virtue of mutual consent.

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[115] Cassim (2007) 384.
[116] Cassim (2007) 384.
[117] Cassim (2007) 385.
[118] Cassim (2007) 385.
[119] Cassim (2007) 387.
[120] Cassim (2007) 388.

If the third party could unilaterally withdraw from a pre-incorporation contract, the contract would be no more than a gentleman's agreement, which in turn would be very prejudicial to the company and the promoter, whom ultimately bore the liability in these instances.[121] The withdrawal by the third party should have been precluded prior to ratification.[122]

There was however one situation where the unilateral withdrawal should not be precluded, and that was where the performance of the pre-incorporation contract falls due prior to the incorporation of the company. Binding the third party to this agreement would have been inequitable towards the third party as the solution for damages being suffered would not lie in a claim based on breach of warranty by the promoter.[123]

The next question was what to do when the third party wrongfully withdraws from the contract? In short this as a very unfortunate situation as the promoter was not a party to the contract and the company was not yet incorporated, whom in fact was the principal.[124] This meant that neither the promoter nor the company could interdict the third party from the unilateral withdrawal. It was only upon ratification that the company gained all the rights and obligations in terms of the contract, therefore the company could only act against the third party after ratification.[125]

2.5.4. Prerequisite of various burdensome requirements needing to be abolished

As already discussed, section 35 and all its requirements were rather burdensome and there was a call that certain requirements should be abolished. The first of the requirements that needed to be given the boot in the reform of the section was that two copies of the contract must have been lodged with the Companies and Intellectual Properties Commission. This requirement took the confidentiality element away from the promoter and the third party. This requirement made the contract open to public scrutiny and was clearly to the prejudice of both the promoter and the third party in that the public could intervene in the contract.[126]

[121] Cassim (2007) 390.
[122] Cassim (2007) 391.
[123] Cassim (2007) 391.
[124] Cassim (2007) 391.
[125] Cassim (2007) 392.
[126] Cassim (2007) 394.

The second requirement that needed to be abolished was that the memorandum of registration must have contained the ratification as an object. This took away the voluntary action and conduct of the company in the ratification of the contract.[127]

It should be noted that the main aspect of a pre-incorporation contract was that both the promoter and the third party should always be aware that they are contracting on behalf of a company that is not yet incorporated. This would revoke the requirement that the promoter must profess to act on behalf of a non-existing entity.[128]

The only requirement that was beneficial to the enforcement of a pre-incorporation contract was that the contract should be concluded in writing or reduced to writing if the contract has been concluded verbally between the promoter and the third party. This requirement created certainty for the third party in that it had a written document to rely upon when seeking enforcement, but it was also to the benefit of the company and the board of directors as they would be incorporating a company knowing that the company was a party to a pre-incorporation contract.[129]

2.6. Conclusion

This chapter considered the definition and requirements of a pre-incorporation contract under section 35. This section has noted that various aspects where the provisions were lacking while also taking cognisance of the suggested reform to bring the legislature in line with modern commercial practices. The next chapter attends to Section 21 of the Companies Act 71 of 2008, which is the current regulating legal provision regulating pre-incorporation contracts.

[127] Cassim (2007) 394.
[128] Cassim (2007) 395.
[129] Cassim (2007) 395.

CHAPTER 3: THE POSITION REGULATING PRE-INCORPORATION CONTRACTS UNDER THE COMPANIES ACT 71 OF 2008

3.1. Introduction

In the previous chapter, I looked at the legal position regarding a pre-incorporation contract under the previous Companies Act and investigated what aspects regarding pre-incorporation contracts were in dire need of reform to be more suitable to the modern legal regime we are currently in.

In this chapter the legal position of a pre-incorporation contract under the current Companies Act 71 of 2008, as put forth in Section 21, is dealt with.[130] This would encompass a look into what the definition of a pre-incorporation contract entails, the requirements that need to be complied with and who bears the risk under the current act in instances of non-incorporation and non-ratification.

Lastly, the aspects that are still lacking under the new act are discussed to put forth proposals for reform regarding the equal distribution of liability herein.

3.2. Definition of a pre-incorporation contract

Section 21(1) defines a pre-incorporation contract as follows:

> *"Section 1: Pre-incorporation contracts*
> *A person may enter into a written agreement in the name of, or purport to act in the name of, or on behalf, an entity that is contemplated to be incorporated in term of this Act but does not yet exist at the time."* [131]

The section puts forth the definition of a pre-incorporation contract. That it is a written contract entered into prior to the incorporation of the company by a person whom purports to act in the name of, or on behalf of the proposed company with the intention that the proposed company will be incorporated and that upon incorporation the company will ratify the contract and, from that moment forth, be bound by the agreement.[132]

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[130] The Companies Act 71 of 2008.
[131] Section 1 of the Companies Act 71 of 2008.
[132] Cassim (2013) 149.

It appears from the above that section 21 applies only where a promoter acts as a promoter on behalf of the company or in the name of the company to be formed. It does not apply to instances where the promoter contracts in his personal name, in that this would be regulated by the common law principles of *stipulatio alteri,* in that the person concluding the contract is acting in the capacity of a principal and not a promoter.[133] This has been discussed at length already.

3.3. What are the elements that make up a pre-incorporation contract under section 21 of the Companies Act 71 of 2008?

Now that the definition of a pre-incorporation contract has been established, this section will proceed to investigate the elements and requirements. There are essentially 6 (six) elements that make up a pre-incorporation contract under section 21. These elements are that it is a written agreement, concluded before the incorporation of the company, between the third party and a promoter, whom acts on behalf of the company, whom may ratify the contract upon incorporation and be bound by the agreement.[134]

I will only be concentrating on those elements that have been reformed and retained from section 35.

3.3.1. The agreement must be in writing

One of the requirements that was retained during the reform of section 35,[135] is that the contract must be a written agreement.[136] The term 'agreement' has been widely accepted to be any contract, agreement or understanding between or amongst two persons with the common intention to acquire the rights and obligations as set out under the agreement.[137]

It is noteworthy to mention that section 2(2) of the Alienation of Land Act,[138] stated that a signature of an agent acting on written authority of another shall not derogate from the legal provisions relating to concluding a written contract.

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[133] Cassim (2012) 153.
[134] Cassim (2012) 151.
[135] The Companies Act 61 of 1973.
[136] Delport (2020) 106(11).
[137] Cassim (2012) 151.
[138] 68 of 1981.

The requirement of the contract having to be in writing creates a sense of certainty and also ensures that the board of directors receive full disclosure of the contract and its terms prior to ratification thereof.[139] This is an important requirement due to the fact that the written contract would form an integral part of the company's records.[140]

During the reform of the previous section 35, the administrative burdensome requirements of the contracts having to be lodged with the Companies and Intellectual Properties Commission, that the memorandum of registration must contain the objects of ratification, together with the requirement that the contract no longer needs to be notarial certified, have duly been disposed of.[141]

Section 21 however still extended the option to the contracting parties for the lodging of the memorandum of registration with the Companies and Intellectual Properties Commission on a voluntary basis.[142]

The major reform as brought about by the Companies Act 71 of 2008 in section 19(1)(b),[143] is that the new Companies Act gives the company the capacity of a natural person insofar as it is possible for a juristic person. Under the previous Companies Act, the company had an extremely limited capacity and could only validly operate as provided for in the memorandum of registration. The reform of the new Companies Act thus makes it obsolete for the ratification to be contained in the memorandum of registration.[144]

The disposal of this requirement has both positive effects as stated above as well as negative effects. The main negative effect is that the disclosure to potential investors is now removed from the requirements and therefore the protection offered to investors have now also been disposed of. Consequently, it is cumbersome for the investors to determine the commercial potential of a company prior to investing.[145]

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[139] Cassim (2012) 152.
[140] Ncube (2009) 260.
[141] Cassim (2012) 152.
[142] Cassim (2012) 152.
[143] Section 19(1)(b) of the Companies Act 71 of 2008: "*From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company –*
(b) has all of 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".
[144] Ncube (2009) 260.
[145] Ncube (2009) 260.

The requirement of having the pre-incorporation contract lodged with the Companies and Intellectual Property Commission operated to the detriment of the company and the third party. The parties usually wished to have the contract as concluded between them to remain confidential and the operation of this requirement opened the door to unfair practices in allowing competitors to interfere.[146]

The disposal of requirements have been welcomed with open arms by the legal fraternity as it removed the major disadvantage that the contracts would be open to public scrutiny.[147] Having the pre-incorporation contracts open to public scrutiny would result in these contracts not being concluded. Thus, the purpose of the Companies Act would not be given effect to in that companies would not be utilised to further the economy of South Africa in this manner.[148] These requirements can still be complied with on a voluntary basis should the contracting parties wish it to be complied with.[149]

3.3.2. Promoter's agency status

Under the previous Companies Act,[150] the promoter had to "profess to act as agent or trustee" on behalf of the company not yet formed. This wording and inadvertently the requirement, was removed by section 21 of the new Companies Act.[151] Section 21 has replaced the confusing phrase as put forth in section 35 with "purport to act in the name of".[152]

The use of the word "purport" is indicative that the section applies to pre-incorporation contracts entered into expressly or by implication with the intention to be bound.[153] The use of the word "purport" thus widened the ambit and application of section 21 since it includes the situation where a pre-incorporation contract has been entered into by implication.[154]

It should be noted that even though section 35 stated that a person may profess to act as a promoter or a trustee, section 21 has removed the application to situations where persons

[146] Ncube (2009) 261.
[147] Cassim (2012) 153.
[148] Section 7 of the Companies Act 71 of 2008.
[149] Cassim (2012) 10.
[150] The Companies Act 61 of 1973
[151] The Companies Act 71 of 2008.
[152] Section 21(1) of the Companies Act 71 of 2008.
[153] Ncube (2009) 262.
[154] Ncube (2009) 263.

acted in the capacity of a principal instead of a promoter. However, in these instances the trustees could still rely on the common law contract of *stipulatio alteri.*[155]

3.3.3. Ratification

Section 21 has statutorily incorporated ratification in subsection 21(4). It states that the pre-incorporation contract is to be ratified within 3 (three) months after the incorporation of the company.[156] This has created certainty as to the question regarding when ratification must be completed, whereas the previous section 35 was very ambiguous in that it only stated that ratification had to be done within a reasonable time or as agreed upon in the contract itself.

This section thus operates in the favour of both the company and the third party by providing the statutory protection in this regard.[157] The company herein has a specified period in which it must get all the necessary affairs in order to be able to ratify the pre-incorporation contract. While at the same time it provides a maximum amount of time that the third party must remain patient while waiting for the ratification of the contract by the company.[158] As in the previous position this aspect must be done by the board of directors of the incorporated company.[159]

As we all know, ratification may be express or even implied. Express ratification entails unequivocal language or conduct whereas implied ratification occurs when the principal acts in a way that can only be explained as acceptance of the terms and conditions of the contract.[160]

The section is still a snag point when it comes to the question of implied ratification or even ratification by conduct. The main question is if the company received any benefit under the pre-incorporation contract, could this be ratification by implication due to the conduct of the company.[161] The aspect of ratification by conduct also includes conduct in the form of omissions by the board of directors or even the principal.[162] This position could cause various practical difficulties due to its ambiguity.

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[155] Ncube (2009) 263.
[156] Section 21(4) of the Companies Act 71 of 2008.
[157] Ncube (2009) 264.
[158] Ncube (2009) 264.
[159] Cassim (2012) 154.
[160] Delport *(*2018) 2-188.
[161] Cassim (2012) 11.
[162] Delport *(*2018) 2-188.

Ratification at common law level requires the essential elements of any conduct by a corporate organ signifying a corporate intention to be bound and full knowledge of the terms of the contract.[163] This is an essential, and rather difficult, aspect that the third party would have to prove to be able to rely on implied ratification when instituting legal action based on the conclusion of a pre-incorporation contract.[164]

A noble reform of the principle of ratification is that the board of directors have the power to ratify the contract in its entirety, partially or even conditionally.[165] This was not an option under the previous position. This is a honourable reform in that it creates some form of certainty for the third party in that even though the entire contract is not ratified, there is still the option for a portion of the contract being ratified.

Subsection 21(4) has thus retained the positive step requirement by stating that the company must actively ratify a contract, which it would want to act in accordance with or make enforceable.[166]

Subsection 21(5) has also put forth the aspect of deemed ratification.[167] This occurs when the board of directors fail to ratify or reject the pre-incorporation contract within the allotted period of 3 (three) months. Thus causing the contract in its entirety to be enforceable against the company or the third party whether there was an intention to be bound or not.[168] This position is very advantageous to the third party who would be in possession of a valid and binding contract against the company.[169] However it being to the advantage of the third party, this could be very harsh and detrimental to the company in that it would be bound by an agreement it never had the intention to be bound to, or even worse an agreement they had no knowledge regarding its existence.[170]

It has been stated that the 3 (three) month period could in certain circumstances be very arbitrary in that depending on the facts of the matter it could be too short of a time period for the company to get its affairs in order.[171]

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[163] Cassim (2012) 11.
[164] Cassim (2012) 12.
[165] Cassim (2012) 154.
[166] Ncube (2009) 264.
[167] Section 21(5) of the Companies Act 71 of 2008.
[168] Ncube (2009) 265.
[169] Ncube (2009) 265.
[170] Cassim (2012) 154.
[171] Delport (2018) 2-188.

It is trite knowledge that the liability of the promoter is only discharged upon the ratification of the contract by the company, the legislature included this aspect in the wording of the section itself under subsection 21(6)(b).[172] The liability being discharged is contingent on the ratification of the contract due to the fact that the contract only becomes enforceable against the company once ratified.[173] The transfer of liability from the promoter to the company is truly helpful where the failure for ratification is not in any way attributable to the fault of the promoter.[174]

Therefore, the transfer of liability from the promoter to the company upon ratification is a particularly important component of the fault-based liability system that would be fully discussed in Chapter 5. In the premise of fault-based liability, a promoter can only be held liable when the non-ratification or non-incorporation is due to the direct fault of the promoter.

There has been confusion regarding the retrospective effect of the ratification of a pre-incorporation contract. This aspect has been clarified by the wording of subsection 21(6)(a), which clearly states that the contract is enforceable against the company "as if the company had been a party to the agreement when it is made".[175] In order to be in line with the common law principle of ratification, pre-incorporation contracts should be enforceable retrospectively to the date that the contract was concluded between the promoter and the third party rather than only upon the date of incorporation.[176]

3.4. Who bears the liability in instances of non-incorporation or non-ratification?

The reform of the previous section 35 took to the balancing of the conflicting rights and obligations of the company, the promoter and the third party.[177] As discussed in the previous chapter we saw that under the previous act the protection was afforded to the company and the promoter to the detriment of the third party.[178] That said, if the company was never incorporated then the contract simply lapsed, and the promoter was released from his liability in totality while the third party was burdened with the full risk and liability.[179]

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[172] Section 21(6)(b) of the Companies Act 71 of 2008.
[173] Section 21(6)(a) of the Companies Act 71 of 2008.
[174] Ncube (2009) 265.
[175] Ncube (2009) 265.
[176] Cassim (2012) 155.
[177] Cassim (2012) 156.
[178] Cassim (2012) 13.
[179] Cassim (2012) 156.

As a stark contrast to section 35 of the previous Companies Act,[180] subsection 21(2) introduces the principle of promoter liability.[181] This enables the third party to seek relief against the promoter for damages suffered in instances of non-incorporation and non-ratification.[182]

The reformed section reads as follows:

> *"A person who does anything contemplated in subsection (1) is jointly and severally liable with any other such person for all liabilities created as provided for in the pre-incorporation contract while so acting, if –*
> *(a) The contemplated entity is not subsequently incorporated; or*
> *(b) After being incorporated, the company rejects any part of such an agreement or action."*

Now that the aspect of whom bears the liability has been addressed, the next logical question that needs to be answered is with whom the promoter is jointly and severally liable. This answer is not so forth coming from the section itself.

In terms of the abovementioned, the promoter is jointly and severally liable for all the liabilities created in terms of a pre-incorporation contract for the instances where the company is not ultimately incorporated or when the company does not ratify the pre-incorporation contract.[183] This could be seen by the interpretation of the section and the usage of the phrase *"any other such person"* which extends the liability to any such person whom acts in the capacity of an agent or a promoter, whether legally appointed or *de facto* occupying the position,[184] but also takes it even a step further by stating that persons whom "*purport to act"* on behalf of the company will be held liable.[185]

It should be noted that Ncube formed the opinion that it could be argued that the legislature intended this section to cover those instances where there is more than one promoter whom is contracting on behalf of the company to be formed.[186] It is common practice that one pre-incorporation contract has a group of promoters, that contract on its behalf, and therefore to

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[180] The Companies Act 61 of 1973.
[181] Section 21(2) of the Companies Act 71 of 2008.
[182] Ncube (2009) 266; Delport (2018) 2-195
[183] Section 21(2)(a)–(b) of the Companies Act 71 of 2008.
[184] Ncube (2009) 266.
[185] Cassim (2012) 15.
[186] Ncube (2009) 266.

limit the liability to the signatory of the contract would in no circumstances be equitable and fair towards the interest of justice. Without this important addition to the section only the promoter whom signed the contract on behalf of the company to be formed would be held liable.[187] This is a very amendable reform of the previous section 35.[188]

Another advantage that this section provides the third party with, is the fact that the promoters are liable jointly and severally. This means that the third party can successfully recover the full amount of damages from one or all of the promoters. The promoter would be responsible to recover their pro rata share of the damages from the other promoters, thus making his legal position stronger.[189]

The section also provides protection for promoters when promoters-turned-executive-directors elect to not ratify the contract after the incorporation of the company, or elects to conclude another contract on the same or similar terms. In these instances, it would be unequitable to hold the signatory liable for a situation he has no control over.[190]

As previously discussed, a promoter's liability is only discharged upon the ratification of the pre-incorporation contract, whether actual or deemed, or when novation of the pre-incorporation contract occurs, which will now be discussed.[191] The legislature made an exception for the liability of the promoter in that if the company is incorporated and then elects not to ratify the contract concluded for its benefit, but then proceeds with a novation, then the liability of the promoter is released even though the contract was never ratified.[192] This is an honourable position to take by the legislature in their endeavour to reform section 35 as they offered some form of protection to the promoter.

In subsection 21(2) the Act states that the promoter is liable for the liabilities under the pre-incorporation contract, but in the same breath the act is completely silent on whether the promoter would be entitled to the benefits under the contract or whether the promoter may take any steps to enforce the contract against the third party.[193] In order to reach a positive answer to this conundrum we would have to turn to our common law. In our legal regime it is not an automatic consequence that once a person is liable under a contract for the liabilities,

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[187] Ncube (2009) 266.
[188] Cassim (2012) 156.
[189] Ncube (2009) 267.
[190] Cassim (2012) 157.
[191] Section 21(3) and section 21(6)(b) of the Companies Act 71 of 2008.
[192] Section 21(3) of the Companies Act 71 of 2008.
[193] Cassim (2012) 16.

it would be able to enforce the contract against the other concluding party, nor is it entitled to receive the benefits under the contract in question.[194] Put simply, having personal liability does not necessarily mean that the promoter is entitled to any benefit under the contract itself.[195] This question of law will have to be decided by a competent court in order to provide clarity to the legal fraternity in this regard.

However burdensome the section is on promoter liability, the legislature ensured that the promoter has some form of recourse in instances where they have clearly been wronged by the company and its directors and is now liable towards to the third party for a benefit which the company has received. Subsection 21(7) provides that if a company rejects the pre-incorporation contract, the promoter has the right of recourse to lay a claim against the company for the benefit it has received or is entitled to receive under the pre-incorporation contract.[196] This section enables the promoter after discharging his liability towards the third party, to be reimbursed partially or in full by the company.[197] This is a protection mechanism against the company being unjustifiably enriched by the contract to the detriment of the promoter.[198]

The benefit to be received or entitled to be received by the company is not defined by the act but logic dictates that goods received would have to be returned, and where this is an impossibility then the relative value of the goods or services would have to be reimbursed.[199] The question now arises regarding the situation if the company is not able to return the goods or services and whom is also not in a position to financially reimburse the promoter. The unfortunate truth is that the company may not be forced to now ratify the contract but rather that the company would now face liquidation proceedings.[200]

Even though legislature could be commended for the reform of the previous section 35 into the current section 21 there are still some inconsistencies that have been left unaddressed by the legislature. The following section will now turn our attention to these inconsistencies.

3.5. Inconsistencies that still needs to be addressed by the legislature

[194] Cassim (2012) 17.
[195] Cassim (2013) 157.
[196] Section 21(7) of the Companies Act 71 of 2008.
[197] Ncube (2009) 267.
[198] Cassim (2012) 17.
[199] Ncube (2009) 267.
[200] Ncube (2009) 267.

Section 21 still fails to provide full and complete solutions to various situations arising from practice. There are certain situations where it would under no circumstances be equitable to allow, or even enable, promoters to escape liability even if the contract is ratified by the incorporated company.[201] There are also certain situations where the company should not be permitted to avoid any form of liability by not ratifying the contract.

This section will now consider these situations which include the judicial discretion that should be extended to the courts, the use of fly-by-night companies as well as the uncertainties regarding the interim period between the conclusion of the contract and the ratification thereof.

3.5.1 Judicial discretion

Section 21 omitted the wide judicial discretion that empowers the courts to better balance the liabilities between the company and the promoter on a facts-to-facts basis by apportioning the liability between the parties where it would be just and equitable.[202] The inclusion of this aspect into section 21 would have offered all the parties more protection which could be tailor made to each situation based on the facts of the matter at hand.

3.5.2 Fly-by-night companies

The use of a fly-by-night company occurs in the situation where the promoter subsequently realises that the pre-incorporation contract is no longer beneficial to the company to be formed, realises the looming liability it is facing, and then procures an empty shell company to ratify the contract – thus releasing the promoter from his liability in terms of the pre-incorporation contract.[203] This is purely an act of opportunistic ratification of a contract or a sham incorporation of a company.[204]

The use of these fly-by-night companies results in the discharge of the promoter's liability while leaving the third party with a worthless action based on breach of contract against a company without any assets.[205]

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[201] Cassim (2012) 19.
[202] Cassim (2012) 20.
[203] Cassim (2012) 20.
[204] Cassim (2012) 157.
[205] Cassim (2012) 20.

3.5.3 The interim period

Another lacking aspect of section 21 is that the section is still silent on the solutions to how the parties are to regulate the period between the execution of the pre-incorporation contract and the ratification by the incorporated company.[206] Therefore, the previously discussed practical problems regarding unilateral withdrawal on the part of the third party as well as whether mutual cancellation is permissible, is still left unresolved.

3.6. Conclusion

Now that the previous section 35 and the reform it underwent to give the current section 21 regulating the aspects of pre-incorporation contracts has been considered, it is clear that there is still a large discrepancy in whom should bore the liability in instances of non-incorporation and non-ratification.

To propose recommendations for the manner in which the apportionment of liability should be handled by legislature, I now turn to consider the position in various foreign jurisdictions.

[206] Cassim (2012) 21.

CHAPTER 4: A COMPARATIVE OVERVIEW OF PRE-INCORPORATION CONTRACTS WITHIN THE JURISDICTION OF AUSTRALIA AND CANADA

4.1. Introduction

In the previous chapters, the elements and definitions of pre-incorporation contracts were viewed as the legislative enactments that evolved within our law – from the initially discussed provisions contained in the 1973 Companies Act to the provisions contained in the 2008 Companies Act as well as addressing and discussing the areas that are still lacking within our legal regime.

In this chapter, I look towards foreign jurisdictions to find solutions regarding the unequitable distribution of liability between the company and the promoter within our law. This section would be discussing Australian and Canadian law to see how they deal with the distribution of liability. To reach our conclusion, we would be looking at the legislative regulation in the jurisdiction we are investigating and then turn our attention to how they deal with liability in various instances in which our legal regime is lacking.

Firstly, the Australian jurisdiction is considered – how it is similar and different from our legal regime – whereafter I turn to the Canadian jurisdiction.

4.2. Australia: Legislative regulation

4.2.1. Common law provisions

As in South African law the regulation of the legal principles that govern pre-incorporation contracts have evolved from common law principles until legislative provisions have been brought in by legislature.

Under the common law position a company lacks legal capacity to contract until such time as it has been registered, which flows directly from the principle that the company cannot be a party to a contract prior to its registration.

With regards to ratification of a pre-incorporation contract, Australia also followed the common law principle as set forth in the case of *Kelner.*[207] As we have already discussed one of the main rules in terms of common law is that a principal cannot ratify a contract unless it was an existing entity at the time of the conclusion of the contract,[208] even though it has been said that a company would be bound by the contract immediately upon registration. Ratification will not be allowed after any time as specifically set within the contract itself, any time fixed by the parties or after the expiry of a reasonable period.[209]

Under the Australian common law position, the only way a company would be affected by the contract, other than upon ratification, is when it is novated upon registration or when the benefit of the contract is assigned or ceded to the company after registration.[210] As in South Africa this common law principle has not stopped persons whom wish to contract on behalf of a non-exiting entity.[211]

There are however exceptions to the *Kelner*[212] case under Australian law namely firstly, where the promoter purports to be acting not "for" but "as" the non-existing entity, secondly where the contract could not be performed and lastly, where it is clearly the intention of the contracting parties that the promoter is not to be held personally liable if the company is unable or incapable of honouring its obligations.[213]

Now that we have laid down the common law principles, we can with ease turn our attention to the legislative measures that were implemented by the Australian legislature in 1982.

4.2.2. Section 81 of the National Companies Code

In 1982 the Australian judiciary enacted the National Companies Code (1982)[214] into the legislative sphere to regulate the use of pre-incorporation contracts within their jurisdiction.

Section 81 reads as follows:

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[207] Kelner v Baxter (1866) LR 2 CP 174.
[208] Hambrook *Pre-Incorporation Contracts and the National Companies Code: What does Section 81 really mean* (1982) Adelaide Law Review 119, 119.
[209] Hambrook (1982) 119.
[210] Hambrook (1982) 120.
[211] Hambrook (1982) 119.
[212] Kelner v Baxter (1866) LR 2 CP 174.
[213] Palmer *Pre-incorporation contracts and the implied warranty of authority* (1975) University of Queensland Law Journal 123, 124.
[214] National Companies Code (1982).

"Ratification of contracts made before formation of company

81. (1) *In this section-*

(a) a reference to a non-existent company purporting to enter into a contract shall be construed as a reference to-

(i) a person executing a contract in the name of a company, where no such company exists; or

(ii) a person purporting to enter into a contract as agent or trustee for a proposed company;

(b) a reference to a person who purports to execute a contract on behalf of a non-existent company shall be construed as a reference to a person who executes a contract or purports to enter into a contract as mentioned in sub-paragraph (a) (i) or (ii);

(c) a reference, in relation to the purported entry into a contract by a non-existent company, to the formation of the company shall be construed as a reference to-

(i) where a person has executed a contract in the name of a company and no such company exists-the formation of a company that, having regard to all the circumstances, is reasonably identifiable with the company in the name of which the person executed the contract; or

(ii) where a person has purported to enter into a contract as agent or trustee for a proposed company-the formation of a company that, having regard to all the circumstances, is reasonably identifiable with the proposed company.

(2) *Where-*

(a) a non-existent company purports to enter into a contract; and

(b) the company is formed within a reasonable time after the contract is purported to be entered into, the company may, within a reasonable time after it is formed, ratify the contract.

(3) *Where a company ratifies a contract as provided by sub-section (2), the company is bound by, and entitled to the benefit of, that contract as if the company had been formed before the contract was entered into and had been a party to that contract.*

(4) *Where a non-existent company purports to enter into a contract and-*

(a) the company is not formed within a reasonable time after the contract is purported to be entered into; or

(b) the company is formed within such a reasonable time but does not ratify the contract within a reasonable time after the company is formed, the other party or each of the other parties to the contract may, subject to sub-sections (6) and (9), recover from the person or any one or more of the persons who purported to execute the contract on behalf of the non-existent company an amount of damages equivalent to the amount of damages for which that party could have obtained a judgment against the company if-

(c) where the company has not been formed as mentioned in paragraph (a)-the company had been formed, and had ratified the contract as provided by sub-section (2); or

(d) where the company has been formed as mentioned in paragraph (b)-the company had ratified the contract as provided by sub-section (2), and the contract had been discharged by reason of a breach of the contract constituted by the refusal or failure of the company to perform any obligations under the contract.

(5) *Where-*

(a) proceedings are brought to recover damages under sub-section (4) in relation to a contract purported to be entered into by a non-existent company; and

(b) the company has been formed, the court in which the proceedings are brought may, if it thinks it just and equitable to do so, make either or both of the following orders:

(c) an order directing the company to transfer or pay to any party to the contract who is named in the order, any property, or an amount not exceeding the value of any benefit, received by the company as a result of the contract;

(d) an order that the company pay the whole or a specified portion of any damages that, in those proceedings, the defendant has been, or is, found liable to pay.

***(6)** Where, in proceedings to recover damages under sub-section (4) in relation to a contract purported to be entered into by a non-existent company, the court in which the proceedings are brought makes an order under paragraph (5)(c), the court may refuse to award any damages in the proceedings or may award an amount of damages that is less than the amount that the court would have awarded if the order had not been made.*

***(7)** Where-*

(a) a non-existent company purports to enter into a contract;

(b) the company is formed, and ratifies the contract as provided by sub-section (2);

(c) the contract is discharged by a breach of the contract constituted by a refusal or failure of the company to perform all or any of its obligations under the contract; and

(d) the other party or any one or more of the other parties to the contract brings or bring proceedings against the company for damages for breach of the contract, the court in which the proceedings are brought may, subject to sub-section (9), if it thinks it just and equitable to do so, order the person or any one or more of the persons who purported to execute the contract on behalf of the company to pay to the person or persons by whom the proceedings are brought the whole or a specified portion of any damages that the company has been, or is, found liable to pay to the person or persons by whom the proceedings are brought.

***(8)** Where a person purports, whether alone or together with another person or other persons, to execute a contract on behalf of a non-existent company, the other party to the contract, or any of the other parties to the contract, may, by writing signed by that party, consent to the first-mentioned person being exempted from any liability in relation to the contract.*

***(9)** Where a person has, as provided by sub-section (8), consented to another person being exempted from liability in relation to a contract that the other person purported to execute on behalf of a non-existent company-*

(a) notwithstanding sub-section (4), that first-mentioned person is not entitled to recover damages from that other person in relation to that contract; and

(b) a court shall not, in proceedings under sub-section (7), order that other person to pay to the first-mentioned person any damages, or any proportion of the damages, that the company has been, or may be, found liable to pay to that first-mentioned person.

***(10**) If-*

(a) a non-existent company purports to enter into a contract;

(b) the company is formed; and

(c) the company and the other party or other parties to the contract enter into a contract in substitution for the first-mentioned contract, any liabilities to which the person who purported to execute the first-mentioned contract on behalf of the company is subject under this section in relation to the first-mentioned contract (including liabilities under an order made by a court under this section) are, by force of this sub-section, deemed to be discharged.

(11) *Any rights or liabilities of a person under this section (including rights or liabilities under an order made by a court under this section) in relation to a contract are in substitution for any rights that the person would have, or any liabilities to which the person would be subject, as the case may be, apart from this section, in relation to the contract.*

(12) *Where-*

(a) a person purports to enter into a contract as trustee for a proposed company; and

(b) the company is formed within a reasonable time after the person purports to enter into the contract but does not ratify the contract within a reasonable time after the company is formed, then, notwithstanding any rule of law or equity, the trustee does not have any right of indemnity against the company in respect of the contract.

(13) *For the purposes of this section, a contract may be ratified by a company in the same manner as a contract may be made by a company under section 80 and the provisions of section 80 have effect as if-*

(a) the references in that section to making a contract were references to ratifying a contract; and

(b) the reference in sub-section (3) of that section to a contract executed, or purporting to have been executed, under the common seal of a company were a reference to a contract ratified, or purporting to have been ratified, under the common seal of a company.

This section states that a company may ratify a contract within a reasonable period after the incorporation of the company, whereafter the company is bound to, and entitled to, the benefits under the contract. If the company is not incorporated or did not ratify the contract, the parties may recover damages on judgement terms. The section includes a clause which gives the parties the option of exempting the promoter from personal liability.

Section 81 now permits a company to ratify certain pre-incorporation contracts, provided that the company is formed within a reasonable time from the conclusion of the contract on its behalf, and provided that ratification of the contract occurs within a reasonable time from the registration of the company.[215] This is known as the Combined Warranty Approach.[216] In the event that the company fails to ratify the contract the promoter will be held liable if it does not have a written exemption clause contained within the contract.[217] This will be discussed in the next part of the chapter.

The enacted section applies to contracts purportedly entered into by a non-existing company, which inadvertently takes the form of two different contracts.[218] Firstly, where the promoter enters the contract in the name of the company while it is still non-existent and thus acting in

[215] Section 81(2) of the National Companies Code (1982).
[216] Cassim *Pre-Incorporation Contracts: The reform of Section 35 of the Companies Act* (2007) SALJ 364, 373.
[217] Hambrook (1982) 128.
[218] Section 81(2) of the National Companies Code (1982).

his capacity as a principal and not a promoter.[219] Secondly, where a person purports to enter into the contract as a promoter for the proposed company.[220] It should be noted that where the promoter has contracted as principal then section 81 would not be applicable.[221]

A promoter can only have purported to contract in his capacity as promoter for the proposed company if the parties believed or knew that the company was not yet in existence. If the parties wrongly believed that the company is in existence, then the promoter would have acted for an existing company and not for a proposed company.[222] On the other hand, where the promoter acts in the mistaken belief that the company is registered, then section 81 would have no application. This would be true even if the third party was aware, or believed, that the company had not yet been formed.[223] It is the manner in which the promoter acts and contracts that is decisive regarding the application of section 81. Those contracts that fall outside the scope of the section would still be governed by the common law position as already discussed.[224]

When it comes to ratification, the company may ratify the pre-incorporation contract in the same manner as that contract could be entered into by the company.[225] As in South African law there is no specific manner stipulated for ratification within the section itself.[226] In practice however it would be the board of directors that would see to the ratification of the contract, while ratification could be implied or express.[227] As stated above, ratification has to occur within a reasonable time period from the registration of the company. What constitutes a reasonable time period would be decided by the surrounding circumstances of the contract itself.[228]

The next aspect that has to be discussed is the interim period between the conclusion of the contract and the ratification. Under section 81 there is no binding contract unless the promoter has contracted as a principal, which would in any case cause the contract to fall outside the

[219] Section 81(1)(a)(i) of the National Companies Code (1982).
[220] Section 81(1)(a)(ii) of the National Companies Code (1982).
[221] Hambrook (1982) 129.
[222] Hambrook (1982) 129.
[223] Hambrook (1982) 130.
[224] Hambrook (1982) 130.
[225] Section 81(13) of the National Companies Code (1982).
[226] Hambrook (1982) 130.
[227] Hambrook (1982) 141.
[228] Hambrook (1982) 131.

scope of application of the section.[229] During the interim period the promoter would not be held personally liable as there is no binding contract.[230]

At common law it has been stated that ratification is effective notwithstanding that the third party had purported to withdraw from the agreement prior to ratification. This was confirmed in the *Bolton Partners Ltd v Lambert (*hereinafter referred to as "*Bolton Partners*")[231] case, which stated that strict application of the abovementioned principle and case law means that the third party could not withdraw unilaterally to prevent ratification.[232]

Hereafter, the section deals with the manner in which the liability of the promoter was dealt with under the common law provisions as opposed to the legislative management of liability.

4.3. Australia: Liability of the promoter

4.3.1. Common law provisions

Under Australian common law there is no rule that states that a person whom contracts on behalf of a non-existing principal is to be personally held liable on the contract. The true intention of the parties should always prevail in these circumstances.[233] In these instances a promoter would only be held liable if both parties were aware of the non-existence of the principal company. The reasoning behind this is that the parties must have intended to conclude a binding agreement, and to give effect to the agreement is to hold the promoter personally liable.[234]

This aspect was discussed in the case of *Marblestone Industries Ltd v Fairchild (*hereinafter referred to as "*Marblestone*"),[235] in which it was held that personal liability of the promoter is dependent on proof of the subjective knowledge, on the part of the promoter, of the non-registration of the company. However, promoters would not be held personally liable if it is impossible to sensibly construe the terms of the contract with the names of the promoter inserted, wherever the name of the company is to appear.

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[229] Hambrook (1982) 131.
[230] Cassim (2007) 359.
[231] Bolton Partners Ltd v Lambert (1889) LR 41 Ch D 295.
[232] Hambrook (1982) 135.
[233] Kelner v Baxter (1866) LR 2 CP 178.
[234] Hambrook (1982) 121.
[235] Marblestone Industries Ltd v Fairchild (1975) 1 NZLR 529, 542.

This now begs the question as to what to do in the situation where the parties wrongly believed that the company was in existence at the conclusion of the contract, as it would be exceedingly difficult to prove that the promoter was intended to be personally liable. In case law this aspect was dealt with in the matter of *Black v Smallwood* (hereinafter referred to as "*Black*"),[236] in which it was held that a promoter who acted only in a ministerial capacity cannot enforce or be personally liable on the contract.

It is therefore suggested under common law, that a promoter is only liable on a pre-incorporation contract, if the parties were aware of the non-existence of the company. The fact that the third party had executed his side of the agreement does not automatically mean that the promoter is liable in terms of the contract.[237]

A promoter may be held liable on a breach of warranty if the promoter purports to act as an agent of a non-existing company.[238] This action should also be available where a third party is induced by the promoter to believe that an enforceable contract with a registered corporation has been concluded.[239] It should be said that the promoter may be held liable for breach of warranty, when the promoter has represented that the company is already in existence.[240] Although this may seem to provide a very solid remedy for the third party, the difficulty would be the appropriate measure of damages.

In the *Wickberg v Shatsky* (hereinafter referred to as "*Wickberg*")[241] matter, the Defendants, being directors of one company and promoters of another, which was intended to take over the liabilities of the first, engaged the Plaintiff to act as the projected company's manager. The Plaintiff was, at the conclusion of the contract, unaware that the company had not yet been incorporated and this displaced the assumption that the promoters were not to be personally liable under the contract. The company was later never incorporated, and the Plaintiff was dismissed from his employment. The Plaintiff succeeded in his claim based on a breach of warranty and was subsequently awarded nominal damages.[242]

The third party is entitled to recover the amount of damages in order to compensate himself for not having a contract with the intended principal. Therefore, he is entitled to damages as

[236] Black v Smallwood (1966) 117 CLR 52.
[237] Hambrook (1982) 123.
[238] Black v Smallwood (1966) 117 CLR 53.
[239] Hambrook (1982) 124.
[240] Palmer (1975) 124.
[241] Wickberg v Shatsky (1969) 4 DLR (3d) 540.
[242] Palmer (1975) 124.

would have been based on a claim of non-performance.[243] Due to the fact that a company will be treated as an insolvent entity prior to its registration, due to a lack of funds, the third party would practically only receive nominal damages for breach of warranty as was the conclusion reached in *Wickberg.*[244] [245]

The aspect of nominal damages was also addressed in the matter of *Delta Construction Co Ltd v Lidstone* (hereinafter referred to as "*Delta Construction*"),[246] where the plaintiff was awarded nominal damages against the promoter in his claim based on breach of warranty of authority, in terms of a pre-incorporation contract whereafter the company went insolvent after its registration.

These common law positions have however been amended and changed by the enactment of the legislative provisions under discussion next.

4.3.2. Section 81 of the National Companies Code

If the company referred to in the pre-incorporation contract is either not registered within a reasonable time or, if registered, fails to ratify the contract within a reasonable time, then the promoter is liable to the third party for damages.[247]

In subsection 81(4) of the National Companies Code, it is stated that the promoter is not held liable in the capacity as a principal. The sole liability herein is based on damages that would have been awarded against the company, had the company been formed, ratified the agreement but ultimately failed to perform in terms of the contract.[248]

When the company ratifies the contract, then the company is bound by the contract as if it had been formed prior to the conclusion of the contract and as if it were a party to the contract.[249] If the company then fails to perform it may be sued for nominal damages. The courts still have the power to order that the promoter is to pay the whole or part of the damages as awarded against the company as stated in subsection 81(7) of the Companies Code.[250]

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[243] Hambrook (1982) 125.
[244] Hambrook (1982) 125.
[245] See Wickberg v Shatsky (1969) 4 DLR (3d) 540.
[246] Delta Construction Co Ltd v Lidstone (1979) 96DLR (3d) 457.
[247] Section 81(4) of the National Companies Code (1982).
[248] Hambrook (1982) 128.
[249] Section 81(3) of the National Companies Code (1982).
[250] Hambrook (1982) 142.

This section has been specifically included to cater for certain instances where the third party would be prejudiced if ratification completely extinguished the promoter's liability. As the promoter may have set up a company, which has insufficient assets to meet the obligations of the pre-incorporation contract, to ratify the contract, while knowing that the company would be unable to perform in terms of the contract.[251] In our legal regime this is known as "fly-by-night" companies.

If the promoter is ordered to pay damages under subsection 81(7) it would be as if the promoter had breached a warranty that the company would be sufficiently solvent to meet its liability in terms of the contract. As we have seen that under common law the promoter does not warrant that the company is solvent and therefore no such order should be made under subsection 81(7) in this regard.[252]

It should be noted that the Australian legislature allows the parties to contract out liability in the form of an exclusion of liability clause.[253] This has been put forth in legislature in subsections 81(8) and 81(9) of the National Companies Code.[254] This provision protects the promoter from orders being made against himself in terms of subsection 81(7).

In terms of subsection 81(8) the third party may grant an express, written, signed exemption from liability in relation to the contract to the promoter,[255] which may be granted at any time as it does not have to be given at the date of the conclusion of the contract, that protects the promoter from being liable towards the third party for damages.[256] The third party may still exempt the promoter from liability in the mistaken belief that the company either is liable or will necessarily become liable upon incorporation.[257]

In these instances, when the third party has transferred some benefit to the company after having exempted the promoter from liability, he will be fully reliant on the company ratifying the contract. This boils down to the fact that if there is no ratification the only remedies available would be quasi-contractual.[258]

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[251] Hambrook (1982) 142.
[252] Hambrook (1982) 143.
[253] Hambrook (1982) 142.
[254] Section 81(8) and 81(9) of the National Companies Code (1982).
[255] Section 81(8) of the National Companies Code (1982).
[256] Section 81(9) of the National Companies Code (1982).
[257] Hambrook (1982) 146.
[258] Hambrook (1982) 146.

As we can see there are quite several similarities between the South African legislative provisions and the Australian legislative provisions that govern pre-incorporation contracts, but there are also a couple of differences and lessons we can incorporate within our legislative regime. The aspects which deem suitable to be included in our law will be discussed in the following chapter.

4.4. Canada: Legislative regulation and the liability of the promoter

4.4.1. Common law provisions

Prior to any legislative provisions being enacted within the state of Ontario, and the bigger area of Canada, all pre-incorporation contracts were governed by common law principles. As in South African common law the principles as put forth in *Kelner,*[259] were included in the Ontario and the Canadian law, such as a promoter may not contract on behalf of the non-existing principal, as well as the problems regarding ratification. This case was duly incorporated and accepted by the Ontario courts.[260]

Under the Canadian common law there were two general rules that governed pre-incorporation contracts. The first is that a person whom signed a contract on behalf of a corporation to be incorporated, was personally liable on the contract, and the second was that once incorporated, the company could not ratify the contract, the promoter, could not be relieved of his liability.[261] Therefore, only the signatory would be held liable under the pre-incorporation contract opposed to the joint and several liability approach as followed in South Africa.[262]

The common law courts were constrained by various principles that flowed from the abovementioned case. The principles which constrained the common law courts were firstly, that an agent whom contracts on behalf of a non-existing principal is personally liable on the contract and the principal cannot ratify the contract upon incorporation. Secondly, that under contractual law two parties exist upon conclusion of the contract. Thirdly, a company only comes into existence upon registration of the corporation under the principles of corporate

[259] Kelner v Baxter (1866) LR 2 CP 174.
[260] Estey *Pre-incorporation contracts: The fog is finally lifting* (2000) Canadian Business Law Journal 7, 8.
[261] Estey (2000) 7.
[262] Cassim (2007) 376.

law, and lastly that extrinsic evidence is inadmissible where the intentions of the parties and the terms of the bargain are clear on the face of the written agreement.[263]

Due to the cumbersome obstacles that was posed by the abovementioned constraints, the courts fumbled in their attempt to overcome the obstacles in providing unified provisions to govern pre-incorporation contracts. The courts could also not overcome the major constraint, in that a non-existent person or entity could agree to become subject to obligations created prior to its incorporation.[264] The only way to achieve a shift in liability from the promoter to the corporation was by way of a novation, that being concluding a contract on the same terms and conditions as the pre-incorporation contract, but the contract is to be concluded between the corporation and the third party.[265]

The strict rule as put forth in the *Kelner*[266] was amended somewhat by the Australian case of *Black,*[267] where both the promoter and the third party believed that the company, they were contracting on behalf of, has already been formed. In this instance the court held that the *Kelner* matter stated that personal liability does not attach to the promoter in each situation, particularly where it is evident that personal liability was never intended when the contract was concluded. Thus, creating the question regarding what the intentions of the parties were upon conclusion of the contract.[268]

The Canadian courts have been applying both the principles set forth in *Kelner*[269] as well as *Black*[270] as the facts of the matter requires. Each case would therefore be decided upon a detailed analysis of the intention of the parties when concluding the contract; the manner in which the promoter signed the contract[271] (whether in his personal name or stated unequivocally that he is acting on behalf of a company to be formed); and lastly the parties' knowledge regarding whether the company was in existence at the time of conclusion of the contract.[272]

Due to the inconclusiveness of the common law provisions, there was a huge call for statutory reform for common law provisions by drafting legislature to properly govern these contracts.

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[263] Estey (2000) 7.
[264] Estey (2000) 7.
[265] Estey (2000) 8.
[266] Kelner v Baxter (1866) LR 2 CP 174.
[267] Black v Smallwood (1966) 177 CLR 52.
[268] Estey (2000) 9.
[269] Kelner v Baxter (1866) LR 2 CP 174.
[270] Black v Smallwood (1966) 177 CLR 52.
[271] Phonogram Ltd v Lane (1981) 3 All ER 182 (CA).
[272] Estey (2000) 9–10.

4.4.2. Section 21 of the Ontario Business Corporation Act and Section 14 of the Canada Business Corporation Act

There were various areas that needed regulation and reform as put forth by various legislative bodies. Some of these included repealing the rules as put forth in *Kelner*[273] as these became outdated and was fraught with inconsistencies.[274] The reform pushed to enable a company to adopt any pre-incorporation contract made on its behalf by a unilateral act and permitting a third party to apply for a court order making the promoter and the company jointly and severally liable under a pre-incorporation contract if it is found just and equitable to do so.[275]

In response to this push section 21 of the Ontario Business Corporations Act[276] (hereinafter referred to as the "OBCA") was enacted into legislation. Section 21 thus proceeded to permit a corporation to adopt a pre-incorporation contract concluded on its behalf, when adopted it immediately became entitled to the benefits and subject to the liabilities under the contract thus releasing the promoter of his liability.[277] Section 21 of the Ontario Business Corporations Act reads as follows:

"Contract prior to corporate existence

21 *(1) Except as provided in this section, a person who enters into an oral or written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to the benefits thereof. R.S.O. 1990, c. B.16, s. 21 (1).*

Adoption of contract by corporation

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt an oral or written contract made before it came into existence in its name or on its behalf, and upon such adoption,

(a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and

(b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract. R.S.O. 1990, c. B.16, s. 21 (2).

Assignment, etc., of contract before adoption

(2.1) Until a corporation adopts an oral or written contract made before it came into existence, the person who entered into the contract in the name of or on behalf of the corporation may assign, amend or terminate the contract subject to the terms of the contract. 2011, c. 1, Sched. 2, s. 1 (5).

Non-adoption of contract

(3) Except as provided in subsection (4), whether or not an oral or written contract made before the

[273] Kelner v Baxter (1866) LR 2 CP 174.
[274] Lawrence Committee Report 1967.
[275] Estey (2000) 11.
[276] Ontario Business Corporations Act RSO 1970.
[277] Estey (2000) 11.

coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order fixing obligations under the contract as joint or joint and several or apportioning liability between the corporation and the person who purported to act in the name of or on behalf of the corporation, and, upon such application, the court may make any order it thinks fit. R.S.O. 1990, c. B.16, s. 21 (3).

Exception to subs. (1)

(4) If expressly so provided in the oral or written contract referred to in subsection (1), a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof. R.S.O. 1990, c. B.16, s. 21 (4)."

The section stated that the promoter is personally bound and entitled to the benefits under the contract. The corporation can adopt a written or oral agreement expressly or tacitly. Upon adoption the company is bound by the contract and the promoter's liability is discharged. An admirable clause is the fact that the court is endowed with the power of fixing the obligations under the contract as joint, joint and several or even apportion the obligations between the corporation and the promoter.

In the event that the corporation did not adopt the pre-incorporation contact, then the promoter would remain liable and would be entitled to recover the value from the company of the benefits it received under the pre-incorporation contract.[278] Section 21 of the OBCA went a commendable step further in providing the third party with the option to apply for a court order to fix and apportion liability as between the promoter and the corporation in such a manner as the court deems fit, regardless of whether the corporation has adopted the contract or not.[279] The section did not initially mandate joint and several liability between the promoter and the company but instead it permitted the court to apportion liability between them on the basis the court deems fit.[280] The amended section now expressly provides for joint and several liability between the promoter and the corporation.

After the enactment of the OBCA the federal system deemed it necessary to enact a federal act that governs the aspects of pre-incorporation contracts. The federal system enacted Section 14 of the Canada Business Corporation Act[281] (hereinafter referred to as the "CBCA"). The CBCA balances the conflicting interests between the corporation, promoter and the third party by making the promoter personally liable, with a co-existent right to any benefits,[282] on a

[278] Estey (2000) 11.
[279] Estey (2000) 11.
[280] Section 21 of the Ontario Business Corporations Act RSO 1970.
[281] Canada Business Corporations Act RSC 1982.
[282] Cassim (2012) 14.

written pre-incorporation contract. This is subject to three relieving principles,[283] which are discussed intertwined with section 21 of the OBCA. Therefore, it has become clear that Canadian law follows the personal liability approach as opposed to Australian law that follows the statutory warranty approach.[284]

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

"Personal liability

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

Pre-incorporation and pre-amalgamation contracts

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt a written contract made before it came into existence in its name or on its behalf, and on such adoption

(a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and

(b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

Application to court

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

Exemption from personal liability

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

The first relief-bearing provision that is contained in both the abovementioned sections, now provide that a promoter would be personally liable on a pre-incorporation contract unless the corporation adopts the contract within a reasonable time after its incorporation, adoption could be by any action or conduct signifying an intention to be bound.[285] Therefore, some act has to be performed with the knowledge of the terms of the agreement in order for the adoption to

[283] Maloney *Pre-Incorporation Transactions: A Statutory Solution* (1985) Canadian Business Law Journal 411, 411.
[284] Cassim (2012) 14
[285] Maloney (1985) 411.

be seen as valid.[286] It has been stated in Canadian law that the best and most formal manner of adoption would be a resolution taken by the board of directors.[287]

In this instance the corporation becomes bound, and the promoter is released from its personal liability.[288] If the pre-incorporation agreement is adopted by the board of directors after the incorporation of the company, the agreement is enforceable against the company as if the company had been a party to the agreement when the agreement has been entered.[289]

Section 14 of the CBCA provides that adoption of the pre-incorporation contract only requires an act that could be seen as a positive act, as stated above, the creation of a new contract by way of novation is no longer needed.[290] There has been certain instances where the interpretation of a positive act extended to the situation where the company has proceeded with the status quo and has failed to object to any of the terms of the agreement, especially regarding employment contracts.[291]

The CBCA essentially provides for only two requirements for a valid adoption. Firstly, the agreement must be in writing and the contract must be accepted within a reasonable time from date of incorporation even though there is no corresponding restriction attached to the time the company may take to incorporate itself.[292] It could be argued that the reasonable time limitation could also apply to the period in which the company is to incorporate itself.[293]

The case of *Landmark Inns,*[294] placed the first judicial limitation on the corporation's right to adopt a pre-incorporation contract. In the matter it was held that repudiation of a contract by a promoter which is then accepted and relied upon by a third party in a claim, prior to the incorporation of the company, precluded the company from adopting the contract upon incorporation.[295] This is in line with the interpretation of the sections as prior to the adoption the promoter is the principal on the contract and can therefore do as he pleases.

On the reverse of the situation, that being where the contract has been repudiated by the promoter, but the repudiation has not been accepted by the third party, the company would

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[286] Maloney (1985) 416.
[287] Cassim (2012) 8.
[288] Estey (2000) 12.
[289] Cassim (2012) 12
[290] Maloney (1985) 411.
[291] Maloney (1985) 417; see McArthur v Times Printing Co 51 NW (1892) 216.
[292] Maloney (1985) 414.
[293] Maloney (1985) 415.
[294] Landmark Inns of Canada Ltd v Horeak (1982) Sask R 30.
[295] Maloney (1985) 415.

still have the choice to adopt the contract upon incorporation. This is plausible in that the contract is still in existence and therefore there is a basis for adoption of the pre-incorporation contract.[296]

The second relieving provision is that a party to the pre-incorporation contract may apply to a competent court for an order fixing obligations under the pre-incorporation contract as joint, or joint and several, or apportion liability between the corporation and the promoter as the court deems fit.[297] This is a sort of umbrella application enabling a party to the contract to apply to a court for apportionment of liability. This is a prominent feature of this jurisdiction.[298] The court's discretion is an independent one of whether the corporation has adopted the contract but subject to the express disclaimer from liability of the promoter under the contract.[299] This provision allows the court to balance the equities between the new corporation and the promoter.[300]

This provision is a great protective measure against the use of fly-by-night companies by the promoter who is desperate to rid himself of their personal liability. He does this by procuring shelf companies with little to no assets to adopt a pre-incorporation contract upon its incorporation.[301]

The third relief-bearing provision is where the sections proceed further by stating that if a pre-incorporation contract expressly provides that the promoter is neither bound nor entitled under the pre-incorporation contract,[302] thus creating a situation where the promoter is able to contract "out" its personal liability if the corporation is not incorporated or the contract is not adopted by the company upon incorporation.[303] This provision enables the promoter to contact out his primary liability, that being his liability upon a claim for breach of warranty, as well as his secondary liability under a court order imposing liability for the company's breach of a adopted pre-incorporation contract.[304]

Therefore, even though the company does not adopt the contract, then the promoter would not be held liable under the pre-incorporation contract. If this provision is included in the

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[296] Maloney (1985) 415.
[297] Estey (2000) 12.
[298] Cassim (2012) 20.
[299] Maloney (1985) 429.
[300] Maloney (1985) 429.
[301] Maloney (1985) 430.
[302] Maloney (1985) 411.
[303] Estey (2000) 12.
[304] Cassim (2007) 378.

contract, then the section under the CBCA does not apply to the current instance.[305] The right of the promoter to contract out his liability has come from common law as per the matter *Dairy Supplies Ltd v Fuchs (*hereinafter referred to as *"Diary Supplies*").[306] It was held that if there is sufficient evidence that the promoter had been promised that there would be no personal liability, then he could not be sued on this basis.

The scholars who are against the enactment of this specific section has put forth the argument that it is unfair to allow a promoter to exempt himself from liability with no guarantee that the corporation is incorporated and would adopt the contract.[307] Essentially the argument revolves around the fact that the third party would be uncertain as to what recourse would be available to him.

It has been confirmed in the *Landmark Inns*[308] matter that the contract must contain a specific and clear provision exempting the promoter from liability. This brings the common law in line with the interpretation of the section as put forth in section 14 of the CBCA.[309]

Prior to the legislative enactment of the abovementioned sections, it was up to the courts to ensure that legislature was given the correct interpretation and effect, however it seemed the opportunity has fallen through the cracks with various conflicting decisions.

The first matter that dealt with pre-incorporation contracts under the newly enacted legislation in Ontario was the *Westcom Radio Group Ltd v MacIsaac (*hereinafter referred to as "*Westcom"*) matter.[310] Here the Defendant entered into a series of contracts with the Plaintiff regarding placing advertisements on behalf of a company, which both the Defendant and the Plaintiff mistakenly believed that the company had been incorporated. Based on the mistaken belief the Defendant signed in her capacity as director and as a signing officer of the company. The Plaintiff's action for damages under the contract was dismissed.[311] The Plaintiff then appealed to the Divisional Court which matter was ultimately also dismissed.

The trial court relied upon the decision of *Black*[312] and therefore concluded that the Defendant was not personally liable due to not signing in her personal capacity as well as the lack of

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[305] Maloney (1985) 426.
[306] Dairy Supplies Ltd v Fuchs (1959) 18 DLR (2d) 408.
[307] Maloney (1985) 428.
[308] Landmark Inns of Canada Ltd v Horeak (1982) Sask R 30.
[309] Maloney (1985) 429.
[310] Westcom Radio Group Ltd v MacIsaac (1989) 70 OR (2d)591.
[311] Estey (2000) 14.
[312] Black v Smallwood (1966) 177 CLR 52.

evidence that the parties intended that the Defendant would be bound personally. The judge then examined subsection 21(1) of the OBCA and the specific usage of the word "contract" where upon he concluded that this agreement did not conform to the definition of a contract and was therefore a nullity, causing the parties to fall back upon the common law principles as the section would not be applicable.[313]

The conclusion reached by the judge in this matter went completely against the legislative intention of enacting section 21 of the OBCA. The section was applicable in this instance and was to be followed.[314]

After the abovementioned matter, the Ontario Court of Appeal heard various matters on pre-incorporation contracts. One of these matters dealt with the meaning of adoption within the ambit of section 21 of the OBCA. In *Sherwood Design Services Inc. v 872935 Ontario Ltd (*hereinafter referred to as "*Sherwood*"),[315] an agreement to purchase the Plaintiff's assets was signed by individual Defendants "in trust for a corporation to be incorporated". The Defendant's attorney later wrote a letter stating that the Defendant company had been designated as the purchaser and that the documents would be signed at closing of the sale.[316]

The deal then fell through and the designated shelf company was ultimately designated to another client. The Plaintiff instituted a claim based on breach of contract and alleged that the purchase and sale agreement had been adopted by the corporate Defendant due to the lawyer's letter. This argument was supported by the majority of the Court of Appeal and the trial judgement was reversed, in that the Defendant's lawyer has taken an act that would constitute an act of adoption in terms of subsection 21(2) of OBCA.[317]

The *Sherwood*[318] decision laid down the foundation for the *Szecket v Huang (*hereinafter referred to as "*Szecket").*[319] In this matter the Plaintiff's entered into a contract with the Defendant on behalf of a company to be formed. The contract was to deal with the marketing of a newly developed technology. However, the contract was never performed, and the necessary capital was never produced, and the company was subsequently never incorporated. The Plaintiff's therefore sued the Defendant's for breach of contract.

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[313] Estey (2000) 15.
[314] Estey (2000) 18.
[315] Sherwood Design Services Inc v 872935 Ontario Ltd (1998) 39 OR (3d) 576.
[316] Estey (2000) 19.
[317] Estey (2000) 20.
[318] Sherwood Design Services Inc v 872935 Ontario Ltd (1998) 39 OR (3d) 576.
[319] Szecket v Huang (1998) 168 DLR 402.

The trial judge held the Defendant's personally liable, which the Court of Appeal accepted and confirmed but on a different legal basis. The trial judge followed the *Westcom*[320] decision in determining whether the agreement constituted a contract and concluded that there was indeed a contract. The trial judge then proceeded to the interpretation of subsection 21(1) of the OBCA and found that the Defendant was to be held personally liable.[321]

The Court of Appeal criticised the approached followed by the trail judge in that he relied on a mixture of common law principles as well as subsection 21(1) if the only principle to be relied upon was subsection 21(1). The court then examined subsection 21(1) of the OBCA and found that the Defendant is personally liable under the contract in terms of this section and that he was not excluded from the liability in terms of subsection 21(4) since the contract did not expressly exclude his liability.[322]

In the latest decision by the Ontario Court of Appeal, *1394918 Ontario Ltd v 1310210 Ontario Inc (*hereinafter referred to an "*Ontario"),*[323] the Defendant signed an agreement in respect of the sale of land in its capacity as a promoter while the purchaser was described as "Raymond Stern in trust for a company to be incorporated and not in his personal capacity". The Defendant wrongfully asserted that the contract had been repudiated and this view was ultimately accepted by Mr. Stern, whereafter he claimed damages for breach of contract.[324]

The Plaintiff company was ultimately incorporated, and Mr. Stern purported to sign over his rights and obligations to the company, which then sued the Defendant. The Defendant moved to have the matter dismissed based on the argument that the contract had been breached and came to an end, causing it to be impossible for the corporation to adopt the contact, thus making it unenforceable. This argument was ultimately rejected by the Court of Appeal and it was held that the Plaintiff corporation could enforce the agreement and institute proceedings based on it.[325]

This matter was important in that it solidified the aspect that if a promoter is held personally liable under a pre-incorporation contract, then he is also entitled to the benefits under the contract up until adoption has occurred. The court held, in this respect, that subsection 21(1)

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[320] Westcom Radio Group Ltd v MacIsaac (1989) 70 OR (2d) 591.
[321] Estey (2000) 23.
[322] Estey (2000) 25.
[323] 1394918 Ontario Ltd v 1310210 Ontario Inc (2002) 57 OR (3d) 607.
[324] Perell *Pre-incorporation contracts and 1394918 Ontario Ltd v 1310210 Ontario Inc.: Some answers, some questions* (2002) Canadian Business Law Journal 291, 292.
[325] Perell (2002) 292.

of the OBCA meant that the contract is created in statute and is aimed at meeting the needs of parties who wishes, has negotiated for, liability to be assumed by the corporation not yet formed. Therefore, if the promoter is held personally liable and bound by the contract then he would be entitled to the benefits as well.[326]

From the research on the position in Canadian law regulating pre-incorporation contracts, it is clear that under the legal regime we have five situations which could arise from the conclusion of a pre-incorporation contract.

The first situation is where there is no pre-incorporation contract as the agreement concluded falls outside the ambit of the relevant legislation. These agreements would have to be dealt with in terms of common law.[327] This was the case as in the decision of *Westcom.*[328]

The second situation is where there is a pre-incorporation contract but the contract contains no disclaimer regarding the liability of the promoter and the corporation does not adopt the contract.[329] In these instances the promoter and the third party would be bound by the contract while the promoter would also be entitled to the benefit under the contract.[330] At first glance, however it seems that no corporation could be held liable as no adoption occurred, but the third party can elect to approach a court to make an order regarding the apportionment of liability between the promoter and the corporation.[331] This situation was illustrated in the *Szecket* matter.[332]

The third situation is where the pre-incorporation contract does not contain a disclaimer clause regarding the liability of the promoter, but the corporation has adopted the contract upon incorporation.[333] Here the third party and the corporation is bound by the agreement and entitled to the benefits under the contract, while the promoter is relieved from his personal liability.[334] This situation was illustrated by the *Sherwood.*[335]

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[326] Nwafor *Company Promoters and the Enforcement of Pre-incorporation contracts* (2010) SA Merc LJ 66, 75.
[327] Perell (2002) 297–298.
[328] Westcom Radio Group LTD v MacIsaac (1989) 70 OR (2d) 591.
[329] Perell (2002) 301.
[330] Section 21(2) of the Ontario Business Corporations Act.
[331] Perell (2002) 302.
[332] Szecket v Huang (1998) 42 OR (3d) 400.
[333] Perell (2002) 302–303.
[334] Perell (2002) 303.
[335] Sherwood Design Services Ltd v 872935 Ontario Ltd (1998) 39 OR (3d) 576.

The fourth situation is where there is a pre-incorporation contract that contains a disclaimer regarding the liability of the promoter and the corporation adopts the contract.[336] In these instances the third party and the company is bound by the contract while the liability of the promoter is relieved, all the while the promoter is not exposed to an order under subsection 21(3) of the OBCA.[337] This matter was dealt with in the matter of *Ontario.*[338]

The fifth and final situation is where there is a pre-incorporation contract that contains a disclaimer regarding the promoter liability, but the corporation does not adopt the contract. In these instances, the contract would remain a nascent contract and no party could be sued under the contract. Here the promoter is not exposed by subsection 21(3) of the OBCA and there is no corporation to hold liable with the promoter.[339]

Thus, it is clear that the Canadian legislature properly catered for each possible situation that could arise from the use and conclusion of pre-incorporation contracts under the Canadian legislature.

4.5. Conclusion

During the discussions of both Australian and Canadian law regulating the provisions governing pre-incorporation contracts, I noted the various similarities between those provisions and the provisions within our South African law.

While there are many similarities, there are also distinct differences that the South African legislature should take note of and incorporate into our legal regime to ensure that there is a proper distribution of liability between the various parties to a pre-incorporation contract.

In the following chapter contains proposals on how the legislature should approach the aspect of pre-incorporation contracts to ensure that the distribution of liability is equitable. The recommendations are based on features from each of the foreign jurisdictions investigated.

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[336] Perell (2002) 304.
[337] Perell (2002) 305.
[338] 1394918 Ontario Ltd v 1310210 Ontario Inc (2002) 57 OR (3d) 607.
[339] Perell (2002) 305.

CHAPTER 5: SOME PROPOSALS FOR THE LEGISLATIVE REGULATION OF PRE-INCORPORATION CONTRACTS UNDER SECTION 21 OF THE COMPANIES ACT 71 OF 2008

5.1. Introduction

This dissertation took the reader on a journey from common law regulation to the first legislative regulation of pre-incorporation contracts under the Companies Act 61 of 1973 all the way to our current legislative regulation under the Companies Act 71 of 2008.

It concentrated on the lacunae of the Companies Act 91 of 1973 and took specific cognisance of the proposals set forth by various legal scholars and determined that the judiciary has, in fact, followed some of the proposals and incorporated them in the drafting and enactment of the Companies Act 71 of 2008. However, even though the judiciary could be commended for rectifying most of the lacunae in the previous Companies Act 61 of 1973 there are still some glaring holes that needs to be rectified.

After the investigation of our own legal regime, it proceeded to investigate foreign jurisdictions to take away the lessons they have to offer regarding the way they regulate pre-incorporation contracts. We specifically concentrated on the Australian and Canadian jurisdictions and compared them to our own legal regime to determine in which ways they are superior.

In the discussion below proposals on the regulation of pre-incorporation contracts are put forth to align our legal regime in with the foreign jurisdictions investigated. This will be done by taking various aspects from these jurisdictions to address the identified shortcomings.

5.2. The current regulation of pre-incorporation contracts in terms of section 21 of the Companies Act 71 of 2008 and the lacunae that needs to be rectified

In Chapter 2, the specific lacunae that need rectification were discussed: the lack of judicial discretion of South African courts; the use and abuse of fly-by-night companies by the promoters to avoid their liability; and the regulation of the interim period between the conclusion and the ratification by the company. Each of these will be discussed together with the proposed reformations.

It should be stated that our law currently follows the promoter liability approach even though some scholars are of the opinion that the legislature were rather to follow the statutory warranty approach.[340] Cassim has unequivocally stated that she was fully of the opinion that the latter was to be followed in the South African law. However, this discussion is in favour of the promoter liability approach since there is now certainty regarding the interim period between the conclusion of the pre-incorporation contract and the ratification of the contract.

A discussion of the proposals for the aspects regarding the lack of judicial discretion, the use of fly-by-night companies, together with some additional proposals will commence herein.

5.2.1. The lack of judicial discretion of the courts and the use of fly-by-night companies[341]

Under the current Companies Act, section 21 omitted the wide judicial discretion that would in effect empower the courts to better balance the liabilities between the promoter and the company based on the individual facts of each matter, by apportioning the liability between the promoter and the company.[342] The solution to this problem could be found in the way the Canadian and Australian judiciary regulates this aspect.

In subsection 21(3) of the Ontario Business Corporations Act the legislature made provision for a party to the contract to approach a court for an order fixing the obligations under the contract as joint, or joint and several or even apportioning the liability between the company and the promoter.[343] Upon such an application, the court can make an order it deems fit, just and equitable to the present set of facts. This aspect was later enacted into the federal legislation under subsection 14(3) of the Canadian Business Corporations Act.[344]

Widening the court's discretion in adjudicating these matters would act as a rectification of two of the current major lacunae we have within our law. This provision enables the judiciary to better balance the liability between the various parties by enabling and allowing the courts to apportion the damages between the company and the promoter. This is also an excellent protective provision against the use and abuse of fly-by-night companies by the promoters whom stand to be held personally liable under a contract that he concluded on behalf of a

[340] Cassim (2012) 13.
[341] See par 3.4.5 above for the full discussion.
[342] Cassim (2012) 19.
[343] Section 21(3) of the Ontario Business Corporations Act.
[344] Section 14(3) of the Canadian Business Corporations Act.

company to be formed, upon realising that the company may not be formed or that the company would not be ratifying the contract.[345]

There are various instances where it would be very much permissible to hold the company liable for a pre-incorporation contract which it did not ratify. This aspect is referred to as the secondary liability of the company. In other instances, it would also be permissible to hold the promoter liable for the company's breach of the contract after ratification. This aspect is known as the secondary liability of the promoter.[346]

The most common instance in which the company is to bear the liability, is when the promoter-turned-executive directors initially has the understanding that the pre-incorporation contact will be ratified by the company upon incorporation, but later upon being induced as executive directors then refuse to ratify the contract without any legal grounds to do so.[347] It would under no circumstances be just and equitable to hold the promoter liable for a decision taken by the company and to have the promoter pay damages to the third party for a decision in which he has no control and therefore no direct liability.[348]

Here the only way the liability would be equally distributed is by endowing the courts with the discretion to apportion or even impose the full liability of the promoter to the company whom is in control over the decision to not ratify. This discretion would also ensure that the third party is never left without any legal recourse for the damages that it has suffered on the account of the company.[349] The discretion that is to be endowed on the courts would not only be limited to the power to apportion the amount of liability between the promoter and the company but would also be endowed in order to validate a concluded pre-incorporation contract. This discretion would also be addressing actions of enrichment of the company at the expense of the third party.[350]

When concentrating on the secondary liability of the promoter, we need to look at instances where the promoter has elected to use a fly-by-night company in order to ratify a contract which became apparent to the promoter that the company is not going to ratify. It would be unjust and unequitable to leave the third party without any legal recourse due to the fact that the company has no viable assets or capital against which a court order could be executed,

[345] Cassim (2012) 20; Maloney (1985) 430.
[346] Cassim (2007) 379.
[347] Cassim (2007) 379.
[348] Cassim (2007) 379.
[349] Cassim (2007) 380.
[350] Cassim (2007) 380.

thus allowing the promoter to escape any form of liability.[351] This was illustrated in the Canadian matter of *Landmark Inns.*[352] The imposition of secondary liability on the promoter for the company's breach is a form of statutory piercing of the corporate veil due to the disregarding of the corporation's separate entity in order to impose the liability on the promoter.[353]

The discretion of imputing secondary liability to the promoter should however be capped and should not be extended so far as to hold the promoter primarily liable under the contract itself. The court's discretion should only be limited to apportioning the promoter's liability for his fair share of the damages suffered by the third party due to the company's breach of the contract.[354]

Based on the reasoning above it would be highly beneficial to the South African legal regime to endow the courts with a wide judicial discretion and empower them to make decisions regarding to the validity of the pre-incorporation contract. This would be the most effective manner in ensuring that the interest of all the parties is perfectly balanced and that the conclusion of a pre-incorporation would always be just and equitable.

5.2.2. The express exclusion of promoter liability in terms of pre-incorporation contracts[355]

Another instance that needs regulation in our law is the situation of a completely independent promoter whom would never turn to be a director of the incorporated company but whom is still to be held personally liable in terms of a pre-incorporation contract.

In these instances, we should take a page out of the Canadian and Australian legislative books in that these regimes allow for a promoter to exclude their personal liability in the contract itself. In terms of subsection 21(3) of the Ontario Business Corporations Act,[356] and subsection 14(3) of the Canadian Business Corporations Act,[357] the promoter is entitled to contract "out" his personal liability on the condition that the exclusion is in writing and contained within the

[351] Cassim (2007) 381.
[352] Landmark Inns of Canada v Horeak (1982) 2 WWR 377.
[353] Cassim (2007) 381.
[354] Cassim (2007) 381.
[355] See par 4.3.2 above for the full discussion.
[356] Section 21(3) of the Ontario Business Corporations Act.
[357] Section 14(3) of the Canadian Business Corporations Act.

contract itself. In the Australian legal regime this exclusion of promoter liability is contained within subsections 81(8) and 81(9) of the National Companies Code.[358]

It should be kept in mind that even though the proposal is given that the promoter and third party must be allowed to exclude personal liability in the spirit of the freedom of contract, but that the third party protection must never be circumvented in these instances.[359] In order for an exemption clause to be valid and binding the clause should be reduced to writing and the clause should be expressed in a manner that is depicted by plain language in order to ensure that an unsophisticated layman would in any and all instances understand what agreement they are concluding.[360] It has been stated in Canadian case law in the matter of *Landmark Inns*[361] and the matter of *Szecket,*[362] that implied exemption clauses would never be permitted.[363] This is an aspect which most definitely must be included within our law as it ensures that there is still third party protection in these instances.

Both the foreign jurisdictions have permitted that the exclusion clause could include not only the exclusion of the promoter's primary liability, that being the liability due to a breach of the dual warranty, but also extends to the exclusion of his secondary liability, this approach is followed in the Australian legal regime. However, this approach should be declined within our legal regime and the exemption clauses should be confined to contracting "out" only the primary liability of the promoter.[364]

5.3. The proposed reform of the current section 21 of the Companies Act 71 of 2008

This discussion culminates in the following proposals regarding the legal measures that need to be included within our legal regime to better balance the distribution of liability. These recommendations are based on the research conducted and the wording of the foreign jurisdictions considered. I recommend that the following (stated in bold print) be included in section 21 of the Companies Act and provide my explanation of this in the paragraphs below:

[358] Section 81(8)–(9) of the National Companies Code (1982).
[359] Cassim (2007) 378.
[360] Cassim (2007) 378.
[361] Landmark Inns of Canada v Horeak (1982) 2 WWR 377.
[362] Szecket v Huang (1998) 168 DLR (4d) 402.
[363] Cassim (2007) 378.
[364] Cassim (2007) 378.

"21. Pre-incorporation contracts:

A person may enter into a written agreement in the name of, or purport to act in the name of, or on behalf of, an entity that is contemplated to be incorporated in terms of this Act but does not yet exist at the time.

(1) A person who does anything contemplated in subsection (1) is jointly and severally liable with any other such person for liabilities created as provided for in the pre-incorporation contract while so acting, if-

(a) the contemplated entity is not subsequently incorporated; or

(b) after being incorporated, the company rejects any part of such an agreement or action.

(3) If, after its incorporation, a company enters into an agreement on the same terms as, or in substitution for, an agreement contemplated in subsection (1), the liability of a person under subsection (2) in respect of the substituted agreement is discharged.

(4) Within three months after the date on which a company was incorporated the board of that company may completely, partially, or conditionally ratify or reject any pre-incorporation contract or other action purported to have been made or done in its name or on its behalf, as contemplated in subsection (1).

(5) If, within three months after the date on which a company was incorporated, the board has neither ratified nor rejected a particular pre-incorporation contract, or other action purported to have been made or done in the name of the company, or on its behalf, as contemplated in subsection (1), the company will be regarded to have ratified that agreement or action.

(6) To the extent that a pre-incorporation contract or action has been ratified or regarded to have been ratified in terms of subsection (5)-

(a) the agreement is as enforceable against the company as if the company had been a party to the agreement when it was made; and

(b) the liability of a person under subsection (2) in respect of the ratified agreement or action is discharged.

(7) A party to the pre-incorporation contract may at any time apply to a competent court for an order validating the contract and/or fixing obligations under the contract as joint, or joint and several or apportioning liability between the corporation and the promoter, regardless of whether the pre-incorporation contract has been ratified, and upon such application court may make any order it thinks fit.

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

(9) Where a person purports to conclude a contract on behalf of a non-existent entity, the parties to the contract, may, exempt the promoter from any liability in relation to the contract, provided that:

- ***(a) the exemption clause is in writing and expressly contained within the pre-incorporation contract;***
- ***(b) the third party had expressly consented to the exemption;***
- ***(c) the exemption clause is signed by both the third party and the promoter;***
- ***(d) the exemption clause must be concluded simultaneously with the conclusion of the pre-incorporation contract.***

(10) Where the third party has, consented to the promoter being exempted from liability in terms of subsection (9) in relation to the pre-incorporation contract -

- ***(a) the third party is not entitled to recover damages from the promoter in terms of the pre-incorporation contract; and***
- ***(b) a court shall not, in proceedings under sub-section (7), order the promoter to pay to the third party any damages, or any proportion of the damages, that the company exclusively has been, or may be, found liable to pay to third party. "***

5.3.1. Explanation of proposed subsection (7)[365]

The proposed addition of the added subsection (7) deals with the proposal that our law should endow the courts with a wider judicial discretion regarding the aspects of pre-incorporation contracts. Therefore, this proposed section goes about doing just that, providing the courts with the judicial discretion it needs in order to validate concluded pre-incorporation contracts to ensure that the true intention of the contracts is given effect to between the parties. Providing the court with having the power to fix the obligations under a pre-incorporation contract as joint, or joint and several between the company and the promoter. Having the power to apportion the damages between the former parties as the court deems fit.

This is to the ultimate advantage of the third party as well as the promoter and the company. The advantage to the third party lies in the fact that he has a form of legal recourse in situations where promoters and companies allege that due to certain defects within the contract itself the contract has become unenforceable. This is done in an ultimate attempt to escape liability under the pre-incorporation contract, upon realising that the contract is no longer financially viable or beneficial to the company.

This provision is also to the advantage of the promoter and the company in that it provides them with a form of legal recourse if the third party attempts to unilaterally withdraw from the contract prior to incorporation or ratification of the contact. This is made possible due to the wording of the subsection in that it states that ratification is not a pre-requisite for the parties to approach the courts for an order in this respect.

5.3.2. Proposed subsections (9) and (10)[366]

The proposed addition of the added subsections (9) and (10) deals exclusively with the proposal that the South African law should provide the parties to the contract with the option of excluding the liability of the promoter. However, a blank exclusion of liability could give rise to a myriad of problems for the parties and the courts alike. Therefore, certain requirements have been added which is under discussion here. Non-compliance with the strict requirements

[365] See paragraphs 4.3.2 and 4.4.2 for the full discussion regarding the wider discretion of the courts in the Australian and Canadian jurisdictions.
[366] See paragraph 4.3.2 for the full discussion on section 81(7) of the National Companies Code as followed in the Australian jurisdiction, and paragraph 4.4.2 for the full discussion on section 21(3) of the Ontario Business Corporations Act and section 14(3) of the Canadian Business Corporations Act followed in the Canadian jurisdiction.

under the proposed subsection would result in the exemption clause being defective and the promoter would still be liable under the pre-incorporation contract.

5.3.2.1 Requirement 1 and 3: “Exemption clause is in writing and expressly contained within the pre-incorporation contract” and “The exemption clause is signed by both the third party and the promoter”[367]

In order to avoid a probable, he-said-she-said situation, we have included the requirement that the exclusion clause should be reduced to writing as well as having to be expressly stated in the pre-incorporation contract itself.

This provides a relief regarding the struggle of litigation upon verbal agreements, as this problem is expressly being curved in the requirement. This also functions as a manner in which to provide certainty for both the third party and the promoter regarding the terms of the exclusion of liability.

The appending of both the third party’s and the promoter’s signature to the exemption clause ties in with the requirement that the third party must consent to the inclusion of the exemption clause in that it denotes and depicts the consent as extended by the third party.

5.3.2.2 Requirement 2: “The third party had to expressly consent to the exemption”[368]

This requirement is added as a protective measure to the third party in that he would have to expressly consent to the exemption of liability and could therefore not fall into the trap of being unaware of the contents of the contract which he is concluding with the promoter.

What would amount to an “express consent” would be that a specific subclause should be included within the exemption clause itself wherein it is noted that the third party had given his consent to the inclusion of the exemption clause.

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[367] See paragraph 4.3.2 for the full discussion on section 81(7) of the National Companies Code as followed in the Australian jurisdiction, and paragraph 4.4.2 for the full discussion on section 21(3) of the Ontario Business Corporations Act and section 14(3) of the Canadian Business Corporations Act followed in the Canadian jurisdiction.

[368] See paragraph 4.3.2 for the full discussion on section 81(7) of the National Companies Code as followed in the Australian jurisdiction, and paragraph 4.4.2 for the full discussion on section 21(3) of the Ontario Business Corporations Act and section 14(3) of the Canadian Business Corporations Act followed in the Canadian jurisdiction.

If the third party is a close corporation or a private company the best manner to deal with this aspect is to have a separate special board resolution authorizing the exemption clause.

5.3.2.3 Requirement 4: "The exemption clause has to be concluded simultaneously with the conclusion of the pre-incorporation contract."

The inclusion of this requirement is to cater for the instances where a promoter becomes aware that the company would not be incorporated or that upon incorporation the company would refuse to ratify the pre-incorporation contract, and to escape liability forces or persuades the third party to conclude an exemption clause.

Having the requirement that both the exemption clause and the pre-incorporation contract having to be concluded simultaneously, thus removes the danger or possibility of the above occurring to the detriment of the third party. Thus, it operates as a protective measure in favour of the third party.

5.3.3. Proposed subsection (10)[369]

Subsection (10) deals with the liability of the promoter if an exemption clause was contained and concluded by the third party and the promoter in terms of subsection (9). The section in effect deals with two different situations. The first being the general liability of the promoter under the pre-incorporation contract, and secondly the situation where the court has made an order in terms of proposed subsection (7) which expressly stated that the company is to be held liable.

In terms of subsection (10)(a) the third party cannot hold the promoter liable under the pre-incorporation contract since a valid exemption clause had been concluded between the parties. Therefore, that the third party has extended his consent to the inclusion of the exemption clause and could therefore not plead ignorance in this regard to hold the promoter liable.

Subsection (10)(b) deals with the situation where a competent court had made an order in terms of subsection (7) stating that the company is to be held liable under the pre-incorporation

[369] See paragraph 4.3.2 for the full discussion on section 81(7) of the National Companies Code as followed in the Australian jurisdiction.

contract. Therefore, since an exemption clause has been concluded the promoter could not be ordered to be liable with the company, whether joint or joint and severally.

5.4. Conclusion

This discussion ranged from ascertaining the type of contract that a pre-incorporation contract is together with its requirements to be valid. It specifically concentrated on its common law basis and various case law which moulded and shaped the requirements and essence of a pre-incorporation contract. After determining and investigating what a pre-incorporation contract is under common law, it commenced with the investigation into how legislature has enacted and changed the legislature that regulates these types of contracts.

The dissertation considered the legislative enactment of the rules that regulated pre-incorporation contracts under the 1973 Companies Acts and the glaring gaps that needed to be addressed in the newly enacted 2008 Companies Act extensively. Even though the 2008 Companies Act has filled some of the gaps there are shortcomings that remain.

This piece set out to investigate what foreign jurisdictions could be considered and lessons learned in order to draft viable proposals to fill these remaining gaps. I looked at the Canadian and Australia jurisdictions and how they differ from our legal regime while taking cognisance of the ways in which these jurisdictions deal with these issues.

After this extensive research endeavour, the piece puts forth the various proposals that would be beneficial in developing our legal regulatory regime for pre-incorporation contracts.

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