UNIVERSITY OF KWAZULU-NATAL

An analysis of corporate capacity and authority of agents under South African company law

By

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DECLARATION

I, Sthembiso Ishmael Mbhele, hereby declare that:

1 the research reported in this dissertation is my original work, except where otherwise indicated;

2 this dissertation has not been submitted for any degree or examination at any other university;

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   a their words have been re-written but the general information attributed to them has been referenced; and

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DEDICATION

I dedicate this research to my children Samkelo Clint Mbhele, Velokuhle Nkosinothando Mbhele and my beautiful wife, Zanele Mbhele. Their unconditional love, support and patience inspire me to be better with each day. They are my pillar of strength.

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ABSTRACT

The common-law *ultra vires* doctrine has played a major role in the development of company law globally. It simply entails that if a company or its directors entered into an agreement or conducted activities that were beyond its legal scope of powers, that contract or conduct was illegal and would be rendered void *ab initio*. This doctrine followed the common-law principle that when a company was formed, it could only conduct business within the limited scope as prescribed by the company's charter or constitution. It protected interests of shareholders of the company where a contract was entered into either without their consent or without all the internal requirements having been complied with. However, its application became problematic as expecting company executives to obtain shareholders' approval for all intended transactions would render business untenable. Also, companies abused the doctrine by simply invoking it in order to escape performance of certain contractual obligations. Hence, several legal principles such as the Turquand rule and the doctrine of Estoppel were introduced in order to balance the interests of all parties. The Turquand rule simply protects bona fide third-parties transacting with a company from suffering harm due to the company's failure to comply with its internal procedures. This rule proscribes companies from escaping liability from a valid contract solely on the grounds that it was *ultra vires*. Although the rule was incorporated into the Companies Act 71 of 2008, section 20 (7) and (8) of the Act is seemingly confusing regarding the application of the *ultra vires* doctrine in tandem with the Turquand rule. Evidently, there are gaps that need to be addressed regarding the interests of shareholders and third parties who transact with the company. Hence, this study sets out to critically analyse corporate capacity and how the *ultra vires* principle on the company and its agents has evolved. The research will further explore the Turquand rule, portray the challenges encountered in the interpretation and application of the rule in South Africa, and ascertain its future in the corporate system. The doctrines of estoppel and constructive notice will also be discussed in the study.

Keywords: common-law, estoppel, third-party, Turquand rule, *ultra-vires*

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CHAPTER 1: RESEARCH OVERVIEW

1.1. Introduction and background to the study

The common-law doctrine of *ultra vires* has played a major role towards the development of company law worldwide. The doctrine simply means that if a company or its directors entered into an agreement or conducted activities that were beyond its scope of powers, that contract or conduct was unlawful or contrary to public policy (Rajak, 1995). The Latin term *ultra vires* simply refers to going beyond one's legal powers. This doctrine followed the common law principle that when a company was formed it could only conduct business within the limited scope within which it was formed and such scope was influenced by the company's charter or constitution (Griffin, 1998). Under common law any contract entered by the company's directors which was not in accordance with the constitution of the company was void *ab initio* (Rajak, 1995). This offered more protection to the shareholders of the company who would claim that a contract was entered into either without their consent or without all the internal requirements having been complied with.

Third parties were assumed to have knowledge of whether the persons entering into the agreements had the express power to do so. Such was termed the doctrine of "constructive notice" (*Ernest v Nicholls*, 1857). This doctrine placed a difficult and somewhat impracticable onus on third parties as this would require one to have sensitive knowledge including voting procedures and quorum requirements. However, its application became problematic as expecting company executives to pass all their intended transactions for approval by shareholders would render business untenable. Also, it became apparent that the doctrine became subject to abuse by companies wherein companies could enter into agreements which would benefit them and thereafter refuse to perform obligations attached to such agreements on the basis that such agreements were *ultra vires* (Delport, 2011). Hence, the doctrine stifled the interests of third parties to whom companies contracted with as there was no protection for them.

Several legal principles were thereafter introduced with a view to balancing the scales by protecting the interests of third parties. Some of these principles include the Tarquand rule as well as the doctrine of estoppel. The doctrine of estoppel simply precludes a company or its principals from denying liability against a third party when the company or its principal has acted in such a way as to mislead the third party into believing that the agent has actual authority, and the third party acted on such misrepresentation (*Makate v Vodacom (Pty) Ltd*, 2016). The Turquand rule, also referred to as the indoor management rule, was imported into South African law from England as an exception to constructive notice. Simply put, the rule emanated from the English court case of *Royal British Bank v Tarquand* (1856) which was primarily concerned with the limitation placed by the constitution of the company on powers of its directors to transact on its behalf. Summarily, the court developed a principle that a bona fide third party should not suffer harm due to the company's failure to adhere to its internal processes. This rule applies even when the third party has or should have constructive knowledge of the formalities as required by the company's constitution. It maintains that a third party is not mandated to enquire before entering into a transaction. The effect of the rule is to ensure that companies cannot evade accountability from a valid contract solely on the basis that the contract was *ultra vires* (Cassim, 2012). This rule has since been integrated into the South African legal system and has been in effect ever since (*Tuckers Land and Development Corporation (Pty) Ltd v Perpellief*, 1978). It worthy to note that the Turquand rule now applies to different areas of law in South Africa (*The Mine Workers' Union v Prinsloo*, 1948).

The *ultra vires* has since lost its traditional effectiveness as company law in most countries, including South Africa, is now being regulated by legal instruments such as statutes or Acts of parliament. It is a trite rule that where common law is at loggerheads with a statute, then a statute takes precedence. In addition, companies now simply add subjective objects clauses in their constitution, the clauses of which give directors powers to carry out any business transactions related to the company which could benefit its shareholders. In South Africa, for instance, the constructive notice doctrine was expunged by the introduction of section 20 (7) of the Companies Act 71 of 2008 which entitles a bona fide third party to assume that the company's formal procedural requirements prescribed by the Act, its memorandum of incorporation and its rules

have been fulfilled, unless the party “knew or reasonably ought to have known” of any shortcoming or lack of compliance. Hence, the doctrine has been diluted (*Bell Houses Ltd v City Wall Properties Ltd*, 1966).

It is clear from the above that the Turquand rule is now commonplace in South African corporate law. However, there is still confusion as to whether the rule is applied in accordance with section 20 (7) of the Companies Act of 2008 or common law as prescribed by section 20 (8). Section 20 (8) provides that the statutory indoor management rule must be interpreted in tandem with the common law rule. Scholars have noted that there seems to be a sharp contrast between the legislative and the common law rules (Jooste, 2013; Cassim, 2012). The common law rule does not protect a person who “knew” that an internal requirement was not fulfilled, while section 20 (7) not only proscribes protection to a third party who “knew” but also to a party who “reasonably ought to have known” of nonfulfillment of the formal requirement prior to the transaction taking place (Cassim, 2012). This therefore begs an inquiry into the significance of such a contrast and the effect thereof in drawing a line between the two. One assumption may be that the statutory rule is narrower than common law. Also, if a distinction between the two is material, it begs the question as to which rule should take precedence as the Act requires both to be construed concomitantly.

Therefore, after examining the literature in this field of corporate governance and company management, it has become evident that there are gaps that need to be addressed regarding the interests of shareholders and third parties who transact with the company.

1.2. Problem statement

As already highlighted above, although principles such as the Turquand rule and estoppel were introduced to counteract the *ultra vires* doctrine, it must be noted that strict compliance with corporate governance principles pertaining to legal capacity to transact on behalf of a company is still a challenge in the current South African economy, particularly in state-owned and private institutions. Reports of scandals involving senior company executives entering into transactions either without following

due process or without obtaining consent from appropriate structures is a major cause for concern. This in turn results in unfavourable consequences for the company, its employees, shareholders, third parties transacting with the company, and the economy at large. A typical example is the current court case *of Makate* (*Makate v Vodacom (Pty) Limited,* 2016) in which the issue of the capacity or authority of a company's employee who entered into an oral agreement with a third party was tested in the Constitutional Court. The Constitutional Court, in its ruling in favour of Makate, ordered that he should be compensated, and such decision could potentially result in the company losing million or billions of rands. It must be noted that while the Constitutional Court ruled in favour of Makate, settlement regarding the appropriate compensation due to him had not been reached at the time of this research.

1.3. Purpose of the study

The study seeks to critically analyse the way capacity of the company is determined and how the law has evolved regarding when a company or its agents act beyond its capacity. The research also outlines the legal implications where directors or agents act beyond their authority. The study will also compare and analyse existing legal principles, particularly the common-law *ultra vires* doctrine, estoppel and the Turquand rule in South African corporate law. The research will further explore the Turquand rule, portray the challenges encountered in the interpretation and practical application of the rule in the South African context, and ascertain its future in the corporate legal system.

1.4. Research Objectives

The following specific objectives guide the study:

a) To explore the method in which capacity of the company is to be measured and how the law has been fundamentally developed as far as the conduct of directors and company employees acting beyond their authority.

b) To examine the effectiveness of the Companies Act in addressing the capability of a company to transact with third parties and the protection offered to the shareholders and third parties alike.

c) To investigate the level of understanding on corporate capacity and the relevant legal doctrines among company executives who engage in day to day transactions on behalf of their respective companies.

1.5. Research Questions

The questions that underpin the study are presented below:

a) What is the current position on corporate capacity and the authority of agents under South African law?

b) Is the *ultra vires* doctrine still relevant in South African legal system?

c) What are the challenges encountered in the interpretation and practical implementation of the Turquand rule in the present day context?

d) What is the future of the Turquand rule in determining corporate capacity?

e) Are company agents aware of the current legal position relating to corporate capacity?

1.6. Importance of the study

This research is important in that:

- It seeks to identify the challenges or shortcomings encountered in the interpretation and practical application of the legal principles underpinning capacity and authority of corporate agents in South African law.

- There is limited research that investigated and measured the effectiveness of these legal principles and the current legislation in the present-day corporate

sector. This study will contribute towards generating new knowledge and also lead to further research on the topic.

1.7. Expected outcomes of the study

This study seeks to examine a phenomenon that is at the very core of the day to day operations of corporations in South Africa. It is significant as it sets out to clarify how a company delegates its powers to its representatives who go out to conduct day to day activities on the company's behalf with ostensible authority since the company cannot act on its own. It seeks to understand how the theoretical doctrines of *ultra vires* and Turquand rule are applied when solving practical business problems relating to authority of company agents. The study will be able to clear the confusion with respect to the relationship of these common law principles with the statutory principles that have either improved or abolished them. This study will also be able to measure the effectiveness of these principles in the current South African corporate system.

1.8. Chapter organisation

Chapter 1 has provided an introduction to the study, the problems the study intends to identify, and its significance to the body of research.

Chapter 2 shall entail an analysis of the literature encompassing the study. In the chapter, the evolution of the concept of corporate capacity in South Africa shall be discussed, with several doctrines such as *ultra vires*, constructive notice, estoppel and the Turquand rule forming the core of the discussion.

Chapter 3 will focus on the research design and methods to be applied in the research.

The findings of the data collection methods used in the research shall be highlighted in Chapter 4.

Chapter 5 will thereafter discuss the results of the interviews in detail.

Chapter 6 shall conclude by providing the overall findings from the literature and the research itself. The limitations of the study as well as recommendations shall also be outlined in Chapter 6.

1.9. Conclusion

It must be noted that a company, as a juristic person, operates separately from those who own it. It is incapable of handling its own day-to-day dealings and, as such, reliance is placed on crucial stakeholders such as directors, managers and employees. When the company contracts with third parties its legal capacity, or the capacity of its representative, must be clarified so as to curtail *ultra vires* transactions. Hence, the *ultra vires* principle was essential in safeguarding the company and its shareholders. As the doctrine lost traction due to abuse and legislative reform, several doctrines such as constructive notice, estoppel and the Turquand rule. However, strict compliance with corporate governance principles pertaining to corporate capacity and legal authority in South African companies is still a huge challenge despite the prevalence of the principles such as the Turquand rule.

In light of the above, this research set outs to provide a critical analysis of corporate capacity and its evolution in South Africa. It sets out to test the effectiveness of current common law and legislative provisions relating to the capability of a company to deal with third parties, and to determine how the concept of capacity is understood by company executives who actively participate in the daily dealings of their respective companies. The research is vital as it investigates how the applicable doctrines are practically applied in real life challenges relating to authority of company agents and it measures their effectiveness. An outline of the whole study has been provided in this chapter.

CHAPTER 2: LITERATURE REVIEW

2.1. Introduction

Although a company is a legal persona, it cannot trade on its own. It therefore relies on its employees or agents to act or contract on its behalf. However, such employees or agents must possess the legal capacity to transact on the company's behalf, lest their actions will be rendered null and void. As such, the capacity of a company simply refers to its legal competency as prescribed by its memorandum or constitution, with such powers being enforced by employees specifically delegated to do so. This is in line with the *ultra vires* doctrine which dictates that a company cannot perform any other objects falling outside the objects of its memorandum (Cassim, 2012). Where the company acted or performed a transaction falling outside the scope of its powers or its legal capacity, such transactions would be rendered null and void with no possibility of being ratified (*Ashbury Railway Carriage and Iron Co v Riche*, 1875). The *ultra vires* doctrine is undoubtedly the focal point from which corporate capacity was birthed and can be understood in the South African corporate system. The doctrine evolved and found its way in South African law. However, other doctrines such as the Turquand rule, constructive notice, estoppel, and legislation such as the Companies Act of 2008 have evolved the issue of legal capacity to such an extent of ascribing a company legal authority and capabilities of an individual and unrestricting legal capacity (Cassim *et al*, 2012).

In this chapter a discussion on the evolution of corporate capacity will be undertaken, with particular attention to the doctrines such as *ultra vires*, constructive notice, estoppel and Turquand rule. This chapter will also highlight the challenges encountered in the interpretation and implementation of the Turquand rule and its future in our legal system.

2.2. The evolution of corporate capacity in South Africa

2.2.1. Ultra vires doctrine

2.2.1.1. Development and application of the doctrine

The term "*ultra vires*" refers to action or a transaction performed by an individual on behalf of a company which, though not unlawful or against prescripts of public policy, falls outside the legal scope of the organization outlined by the acts or principles governing it (*Durban City Council v Glenore Supermarket and Café*, 1981). Historically, the doctrine sought to protect shareholders and their monetary interests from unauthorised or fraudulent conduct by members of the company as well as protecting third parties, particularly creditors (*Ashbury Railway Carriage and Iron Co*, 1875).

If must be noted that two requirements must be met in determining whether a particular transaction is *ultra vires*. Firstly, the company was required to have the legal capacity to transact in line with the objects contained in its memorandum of association. Secondly, it had to give the member representing it the authority or delegated power to transact on its behalf. In the absence of the former, the company had no legal existence and, in the absence of the latter, whatever agreements entered into without the company's consent or authority were without force or effect.

In section 52 (1) (b) of the Companies Act 61 of 1973, it became obligatory for an entity to outline its objects in the memorandum in order to give legislative effect to the common law doctrine.

The doctrine was also adopted by section 33 (1) of the Constitution of the Republic of South Africa which necessitates administrative action to be legal, rational and procedurally fair (Constitution, 1996). The conduct of an administrator when measured against the *ultra-vires* doctrine is considered in the context of the powers that have been given to him or her by the enabling legislation. This is a fundamental principle of constitutional democracy. Any *ultra-vires* action is relatively subject to review. This is

precisely so because the public has an interest in ensuring that the administrators do not operate outside their powers (Egert, 1986).

2.2.1.2. Consequences of the *ultra vires* doctrine

The doctrine historically sought to protect shareholders from irregular actions of directors that would have negative effects on their financial interests. Contracts which fell outside the scope and powers of agents were rendered null and void in law. Hence, they could not be implemented by the company or the third party contracting with it (Cassim, 2012). The effect would be that shareholders were absolved from any liability that arose and third parties would be left with little or no legal recourse, unless they could prove that the company benefited from the transaction.

According to common law, a company's memorandum or constitution is deemed as a contract governing the relationship of the company and its shareholders (*Hickman v Kent or Romney March Sheep Breeders' Association*, 1915). In the modern legal system, the same is established in section 15 (6) of the Companies Act 71 of 2008. Hence, shareholders are permitted in common law to approach courts to interdict the company from entering into and performing- *ultra vires* contractual agreements. Likewise, section 20 (4) permits shareholders to make an application to the High Court for an order interdicting the company from taking any action which contravenes the Act.

With regards to the internal dynamics of the company, the doctrine offered a yardstick for assessing the competence of a director or a company representative. If a director or agent exceeded their authority by entering into a contractual agreement falling outside the company's legal capacity, he or she would be held accountable for damages suffered by the company arising from breach of a fiduciary duty not to exceed his or her powers (*Cullerne v London and Suburban General Permanent Building Society*, 1890). Third parties would also hold the director or agent responsible for loss, damages or costs incidental to the cancellation or nullification of the invalid contract.

The doctrine was however affected by drafting techniques wherein companies would easily evade narrowing their objects by including every type of imaginable business in their objects clause, thus concealing the main business of the company. The effect of such techniques frustrated the original purpose of the *ultra vires* doctrine and opened more room for victimisation of innocent third parties (Cassim, 2012). Hence, as echoed by Wedderburn, this signified the death of the *ultra vires* doctrine as it was no longer practically useful (Wedderburn, 1966).

2.2.2. The doctrine of constructive notice

The common law constructive notice operated alongside the *ultra vires* rule in somewhat protecting a company's interests much to the detriment of third parties contracting with its directors' or agents. The doctrine was formulated in the English case of *Ernest v Nicholls* where the House of Lords held that third parties transacting with a company were presumed to understand the company's constitution or its public documents (*Ernest v Nicholls*, 1857). The effect of the doctrine was that a third party transacting with the company had no legal grounds for holding the company liable when he concluded a contract which conflicts with the company's objects, regardless of whether he inspected the company constitution or articles of association (Jooste, 2013). Hence, it had negative connotations for third parties. In the case of *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* (1964), Diplock LJ held as follows:

> "It operates to prevent the contractor from saying that he did not know that the constitution of the corporation rendered a particular act or a particular delegation of authority ultra vires the corporation. It does not entitle him to say that he relied on some unusual provision in the constitution of the corporation if he did not in fact so rely."

The strict common law doctrine was however abolished by section 19 (4), read with section 19 (5) of the Companies Act of 2008. Section 19 (4) of the Act provides that a person may not be considered as having knowledge of any document concerning a company simply because the document is filed or can be accessed at the company's office. Section 19 (5) (a) of the Act reintroduces a rather obscure doctrine. It states that a person must be presumed to know any or all content of the company's

memorandum of incorporation (MOI) if its name is suffixed with the initials “RF” and if the memorandum contains preventive conditions relating to the company. “RF” is simply an abbreviation for “Ring Fenced”.

In terms of section 11 (3) (b) of the Companies Act, if a company’s MOI includes any conditions restricting or prohibiting the amendment of its MOI, then the name of such company must be immediately followed by the expression “RF”. The use of “RF” is thus meant to alert third parties to the prohibitive conditions relating to the company (CIPC Practice Note 4 of 2012). As such, the doctrine of constructive note would only apply in limited circumstances under the Companies Act (CIPC Practice Note 4 of 2012). However, it is unclear whether this provision makes exception for innocent third parties without a legal background or rather a basic understanding of the connotations of the initials “RF”.

Jooste contends that the statutory doctrine is more positive in that it seems to favour both the company and third parties in certain circumstances (Jooste, 2013). Although the application of the statutory doctrine in line with modern doctrines such as the Turquand rule is questionable, its preservation may be necessary in dealing with claims based on supposed authority of a director or agent purporting to contract without actual authority to do so from the company (Cassim *et al*, 2012).

2.2.3. The doctrine of estoppel

It is a well-established principle that estoppel may be relied upon by a third party doing business with a company. As highlighted in Chapter 1, when a company or its principal act in such a way as to mislead a third party into believing that the agent has authority, and the third party acted on such misrepresentation, then the third party can rely on the doctrine of estoppel (*Makate*, 2016). Estoppel is crucial when considered against the partial abolition of the *ultra-vires* rule in which a person cannot have actual authority to conclude contracts falling outside the company’s contractual capability. The sole basis upon which estoppel is used as a valid protection tool is when a third party has relied on the ostensible authority of a director or a person purporting to be

an employee of the company. Ostensible authority simply arises when a company or its board of directors creates an impression, through words or conduct, that a director or employee of the company has been properly authorised to contract on its behalf. A third party relying on ostensible authority of an agent of the company may be allowed to hold the agent liable or prevent the agent or the company from benefitting from misrepresentation. In *NBS Bank Ltd v Cape Produce Co (Pty) Ltd* (2002) the court held that for an aggrieved third party to rely on the doctrine, the following elements must be satisfied:

a) there ought to be representation either by word of mouth or by conduct;
b) the representation should be made by someone with actual authority such as a director;
c) the purported principal should rationally have expected the outsider to act on it;
d) the outsider must have depended on the representation and acted on it;
e) the reliance must be reasonable; and
f) the third party must have suffered prejudiced as a consequence.

Therefore, a company or its purported principal will be estopped from either relying on the ultra vires doctrine or rejecting the purported agent's authority if the above requirements have been met.

2.2.4. The Turquand rule

2.2.4.1. The common law rule

The rule was formulated by the House of Lords in the English court case of *Royal British Bank v Tarquand* (1856) in which the limitation imposed by a company's constitution on the powers of the directors to transact on its behalf was questioned. The court declared that a bona fide third party should not suffer harm due to the company's failure to adhere to its internal processes. The court further iterated that such protection applies even when the third party *may* have constructive knowledge of the internal requirements, but does not have knowledge of whether they have been fulfilled. It further held that the obligation is not on the third party to enquire before entering into a transaction. The effect of the rule is to ensure that companies do not

evade responsibility for contract merely because the contract was *ultra vires* or by simply invoking the doctrine of constructive notice (Cassim *et al*, 2012).

Also referred to as the indoor management rule, it is an exception to the *ultra vires* principle and constructive notice. It protects third parties trading in good faith without knowledge of any internal hurdles affecting the validity of their transactions with the company. Good faith is an important factor determining whether a third party should rely on the rule. A party acting in good faith is not mandated to enquire if the internal formalities were fulfilled, unless he or she knows or suspects otherwise and deliberately concludes the agreement (*Burnstein v Yale*, 1958). One can assume that when contracting, the company or its agent has complied with these internal formalities. In consequence, the company will be prevented from denying liability over a contract on the basis that the requirements were not fulfilled or that the agent lacked capacity (*Mahoney v East Holyford Co Ltd*, 1875). However, directors and other company employees are prevented from relying on this rule as they are expected to be well-versed with the internal formalities of the company, except in exceptional circumstances (*Howard v Patent Ivory Manufacturing Co*, 1883).

This rule has since been integrated into the South African legal system and has been in effect ever since (*Tuckers Land and Development Cooperation (Pty) Ltd v Perpellief,* 1978) albeit with significant changes.

2.2.4.2. The statutory Turquand rule

It must be noted that the rule was introduced in section 20 (7) and (8) of the Companies Act of 2008. In terms of section 20 (7) a third party acting in good faith is entitled to presume that the company's formal procedural requirements prescribed by the Act, its memorandum of incorporation and its rules have been satisfied, unless the third party "knew or reasonably ought to have known" of any lack of compliance. This provision reinforces the common law rule. It further excludes third parties who ought to have known of the internal formalities of the company. It also retains the common law proscription to third parties such as a director, shareholder of officer of the company

as they are expected to have reasonably known of non-compliance with the company's requirements due to their exposure to the records and minutes of meetings of the company (Cassim, 2012). Hence, section 20 (7) is regarded as the statutory Turquand rule.

Section 20 (8) maintains that subsection (7) must be interpreted simultaneously with any common law principle giving effect to supposed validity of a company's actions. This provision preserves the common law rule. It calls for the interpretation and application of the statutory rule, but in tandem with common law. The phrase "concurrently with, and not in substitution for" seems to imply that the common law aspect is still functional and not overhauled by the statutory rule in any way. The application of both provisions may however be problematic, let alone impracticable, as there seems to be a sharp contrast between them (Jooste, 2013). The conflict on both aspects will be highlighted below.

2.5. Challenges encountered in the interpretation of the Turquand rule

While the wording of section 20 (8) implies that the statutory and common law Turquand rule co-exist, there appears to be a dichotomy of these rules in certain aspects. It is presumed that these differences may stem from legislative oversight. Firstly, while common law does not shield a party who knew or assumed that formal requirements were not satisfied, section 20 (7) goes further to exclude a party who "knew or reasonably ought to have known" of the nonconformity. According to Cassim, the statutory rule weakens any assumption that may be made by third parties regarding compliance with internal requirements (Cassim, 2012). As such, the statutory rule can be regarded as narrower compared to common law tenet.

Secondly, the reason why common law indoor management rule entitles a party to assume that formal processes were observed is that a third party may have limited or no access to company records or minutes of proceedings. However, the statutory rule proscribes such protection to the third party as it places an onus on the third party to presume that all company procedures clearly laid down by the Companies Act are

complied with. This statutory requirement may seriously affect innocent and unsophisticated third parties with little or no knowledge of any company law prescripts.

Thirdly, common law protects third parties and there have also been cases where insiders such as directors other than the ones who acted on the company's behalf in the subject matter, shareholders and employees enjoyed the protection of the rule, for instance in the English case of *Hely Hutchinson v Brayhead Ltd* (1967). However, the statutory indoor management rule clearly prevents a director, a shareholder or an employee from relying on the rule. It is unfortunate that the statutory rule fails to make exception for innocent insiders, who are just as vulnerable as third parties to the company. For instance, if a company or its board of directors disposes of a larger part of its assets to a third party without complying with the formal requirements prescribed in section 112 (2) (a) of the Companies Act, and a disgruntled shareholder seeks relief from a court in terms of section 20 (4) of the Act which entitles a shareholder to approach a court for an order to restrain it from contravening any provision of the Act (which, in the case is non-compliance with section 112 which requires a special resolution by shareholders approving the sale or disposal assets), it is unclear whether the court would protect a third party by invoking section 20 (7) or protect the disgruntled shareholder in terms of section 20 (4) of the Companies Act.

2.6. The future of the Turquand rule

Corporate governance is an essential component in promoting a company's growth, continuity and performance (Vaughn, 2006). It plays a crucial role in decision-making and simplifies the process of monitoring and managing risks as the business grows (Bradley, 2010; Wellalage & Locke, 2011). In the modern corporate environment, companies are required to adhere to good corporate governance principles in order to ensure ethical and effective leadership which in turn positively impacts the country's economy (King IV Report on Corporate Governance for South Africa, 2016). Good corporate governance enhances a company's ability to grow sustainably, limits risk of liability, and attracts investment and capital (Naidoo, 2009). The King III Report on Corporate Governance encourages companies to conduct business in an ethical and responsible manner. Likewise, the King IV Report advocates four main outcomes,

namely “ethical culture, good performance, effective control and legitimacy” (King IV Report on Corporate Governance for South Africa, 2016). Although the King Report is not a binding statutory instrument, it is highly encouraged for companies and it is compulsory for all companies listed (or planning to list) on the Johannesburg Stock Exchange (JSE Limited Listing Requirements, 2017).

Corporate governance recognises that the main source of discourse in a company relates to management, with the agency problem being one of the challenges. While proper agency relationships are encouraged in order to avert conflicts of interests between shareholders and management, and while theories such as the Turquand rule may exist in order to protect third parties, corporate scandals still exist. The Steinhoff saga and leadership challenges at some state-owned entities are clear proof that lack of attention on the issues of corporate capacity and corporate governance in companies may have catastrophic effects on the economy. The lack of knowledge by company executives on such pertinent concepts such as *ultra vires,* estoppel and the Turquand rule further exacerbates problems relating to corporate governance and capacity within the corporate environment.

As it stands, the distinction between the common law and the statutory indoor management rule may give rise to a set of problems if further clarity is not given. It is unclear whether the legislature, by giving effect to both the legislative and common law aspects, ought to develop or preserve the rule. It is also difficult to establish the legislative intention for the retention of both aspects in the absence of an explanation by the legislature. Hence, the distinction begs the question as to which rule should take precedence as the Act requires both of them to be construed concurrently without one overriding the other.

It must be noted that there is a general legal presumption that legislation should be construed in accordance with common law or at least change it as little as possible (Steyn, 1963). At the same time, the principle of constitutional sovereignty dictates that where legislation conflicts with common law, then legislation should be given priority (Dugard, 1997). Therefore, it is submitted that an amendment or repeal of

these provisions may be ideal to clarify the future of the Turquand rule in the South African corporate system.

2.7. Conclusion

It must be noted that the *ultra vires* doctrine has been substantial in the evolution of corporate capacity in the South African legal system. It absolved shareholders of a company from liability against contracts or transactions falling outside the company's objects as prescribed in its memorandum of association due to lack of capacity (Cassim, 2012). Where a company acted or performed a transaction falling outside the scope of its powers or its legal capacity, such transactions would be rendered null and void with no possibility of being ratified by the shareholders. However, with the advent of doctrines such as constructive notice, estoppel, the Turquand rule and legislation such as the Companies Act of 2008, the doctrine lost its effectiveness. The common law constructive notice, which operated simultaneously with ultra vires, has also became defunct with the prevalence of section 19 (4) of the Companies Act of 2008, although scholars contend that the statutory doctrine is more positive in that it seems to favour both the company and third parties in certain circumstances (Cassim, 2012).

Estoppel and the Turquand rule became vital in protecting interests of third parties, subject to specific conditions being met. A discussion of the evolution of the Turquand had been done in this chapter. It has been highlighted that there seems to be a distinction between the common law and legislative rules. The main distinction lies in the fact that while common law does not safeguard a third party who knew or assumed that internal formalities were not fulfilled, section 20 (7) goes further to exclude a party who "knew or reasonably ought to have known" of the non-compliance. Furthermore, the phrase in section 20 (8) that the statutory Turquand rule must be construed concomitantly with the common law tenet may however be problematic, let alone impracticable, as there seems to be a sharp contrast between the statutory and common law rule (Jooste, 2013). Hence, it is submitted that an amendment or repeal of section 20 (7) and (8) may be ideal to clarify the future of the Turquand rule in the South African corporate system.

CHAPTER 3: RESEARCH DESIGN & METHODOLOGY

3.1. Introduction

This chapter presents the design and methodology of the study. Firstly, the study area and target population are examined. Furthermore, the research methods for carrying out this research will be explained, the data collection and data analysis methods used will be examined. Lastly, the chapter discusses the ethical considerations of the study and the problems encountered during the research process.

3.2. Target population

This research was conducted in Durban, KwaZulu-Natal. The province is well-known for its natural resources, environmental advantages and its unique cultural heritage which make it a leading tourist destination. Its coastal advantage makes it the centre of trade and industry, with the ports of Durban and Richards Bay processing approximately 80% of the country's cargo tonnage. It is the country's leading timber producer, is the world's largest sand mining and mineral producer and is the leading producer of aluminium, with Richards Bay generating over 4% of the world's aluminium exports. It is the second largest contributor to South Africa's GDP (KZN Top Business Portfolio, 2017). In this light, business within the province plays a critical role in ensuring economic growth and effective corporate governance must be emphasised. However, there is very limited literature outlining the role of poor corporate governance or oversight as a vital factor contributing to corporate failure within the province and the country at large. Neneh and van Zyl contend that shortage of management skills and a lack of proper business training or education among entrepreneurs are some of the reasons resulting in a high failure rate of companies, particularly SMEs, in South Africa (Neneh & van Zyl, 2012).

The target population for this research were senior company executives in the KwaZulu-Natal province, particularly directors, senior managers and company employees conferred with the authority to negotiate and sign contractual agreements or represent their company interests in their day-to-day business activities. A total of ten (10) participants were interviewed. Furthermore, the participants were male and

female, the significance being to ensure equal gender representation and to solicit views from across all spectrums.

3.3. Methodology

An explorative qualitative research method was employed in this research. This was essential because qualitative research entails studying phenomena in their natural surroundings rather than in a restricted setting, hence enabling the researcher to develop the skill to examine the taken-for-granted aspects of the setting he or she studies (Heckman,1998; Schurink, 2003). Qualitative research is effective in tackling a relevant theory in a specified study area because it entails describing, interpreting, verifying and evaluating certain findings of the study and it further contributes to the enhancement of knowledge (Leedy & Ormrod, 2013). At this time of research, there was very limited research on the relationship between corporate capacity and the authority of agents in the South African context. Most of the literature discusses the concept of corporate governance and the need for promoting its practice in line with the King Code on corporate governance. Therefore, the qualitative research approach can greatly enhance our understanding of the issue of corporate capacity and the authority of agents in the South African legal context. In addition, a case study of the research topic within the KZN province was conducted.

3.4. Data collection

Two techniques of data collection were employed in the study. These techniques are discussed below.

3.4.1. Questionnaires

A semi-structured questionnaire was used in this research. A semi-structured questionnaire comprises of a set of questions that are designed to obtain the views of people on a particular topic (Barribal & While, 1994). According to Saunders and Lewis, the interviewer asks a set of predetermined questions in a semi-structured

interview in order to ensure coherence with responses obtained from the interviewees (Saunders & Lewis, 2012). The questionnaire was compiled in English and consisted of open and closed-ended questions. It carried two sections consisting of twenty three questions; the first section was a mere introduction to the topic and getting the participant to shed a bit of light on his or her company's composition, and the second section dealt with the critical questions relating to the corporate governance systems relating to corporate capacity in the participants' companies and it set out to measure their level of understanding of the concept of corporate capacity and the authority of agents in the South African legal context.

All the interviews were done on a face-to-face basis and interview schedules were set up with the consent of the interviewees. All the participants preferred to use English as the medium of communication. Copies of the questionnaire were distributed to the participants before the interview. A questionnaire is advantageous because it is objective, information gathering is quick and responses are collected in a consistent manner. An interview fosters meaningful engagement between the researcher and the participant. In addition, using a questionnaire is advantageous because it is easy to analyze and capture the collected data. The data in the interviews was collected through auditory and manual transcripts with the consent of the participants.

3.4.2. Observation

An observational technique was also used in this research. Direct or overt observation techniques were used together with the questionnaire technique. Although the questionnaire made use of written information, direct observation offered contextual data on settings, interactions, or individuals. Direct observation might allow a researcher to take part in the daily life of the people being observed and it eliminates the element of deception (Holigrocki et al, 1999). Facial expressions, demeanour and body movement provide substantial information about people's attitudes and feelings. Hence, through observation, the researcher was able to measure the emotions of disappointment, failure and optimism that were expressed by the respondents when they talked about the challenges they are facing and their accomplishments with regards to corporate capacity and corporate governance in their companies.

3.5. Data analysis

The data collected in the interviews was analysed and arranged into themes. Data analysis is a process or practice which entails the organising of raw data in order to extract useful information (Gilbert, 1996). In qualitative research, coding only occurs once all the data has been collected (Neuman, 2000). Data analysis was conducted manually by scrutinising all the results from the interviews and selecting themes that corresponded with the research objectives (Zikmund et al, 2013). The analyzed data was then presented in tables, graphs and charts using simple percentages (Daffield, 1998).

3.6. Ethical considerations

Research ethics are very important because cases involving the abuse of people's rights under the pretext of social research have been reported (Bless, 1988). Research ethics emphasise the humane and delicate treatment of research participants by identifying them based on degrees of risk to the research techniques. In other words, while researchers are entitled to explore the truth and knowledge, the rights of other individuals in society must also be respected.

As highlighted above, the nature of this research obliged the researcher to have interviews with corporate participants such as company directors, company secretaries, senior executives and scholars. Hence, legal and ethical considerations were taken into account from the data collection process to the finalisation of this research project. It is importance to note that consultation with the above participants may raise concerns of issues such as privacy or confidentiality. Company executives may not prefer to divulge much detail on their company background or give personal experiences as it may be construed as giving away inside information which is contrary to legislation such as the Companies Act 71 of 2008. Hence, approval from the ethics committee of this institution as well as informed consent from the participants was sought.

However, the researcher intends to closely study and sensitise with provisions of the applicable legislation, regulations, policies and industry codes such as the King IV Report on Corporate Governance. The research also prompts the asking of questions or soliciting of comments on existing cases which are already public record. Of importance is the fact that the research addresses a problem which is critical and probably beneficial to the participants. The researcher also built trust with the participants by being honest, avoiding collecting and reporting on harmful or sensitive information, and allowed the participants to participate and express themselves freely during the interviews. The research also undertakes not to plagiarise other people's work or falsify the data, findings and conclusions in the research. Hence, during the research process, the ethical issues highlighted below were considered.

3.6.1. Informed consent

In this research, an informed consent letter coupled with a copy of the research proposal, preliminary interview questions and a draft gatekeepers' letter were forwarded to the prospective participants in order to allow them to conduct due diligence, consult other stakeholders in their institutions, and make an informed decision before scheduling the interviews. During the interviews, the interviewees were given an introduction to the significant aspects of the research. Issues such as what the research is about and why it is being conducted were explained. This process was done both verbally and through a consent letter which was made the cover page of the questionnaire. The letter clearly clarified how voluntary participation was essential. In so doing, the researcher was able to have interviewees consent to take part in the study.

3.6.2. Confidentiality and anonymity

The researcher guaranteed that confidentiality and anonymity were maintained throughout this research. The research participants are legally and ethically entitled to retain the full right to complete confidentiality, unless they voluntarily waive the right. (Gilbert, 1996; May, 2001). In this research, the identities of the participants remained anonymous since their names and further details were not recorded in the

questionnaires. Instead, code numbers were used. Furthermore, the information provided by the interviewees is protected and stored in a safe place where it is unavailable to anyone other than the researcher.

3.7. Limitations of the Study

3.7.1. The study was limited to South African jurisprudence

As highlighted above, the study will be narrowed down to an analysis of the corporate capacity and the authority of company agents, with particular emphasis on the *ultra vires* doctrine and the Turquand rule in South African corporate law. Although it is trite to understand that most of these principles were imported from English law, an in-depth discussion of English law will not be undertaken and limited literature on English and international law will be used as the study mainly mirrors the South African legal context.

3.7.2. Insufficient data

Since the study was in the form of a qualitative research and also restricted to interviews with senior executives in private and state-owned entities in the KwaZulu-Natal region, the data or information collected was restricted to a limited focus group and literature will be restricted to books, journals, publications and case law. Hence, this study is limited as data collection methods used may not be sufficient enough to help the author in formulating new hypotheses on the problems that may be identified in the research.

3.7.3. Lack of prior research studies on the topic

Alluding to previous research studies is critical in literature review and it helps one to comprehend the research problem being investigated (Wiemann, 2005). This study, however, lacked prior research on the topic of capacity and the authority of agents, particularly juxtaposition of *ultra vires* and the Turquand rule, both common law and statutory. Therefore, this limitation may, on one hand, create an essential opportunity

to promote the need for further research and, on the other hand, hinder the researcher from gaining sufficient data necessary to formulate new hypotheses on the research topic.

3.8. Conclusion

The issue of corporate capacity and the authority of agents, though overlooked, is crucial in the daily decision-making process of a company. Daily reports of company executives being involved in contractual scandals and subsequent costly litigation beg the question as to whether company agents are aware of their legal boundaries when transacting on behalf of their respective companies. This research is significant in that it serves to scrutinise the elements of corporate capacity and to question their effectiveness in the current corporate dispensation.

It was highlighted that the study was conducted in KwaZulu-Natal and senior company executives such as directors and senior managers were mostly targeted and interviewed. Furthermore, qualitative research methods have been used in the form of semi-structured questionnaires and closed interviews with participants at which observation of the interviewees' facial expressions and body movement conveyed substantial information about their attitudes and feelings towards the concept under discussion. The data collection and data analysis methods used were also examined. In terms of the ethical issues surrounding the study, the researcher emphasised informed consent and confidentiality as the key aspects that underpinned the research. Lastly, the problems encountered during the research process such as insufficiency of the data collected, lack of previous research on the topic and the restriction of the study to the South African context were viewed as barriers most likely to hinder the author from formulating new hypotheses on the problems that may be identified in the research.

CHAPTER 4: FINDINGS AND DATA PRESENTATION

4.1. Introduction

The study findings are presented and interpreted in this chapter. The information will be presented in graphs, charts using percentages, figures and tables. The sections covered by the results include the following: the profile of the respondents, a discussion of corporate governance structures within the respective companies to which the respondents belong, a discussion of the availability of oversight measures, an examination of past challenges relating to poor corporate governance particularly lack of corporate capacity, a discussion of the responsive measures put in place to avoid future challenges relating to corporate capacity, and an enquiry regarding an understanding of current legal principles regarding corporate capacity by the respondents and their companies. General comments made by the participants during the interviews will also be discussed.

4.2. Section One: Profile of the respondents

Figure 1: Type of company

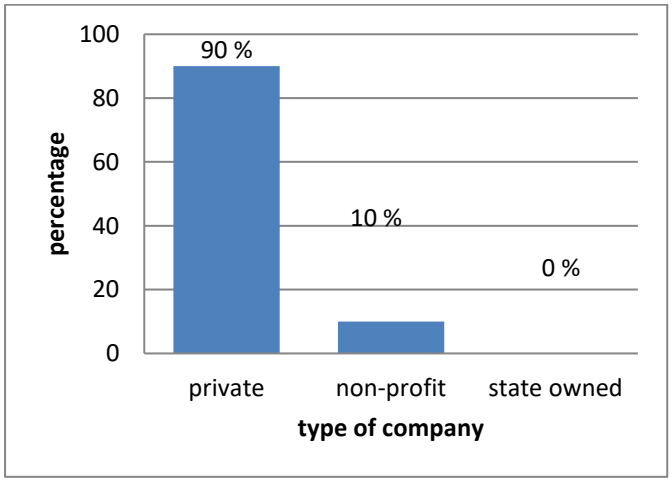
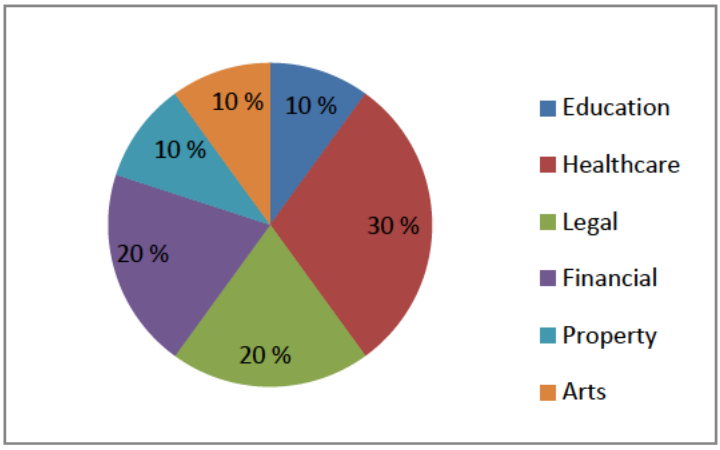


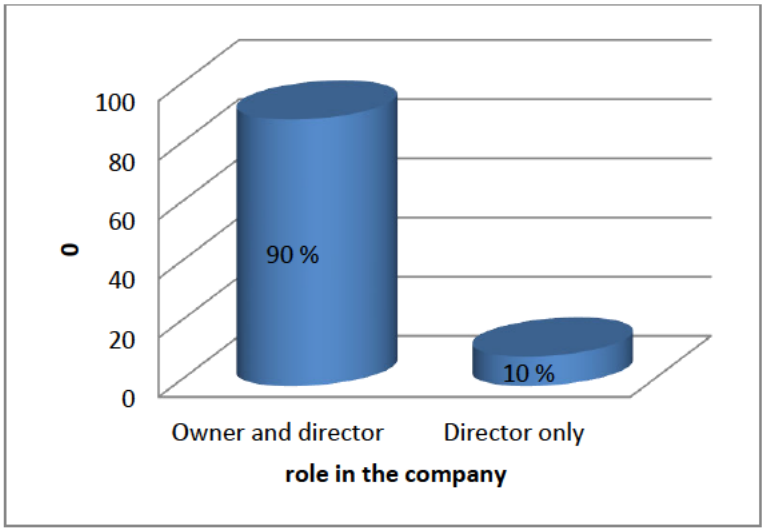
Figure one shows that 90 percent of the respondents were senior executives in private companies which are termed as “profit-making’ companies in the Companies Act. 10 percent of the respondents were from non-profit companies, popularly known as non-profit organisations (NPOs).

Figure 2: The sector or industry the companies operate



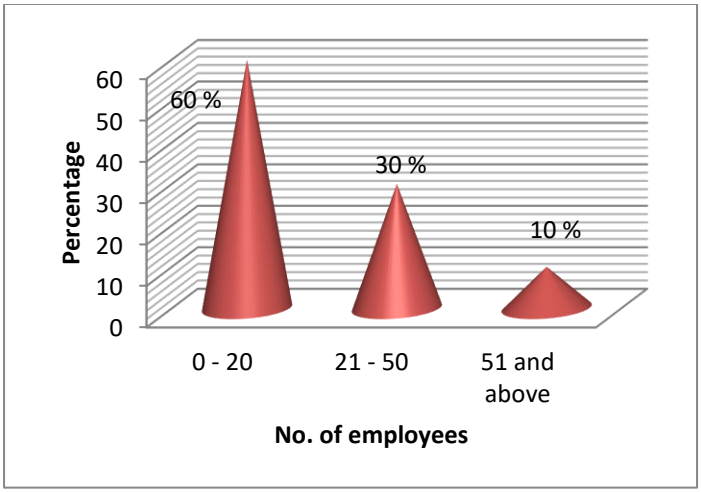
The above figure shows that out of the respondents who were interviewed, 30 percent were from the healthcare sector, 20 percent were from companies which offer legal services, 20 percent were from the financial sector, 10 percent represented property development companies, 10 percent specialised in arts and culture, and 10 percent were from private tertiary institutions.

Figure 3: The role of the interviewees in the companies



The data collected, as shown in figure 3, reveals that 90 percent of the interviewees were owners and also employed as directors of the companies, while only 10 percent of the interviewees were directors. This seeks to suggest that 90 percent of the owners were also directors in the companies.

Figure 4: The number of employees in the business



As can be seen in figure 4 above, 60 percent of the companies employ not more than 20 personnel, 30 percent employ between 21 to 50 employees, while only 10 percent of the interviewee's companies had over 50 employees.

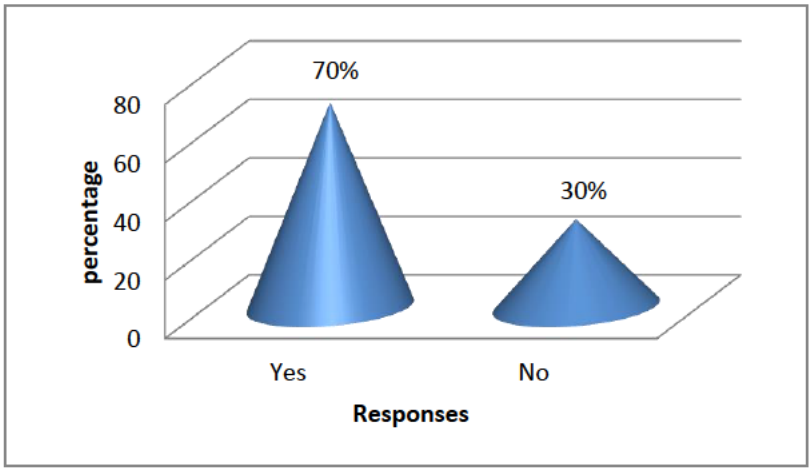
4.3. Section Two: Discussion of the corporate governance structures

Table 1: Does your company have a board of directors or an equivalent structure that provides oversight on the company's performance and relations with other stakeholders?

Company A	Company B	Company C	Company D	Company E	Company F	Company G	Company H	Company I	Company J
Yes	Yes	Yes	No	No	No	No	No	No	Yes

Table 1 shows that out of the ten interviewees, 40 percent confirmed that their companies had established structures to ensure compliance with corporate governance prescripts, while 60 percent of the companies did not have appropriate governance structures.

Figure 5: Does your company have practices or standards to regulate the delegation of contractual authority to directors?



Out of all of the respondents who were interviewed, 70 percent confirmed that their companies have standards in place to regulate the contractual powers of directors and agents, while 30 percent of the interviewees said their companies do not have such standards.

Table 2: Measures in place to deal with ultra vires matters

	COMPANY									
LIST OF MEASURES	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**I**	**J**
Establishment of Memorandum of Incorporation	x	x	x							x
Establishment of board of directors to ensure oversight	x	x	x		x	x	x			x
Establishment of board committees										x
Introduction of measures to ensure oversight of all existing and prospective contractual transactions by directors	x	x	x	x				x	x	x
Delegation of authority from the board to departmental managers	x	x								x

Introduction of written contracts for proposed transactions	**x**	**x**								**x**

In terms of Table 2 above, 40 percent of the respondents confirmed that their companies had put in place memoranda of incorporation which outlined the delegation and separation of powers amongst shareholders, directors, managers and company employees. 70 percent of the interviewees highlighted that their companies have a board of directors which exercises oversight over the day-to-day affairs of the companies. Only 10 percent indicated that their companies had board committees which provided oversight over contracts relating to audits, supply chain, remuneration, ethics and social responsibility. 70 percent of the respondents pointed out that their companies had established measures to ensure that all existing and prospective contractual transactions were scrutinised and approved by directors before being undertaken. 30 percent of the interviewees confirmed that their corporations have channels where contractual authority was transferred from the directors to departmental managers. Lastly, 30 percent of the respondents highlighted that their companies introduced measures to ensure that all contractual agreements entered by, or on the company's behalf were reduced in writing and signed by relevant parties with corporate capacity.

Figure 6: Has your company ever been faced with situations where a director, an agent or an employee entered into contractual agreements that were beyond the scope of his or her powers?

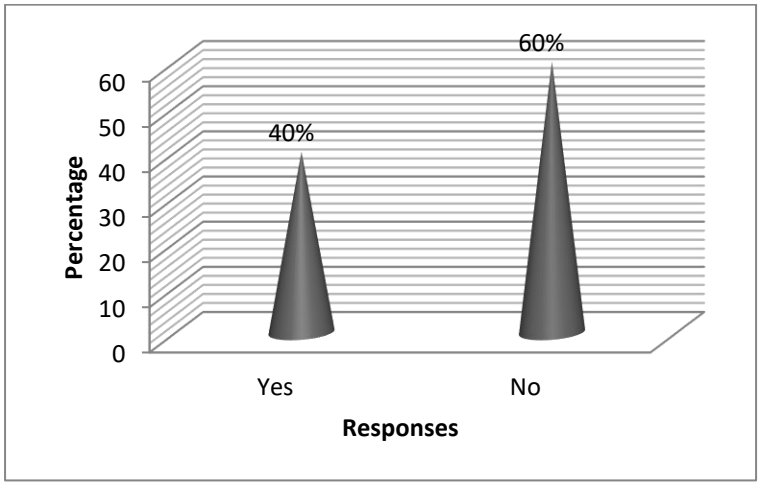
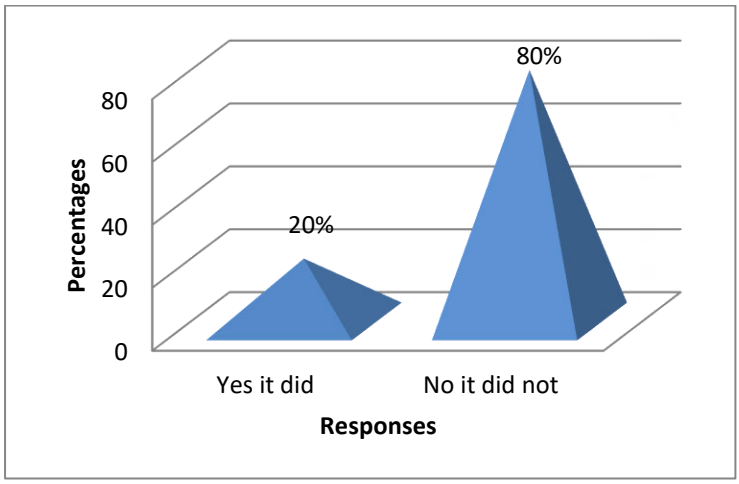


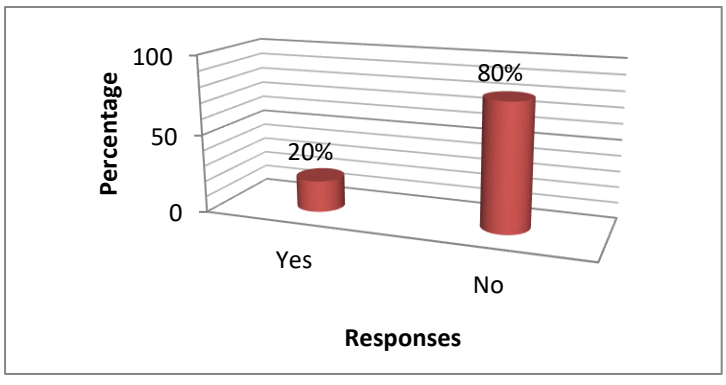
Figure 6 shows that 40 percent of the respondents' companies have had instances where either directors or employees entered into contractual agreements that were *ultra vires*, while 60 percent of the respondents have not had such instances before.

Figure 7: Has your company ever ratified any ultra vires agreements?



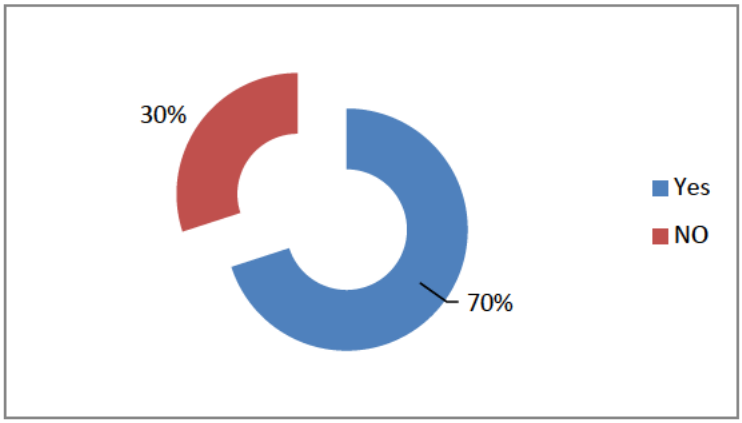
In this figure, 20 percent of the companies confirm having ratified some agreements that had been entered into by company representatives without the requisite capacity, while 80 percent deny ever ratifying contracts that were entered into *ultra vires*.

Figure 8: Has your company ever suffered loss or damages as a result of the ultra vires conduct?



The data collected shows that 20 percent of the companies under consideration suffered financial and reputational loss owing to *ultra vires* conduct by its representatives, while 80 percent of the companies have not suffered any loss.

Figure 9: Whether shareholders enjoy protection against ultra vires conduct which has financial implications on the company



As indicated in figure 9 above, 70 percent of the respondents confirmed that shareholders in the companies enjoyed some form of protection due to the fact that the legal nature of the companies insulates shareholders from liability against third parties, while in 30 percent of the companies, shareholders did not enjoy such protection as they are either sole proprietorships or non-profit entities.

Table 3: Measures implemented to curb future ultra vires incidents

	COMPANY									
LIST OF MEASURES	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**I**	**J**
Implementation of controls to ensure compliance with the Companies Act and other legislation	x	x	x		x	x		x		x
Introduction of measures to ensure oversight and prior approval of all existing and prospective contractual transactions by directors	x	x	x	x	x	x	x	x	x	x
Delegation of authority to specific personnel within the company	x	x	x				x			x

Notifying all relevant stakeholders of the company's policies regarding contractual capacity	x									x

As highlighted in table 3 above, 70 percent of the respondents confirmed that their companies implemented measures to ensure that all transactions complied with prescripts of the Companies Act or relevant legislation. 100 percent of the interviewees indicated that their companies had established measures to ensure that all existing or prospective contracts get the directors' prior consideration before being undertaken. 50 percent of the interviewees confirmed that their companies had conferred contractual capacity to specific personnel within the companies, while 20 percent indicated that they regularly notify all the relevant stakeholders contracting with company on policies pertaining to the company's corporate capacity.

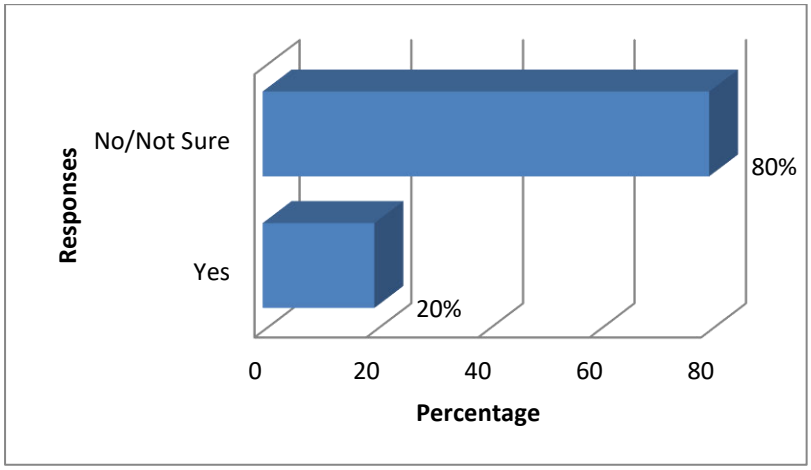
Table 4: Crucial stakeholders doing business with the respondents' companies

	COMPANY									
STAKEHOLDERS DOING BUSINESS WITH THE COMPANY	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**I**	**J**
Government / State Departments	x	x	x	x	x	x	x		x	x
State-owned companies		x	x		x				x	x
Municipalities					x	x	x			x
Private Companies / Partnerships	x	x	x	x	x	x	x	x	x	x
Community Groups	x						x		x	x
Individuals	x	x	x	x	x	x	x	x	x	x

Table 4 shows that 90 percent of the respondents' companies do business with government or state departments, while 50 percent have existing contracts with state

owned companies or parastatals. 40 percent of the companies do business with municipalities, 100 percent of the companies acknowledged conducting business with private companies or partnerships, 40 percent confirm doing business with community groups, and 100 percent conduct day-to-day business with individual clients or service providers.

Figure 10: Whether the companies have existing systems to notify stakeholders on matters of delegation of contractual authority



As indicated in figure 10, 20 percent of the interviewees were able to confirm that their companies have systems in place to notify their stakeholders on matters regarding personnel with the capacity to contract on the company's behalf, while 80 percent highlighted that they did not have such systems or were not aware if they exist.

Figure 11: Are the directors or agents of your company aware of the current legal principles relating to corporate capacity?

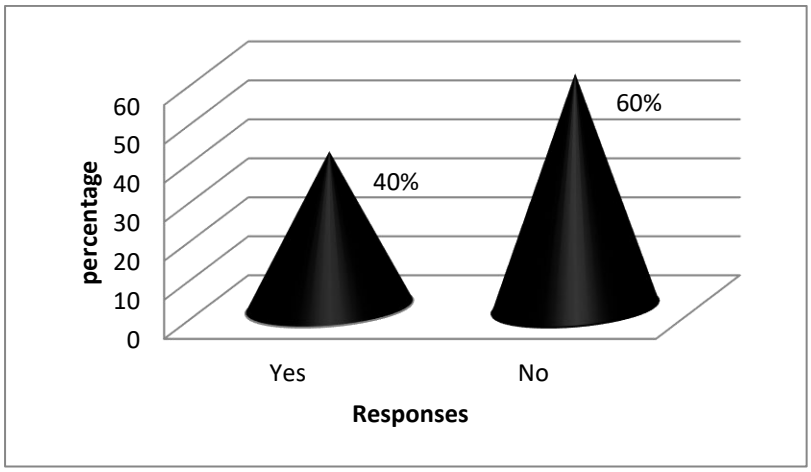


Figure 11 shows that 40 percent of the interviewees confirmed that their company directors are aware of the current legal principles pertaining to corporate capacity, while, on the contrary, 60 percent displayed no knowledge at all. Although 40 percent of the interviewees claimed to be aware of principles relating to corporate capacity, they did not display an acute understanding of the exact legal doctrines underpinning this research such as the *ultra vires*, estoppel and the Turquand rule. However, their understanding of corporate capacity, based on the explanations given by them, suggests that while they may not understand the legal terminology of the above legal doctrines, they were sufficiently trained and understood the principles relating to contractual capacity and the delegation of powers.

4.4. Conclusion

In this chapter, the study findings and the interview results were presented and interpreted. The sections covered by the results include the following: the profile of the respondents, a discussion of corporate governance structures within the respective companies to which the respondents belong, a discussion of the availability of oversight measures, an examination of past challenges relating to poor corporate governance particularly lack of corporate capacity, a discussion of the responsive measures put in place to avoid future challenges relating to corporate capacity, and

an enquiry regarding an understanding of current legal principles regarding corporate capacity by the respondents and their companies. The data that was collected from the interviews was presented in graphs, pie charts using percentages, figures and tables. General comments made by the participants during the interviews will also be discussed in the ensuing chapter.

CHAPTER 5: DISCUSSION OF THE INTERVIEW RESULTS

5.1. Introduction

This chapter discusses the study findings or the results of the data collection methods used in this study. The structure of this chapter follows a similar sequence as the previous chapter. Three sections will be covered in this chapter. The first section focuses on the profile of the interviewees and the roles they play in the companies they represent. The second section explores the corporate governance systems within the respective companies to which the respondents belong. The section will be broken down as it will further discuss other issues such as an examination of past challenges relating to poor corporate governance particularly lack of corporate capacity, a discussion of the responsive measures in place to avoid future challenges relating to corporate capacity, and an enquiry regarding an understanding of current legal principles pertaining to corporate capacity by the respondents and their companies. The last section will discuss some of the general comments and remarks made by the interviewees relating to the issue of corporate capacity with particular reference to past experiences in their companies.

5.2. Profile of the respondents

5.2.1 Type of company

This study illustrates that most of the respondents that were interviewed (90 percent) were from private companies which are termed “profit-making” companies in the Companies Act 71 of 2008. In terms of section 1 the Act, a profit company is incorporated in order to generate financial gain for its shareholders. It also shows that 10 percent of the respondents were from non-profit companies, popularly known as non-profit organisations (NPOs) or section 21 companies. While there is little research or statistics to gauge the types of companies at more risk of falling prey to instances of lack of capacity, one is inclined to opine that such challenges most likely exist in profit-making entities which include private, public and state-owned companies.

5.2.2. The sector or industry the companies operate

The study revealed that out of the participants that were interviewed, 30 percent were from the healthcare sector, 20 percent were from companies which offer legal services, 20 percent were from the financial sector, 10 percent represented property development companies, 10 percent specialised in arts and culture, and 10 percent were from private tertiary institutions. The diversification of the sectors represented by the participants was crucial as it sought to prove that knowledge of corporate capacity is a challenge in both state-owned and private institutions within of the South African economy. In addition, such diversification added credibility to the findings of the study.

5.2.3. The role of the interviewees in the companies

The data collected indicated that 90 percent of the interviewees were both owners and directors of the companies, while only 10 percent of the interviewees were only employed directors with no shareholding or any other pecuniary interests in the company.

5.2.4 The number of employees in the business

The study also shows that 60 percent of the companies employ not more than 20 personnel, 30 percent employ 21 to 50 employees, while only 10 percent of the interviewee's companies had over 50 employees. This finding was crucial as during the interviews it became apparent that companies with more than 20 employees had faced previous challenges with issues of contractual oversight and delegation of authority which in turn may have caused financial loss to the companies.

5.3. Discussion of the corporate governance structures

The second section focused on a better understanding of corporate governance systems in the participants' companies and how existence or lack of such structures

affect their day-to-day activities as they enter into contractual agreements with various stakeholders.

5.3.1. The existence of a board of directors providing oversight of the company

A minority of participants (40 percent) confirmed that their companies had established structures to ensure compliance with corporate governance prescripts, while 60 percent of the companies did not have appropriate governance structures. One of the interviewees indicated that they have a board who preside over daily activities of the company to ensure that all its activities correspond with the company's business plan and budget for the relevant financial year. This is critical because section 66 (1) of the Companies Act provides that activities of a company must be conducted as prescribed by the board which has authority to execute any of the company's functions, subject to compliance with the company's memorandum of incorporation and the Act itself. Cassim et al (2012) confirms that the creation of a board is vital in establishing accountability in the management of the company's affairs.

5.3.2. The existence of practices or standards to regulate the delegation of contractual authority to directors

The data collected indicates that 70 percent of the companies represented by the participants have standards regulating the contractual authority of directors and agents, while 30 percent of the interviewees said their companies do not have such standards. However, upon enquiring as to whether the same measures were also in place to determine the company's contractual capacity, all of the respondents responded that they do not know the difference between contractual authority and contractual capacity. Cassim et al (2012), states that capacity refers to the legal competency of the company, while authority denotes the power of the director or agent to transact on the company's behalf. While the two concepts may be similar, their difference is crucial in determining the binding nature of any contractual agreements concluded by or on behalf of the company with third parties.

5.3.3. Measures in place to deal with *ultra vires* matters

According to the results, 40 percent of the respondents' companies had registered their memoranda of incorporation with the Companies and Intellectual Property Commission which outline the powers of all stakeholders including shareholders, directors, managers and company employees. One of the interviewees said that her company's MOI borrowed most of its principles from the Companies Act and also clearly outlined certain financial transactions which directors could not undertake without the shareholders' resolution. A company's memorandum of incorporation is vital as it outlines the objects of the company. It is the reference point from which one may determine the company's corporate capacity or competency to engage in certain business transactions. In terms of the *ultra vires* doctrine, any transaction that exceeded the company's powers indicated in its constitution was rendered null and void (Cassim et al, 2012). In addition, the constructive notice doctrine suggested that any persons dealing with the company were deemed to be aware of its constitution (Ernest v Nicholls, 1857). Although both common law doctrines were replaced by the Turquand rule, a memorandum of incorporation still plays a critical role in setting out the rights and obligations of all stakeholders, and outlining the business activities which the company is permitted to partake (Cassim et al, 2012).

70 percent of the interviewees highlighted that their companies have a board of directors who exercise and oversee the daily affairs of the companies. As alluded to in 5.3.1 above, a board of directors is vital in exercising oversight and promoting accountability. Only 10 percent indicated that their companies had board committees which provided oversight over contracts relating to audits, supply chain, remuneration, ethics and social responsibility. 70 percent of the respondents pointed out that their companies had established measures to ensure that all existing and prospective contractual transactions were scrutinised and approved by directors before being undertaken. This is crucial in that it reduces the risks of the company incurring costs for contractual undertakings entered into by unauthorised agents. 30 percent of the interviewees confirmed that their corporations have channels where contractual authority was transferred from the directors to departmental managers. Such measure removes any doubt amongst third parties contracting with the company pertaining whether the agents have actual or ostensible authority to act on the company's behalf.

Lastly, 30 percent of the respondents highlighted that their companies introduced measures to ensure that all contractual agreements entered by or on the company's behalf were reduced in writing and signed by relevant parties with corporate capacity.

5.3.4. Past experiences involving ultra vires conduct by directors or employees

40 percent of the interviewees confirmed that their companies have had past challenges where either directors or employees entered into contractual agreements that were beyond the scope of their powers. One of the participants indicated that the main reason for the recurrence of such conduct was that the company staff was not properly trained with the legal principles pertaining to capacity. One of the participants attributed some of the incidents to pure ignorance of the law by the agents thus causing the company serious financial and reputation damage. On the other hand, 60 percent of the respondents have not had such instances before. Most of the respondents attributed such to the fact that their companies are smaller in size and as such they have better control of every activity that takes place under their watch and they can easily delegate contractual authority as and when required, unlike in the bigger companies.

5.3.5. Has your company ever ratified any *ultra vires* agreements?

20 percent of the companies confirm having ratified some agreements that had been entered into by company representatives without the requisite capacity, while 80 percent deny ever ratifying contracts that were entered into *ultra vires*. If an agent conducts a transaction which is beyond the scope of his or her powers, the company may ratify such contract, or invoke agency by estoppel, or can validate the transaction in terms of section 20 (1) of the 2008 Act (Olivier, 2015). If ratified, the contract will be deemed to have been entered between the third party and the company, thus insulating the agent from liability for any loss incurred by the third party emanating from breach of contractual obligations. However, a refusal by the company to endorse the contract results in the agent being deemed personally liable and the bona fide third party has a common law delictual right against the agent for the unauthorised contract.

5.3.6. Has your company ever suffered loss or damages as a result of the *ultra vires* conduct?

The data collected shows that 20 percent of the companies under consideration suffered financial and reputational loss owing to *ultra vires* conduct by its representatives, while 80 percent of the companies have not suffered any loss. One of the respondents highlighted that in one instance, the unauthorised conduct of one of its agents costed them a significant amount of money and they had to concede liability in order to appease the third party (which was a major sponsor) and to avoid engaging in costly legal processes.

5.3.7. The protection of shareholders against *ultra vires* conduct

The study shows that 70 percent of the respondents confirmed that shareholders in the companies enjoyed some form of protection due to the fact that the legal nature of the companies insulates shareholders from liability against third parties. However, this does not mean that they do not suffer the financial consequences that usually follow as an indictment on the company affects their pecuniary interests. On the other hand, section 20 (1) (b) (i) of the Act of 2008 authorises the company to institute proceedings against the unauthorised director or agent for losses incurred, or damages suffered by it. On the other hand, 30 percent of the participants' companies said shareholders did not enjoy such protection as they are either sole proprietorships or non-profit entities. The effect of a sole proprietorship is that the sole director or incorporator of the company assumes personal liability.

5.3.8. Measures implemented to curb future *ultra vires* incidents

The majority of the interviewees (70 percent) confirmed that their companies implemented measures to ensure future compliance with legislative and common law requirements relating to corporate capacity. One of the respondents highlighted that engagement with legal experts and keeping up with legal developments in their industry had become his company's priority. Moreover, all the interviewees indicated that their companies had established measures to ensure that all existing or

prospective contracts get the directors' prior consideration before being undertaken. 50 percent of them mentioned that the size of their companies prompted them to transfer contractual capacity to specific personnel within the companies but subject to the oversight of their legal and compliance departments, while 20 percent indicated that they regularly notify all the relevant stakeholders contracting with company on policies pertaining to the company's corporate capacity through stakeholder meetings, emails and telephone calls.

5.3.9. Crucial stakeholders doing business with the respondents' companies

According to the data in Table 4, 90 percent of the companies represented conduct business with government departments, while 50 percent have existing contracts with state owned companies or parastatals. 40 percent of the companies do business with municipalities, 40 percent confirm doing business with community groups, and all of the companies acknowledged conducting business with private companies or partnerships as well as individual clients or service providers. One of the participants indicated that his company once had a contract that was repudiated by a state-owned company on the basis that certain internal procedures had not been followed and approved by the authorities and as such the contract was null and avoid. Upon enquiring as to which steps his company took to recover losses or damages for the unauthorised contract, the interviewee replied, "*we couldn't fight against the government, we just gave up…"* This response illustrates the poor level of understanding on the part of the respondent regarding the provisions of section 20 (7) of the Companies Act which protects bona fide and unassuming third parties.

5.3.10. Whether the companies have existing systems to notify stakeholders on matters of delegation of contractual authority

As indicated in figure 10, 20 percent of the interviewees were able to confirm that their companies have systems in place to notify their stakeholders on matters regarding personnel with the capacity to contract on the company's behalf. One of the respondents stated that stakeholder meetings, emails, telephone calls and active participation by directors are some of the tools his company adopted in order mitigate

the risks of unauthorised contracts. 80 percent highlighted that they did not have such systems or were not aware if they exist.

5.3.11. The level of understanding by directors or agents of the participants' companies on the issue of corporate capacity

Figure 11 shows that 40 percent of the interviewees confirmed that their company directors are aware of the current legal principles pertaining to corporate capacity, although they did not display an acute understanding of the exact legal doctrines underpinning this research such as the *ultra vires*, estoppel and the Turquand rule when further asked to elaborate. However, when asked to explain what they understood about corporate capacity, it became clear that they were sufficiently trained and understood the principles relating to contractual capacity and the delegation of powers, even though they did not understand the correct legal terminology.

On the other hand, 60 percent of the interviewees displayed no knowledge at all. Knowledge of systems related to corporate governance is essential among company officials who occupy positions of authority. Vaugh and Ryan (2006) maintain that the presence of sound corporate governance standards could play a vital role in promoting sustained productivity growth and economic stability on a national scale.

5.4. Conclusion

This chapter embarked on a discussion and analysis of the results of the data collection methods used in this research. It must be noted that data in this research was collected through structured and semi-structured interviews in which the participation of the interviewee was paramount. Observations throughout the research also assisted in eliciting the attitudes of the interviewees during the interview period. All the participants showed interest in the interview process and their willingness to provide insights into their own institutions was exceptional. In this chapter, the corporate governance systems within the respective companies to which the

respondents belong were explored in order to identify whether the topic under discussion had been prevalent or applied in their institutions. The chapter also explored the level of understanding of current legal principles pertaining to corporate capacity, particularly the Turquand rule, among the interviews and their companies.

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1. Introduction

This study sought to critically analyse and discuss corporate capacity of a company and how the law has evolved regarding when agents act beyond a company's capacity in the South African legal context. A comparative analysis was applied with particular reference to the common-law *ultra vires* doctrine and Turquand rule in South African corporate law. The research further portrayed the challenges encountered in the practical implementation of the Turquand rule and further attempted to ascertain its future in the corporate legal system. As already highlighted in the study, strict compliance with corporate governance principles pertaining to legal capacity to transact on behalf of a company is still a challenge in the current South African economy, particularly in state-owned and private institutions, regardless of the presence of solid legal instruments regulating same. There are numerous reports where non-compliance with prescribed standards have resulted in unfavourable consequences for companies, employees, shareholders, third parties transacting with the company, and the economy at large. Hence, an investigation of the phenomenon was critical. This chapter conveys the conclusions of the study findings, after which recommendations will be made.

6.2. Findings from the literature

The issue of corporate capacity, though unnoticed, gives rise to legal and financial challenges to companies and government institutions on a daily basis, but it is a legal oddity that usually goes unnoticed. This study has revealed the historic background of the issue in the South African law and further established that common law principles concerning contractual capacity and authority of agents have steadily developed and are now contained in the Companies Act 71 of 2008. It has further shown that the *ultra vires* doctrine has since lost much effect in South African legal parlance as it was replaced by the Turquand rule which affords protection to innocent third parties. The study findings have however showed that, despite the presence of a legal instrument regulating corporate capacity, there seems to be little or lack of knowledge among

senior company executives on the issue, and the consequences for such lack of knowledge have proved to be dire in some instances.

The study has also established that there seems to be a number of challenges in the interpretation and practical application of the Turquand rule in the present legal context. Primary challenges relate to the contrast between the common law and the statutory indoor management rule. It has been established that common law does not cater for a third party who “knew” that there was non-compliance with internal requirements, while the statutory rule goes further to proscribe protection to a party “who reasonably ought to have known” of such nonconformity (Cassim et al, 2012). The challenge lies in the fact that the Act requires both rules to be applied concurrently without specifying which rule takes precedence in the event of a material distinction between the two. Hence, it is opined that a failure to address this gap may have consequences on companies, shareholders and third parties should they be presented with a legal challenge related to corporate capacity.

6.3. Findings of the research

It was also crucial to measure the level of understanding of this legal phenomenon among company executives in order ascertain its relevance or effectiveness in the current legal context. The study findings however revealed that a minority of the interviewees claimed to have knowledge of the current legal principles pertaining to corporate capacity, while 60 percent displayed no knowledge at all, whereas such knowledge of systems related to corporate governance is vital in promoting sustained productivity growth and economic stability on a national scale (Vaugh and Ryan, 2006). However, it must be noted that such claimed knowledge was merely general and related to corporate governance, not the specific principles relating to corporate capacity such as the Turquand rule and *ultra vires* doctrine. The study has also established that while a minority of the interviewees confirmed the existence of measures to ensure strict compliance with corporate governance prescripts, particularly relating to capacity and authority of agents, they professed lack of

knowledge on applicable rules regarding corporate capacity and authority of agents, hence they are likely to encounter challenges emanating from unauthorised contracts.

The specific findings of this study revealed that while the Companies Act may be the current authority regulating the determination of corporate capacity of companies and the authority of agents, compliance with such provisions is most likely adhered to by companies with proper corporate governance structures coupled with the existence of efficient legal compliance personnel. However, as highlighted in this research, several headlining stories in private and state-owned companies are proof that lack of proper understanding of the principle may be disastrous to a company and its stakeholders. Hence, recommendations have been made below.

6.4. Limitations of the Study

The study was presented with restrictions as has been fully highlighted in chapter 3. The first challenge related to the study only being limited to the analysis of capacity and authority of agents in the South African corporate law framework whereas issues of capacity and authority of agents also apply to other fields of law. In addition, though most of the doctrines were imported from English law, a detailed discussion of foreign law and foreign literature was not undertaken.

Secondly, the study was also of a qualitative nature and the data collection was only restricted to a limited focus group within the Kwa-Zulu Natal province. Literature was mostly restricted to books, journals, publications and case law. Hence, the study may have been limited by insufficient data as the data collection methods and tools used were not enough to assist the researcher in formulating new hypotheses.

Lastly, prior research on the topic was very limited. As such, the challenge may, on one hand, present an important opportunity to promote the need for further exploration of the topic and, on the other hand, hinder the researcher from gaining sufficient data necessary to formulate new hypotheses on the research topic.

6.5. Recommendations

6.5.1. Amendment of section 20 (7) of the Companies Act

The study has shown that there seems to be a contrast between common law and the statutory Turquand rule as espoused in section 20 (7) and (8) of the Companies Act 71 of 2008. The continued existence of such disparity may give rise to challenges relating to practical application of the rule in the future. At the same time, it must be acknowledged that the Constitution of the Republic of South Africa encourages the development of common law. It is therefore recommended that section 20 (7) of the Act be amended in order to be in line with the common law rule which only proscribes protection to third parties who had actual knowledge relating to non-compliance with internal requirements.

6.5.2. Development of the common law rule

In the alternative to the above, it is recommended that common law be developed, as prescribed by the Constitution, to be in line with section 20 (7) of the Act. The reasons for such is that, a reasonable assumption of compliance by a third party when contracting with state owned or other companies with stricter supply chain or corporate governance measures, should be sufficient to proscribe such protection. As a result, protection will only be afforded to innocent and unassuming third parties.

6.5.3. The need for awareness in the corporate sector

Every financial year, the South African government loses billions of Rands owing to either reckless or wasteful expenditure. Some of the reasons for such financial loss relates to unauthorised contracts or undertakings in the state departments or state-owned entities, with Eskom, SABC, DENEL and SAA serving as examples. Private companies alike suffer the same fate, with the recent example relating to corporate capacity being Steinhoff International. This demonstrates that although companies may attempt to put measures in place to ensure strict compliance with corporate governance measures, lack of particular training among senior executives, employees who conduct day-to-day dealings on behalf of the company, and relevant stakeholders

contracting with companies will still present challenges as particular principles relating to the *ultra vires*, constructive notice, and indoor management doctrines are unknown. In light of the above, it is recommended that company executives and agents be properly educated on the issue as it touches on every supply chain policy, let alone contractual dealings engaged by corporate entities on a daily basis. Hence, if companies and their agents are equipped with such knowledge, legal challenges relating to validity of contractual agreements will be reduced.

6.5.4. Recommendations for further research

Lastly, the researcher holds the view that the issue of corporate capacity and authority of agents has not received much scholarly attention, despite its relevance in the corporate system. It is also evident that there is no statistical work detailing the impact of corporate governance compliance (or lack thereof) on companies, particularly state-owned entities whose malfunction have an effect on taxpayers. This study therefore recommends corporate researchers to do further research and find new information that could detail specific issues such as the extent of damage caused by poor corporate governance in private as well as public companies. It is noted that an investigation of private profit-making companies may be challenging as most of the information relating to such companies, for instance financial statements and internal policies are not privy to the general public.

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APPENDIX 1: Ethical Clearance

UNIVERSITY OF KWAZULU-NATAL
INYUVESI YAKWAZULU-NATALI

18 October 2018

Mr Sthembiso Ishmael Mbhele (9605816)
Graduate School of Business & Leadership
Westville Campus

Dear Mr Mbhele,

Protocol Reference Number : HSS/0364/018M
Project title: An analysis of Corporate Capacity and Authority of Agents under South African Company Law

Approval Notification – Expedited Application

With regards to your response received on 27 August 2018 to our letter of 26 June 2018, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol has been granted **FULL APPROVAL.**

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment/modification prior to its implementation. In case you have further queries, please quote the above reference number. PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours faithfully

[redacted]

Dr Rosemary Sibanda (Deputy Chair)

/ms

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cc Academic Leader Research: Professor Muhammad Hoque
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