DOES THE DOCTRINE OF *ULTRA VIRES* STILL EXIST?

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DECLARATION

I, Mignon Neethling, hereby declare that this dissertation entitled "*Does the ultra vires doctrine still exist?"* is my own original work and has not been submitted to any other institution for higher learning

Signed by __________________________ on this the ________________ of ________________________2007

SUPERVISOR CERTIFICATE

I, K.N. KANGUEEHI certify that this research and writing of this dissertation was carried out under my supervision.

Signature _________________________________

Date____________________

ABSTRACT

A company traditionally owing its incorporation to statutory authority could not effectively do anything beyond the powers expressly or impliedly conferred upon it by its statute or memorandum of association. Any purported activities in excess will be void

even if agreed to by all the members. This was purportedly to protect investors and secondly to protect creditors.

The *ultra vires* doctrine was bolstered with the doctrine of constructive notice which decreed that everyone that deal with the company is presumed to know the contents of the public documents and thereby became a trap for unwary third parties and the company itself. As a result of the undesirable consequence of an *ultra vires* act, companies started including into their objects clause every conceivable trade or activity trying to minimize the risk of an *ultra vires* act.

On the recommendation of the Van Wyk de Vries Commission the Companies Act of 1973 made radical changes regarding the capacities of companies and the consequences of an *ultra vires* act. Section 36 in a nutshell retains the principle that a company's capacity is limited by the objects stated in the memorandum, but decrees that an *ultra vires* act is no longer void.

However, new company law legislations have suggested the idea that a company has the same capacity and powers of a natural person as far as a juristic person is capable of having these powers. Upon closer analysis is becomes evident that a company is therefore considered to have the same capacity as a close corporation and thereby totally eliminating the *ultra vires* doctrine as it is not applicable to a close corporation

Based on this it becomes evident that the *ultra vires* doctrine is no longer applicable and outlived its usefulness. Although a company and close corporation might know have powers that are exactly the same as a natural person the extent of their powers and capacities are still regulated although not through the companies or close corporation act.

TABLE OF STATUTES

- The Closed Corporations Act 69 of 1984
- The Companies Act 28 of 2004

- The Companies Act 61 of 1973
- The Companies Act of 1926

TABLE OF CASES

- Abrahamse v Connock's Pension Fund 1963 (2) SA 76 (W)

- Ashbury Railway Carriage & Iron Company v Riche (1875) LR 7 HL 653
- Attorney General v Mersey Railway [1907] 1 Ch. D.
- Charterbridge Corporation v Lloyds Bank, Ltd. [1969] 2 All E.R 1185
- Cohen v Segal 1970 (3) SA 702 (W)
- Colman v Eastern Counties Rail Co. (1846), 10 Beav. I
- Cotman v Brougham
- Dadoo v Krugersdorp Municipal Council 1920 AD 530
- Ernest v Nicholls (1857) 6 HL Cas. 401
- Foss v Harbottle (1983) 2 Hare 461
- Francios George Hill Family Trust v South Africa Reserve Bank 1992 (3) SA 91
- Khani v Premier, Vrystaat en Andere 1999 (2) SA 863 (O)
- MacDougall v Gardiner (1875) 1 Ch 13 CA
- Mathipa v Vista University and Others 2000 (1) SA 396 (T)
- Mbana v Mnquma Municipality 2004 (1) BCLR 83 (Tk)
- Mineworkers Union v Greyling 1948 (3) SA 831 (A)
- Re Lee, Behrens & Co. Ltd. [1932] 2 Ch. 46
- Re. David Payne & Co. [1904] 2 Ch 608
- Re. Jon Beauforte (London) Ltd. [1953] Ch 131
- Riche v Ashbury Railway Co. (1874) L.R. 9 Ex. 224
- Salomon v Salomon & Co. Ltd [1897] AC 22
- Simpson v Westminster Palace Hotel Co. (1860), 8 H.L. Cas. 712
- Smith v Croft [1987] 3 ALLER 909

- Standard Bank v Wentzel and Lombard 1904 TS 828
- Sutton's Hospital
- The Attorney General & another v The Great Eastern Railway Co. (1880) 5 App. Cas. 473 (HL)
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CHAPTER ONE:

INTRODUCTION

The objects and powers of a company and the *ultra vires* doctrine are some of the most debated aspects of company law, and intimately connected with the subject of the Memorandum and Articles of Association of a company.[1]

Firstly, it is important to define what is meant when the term *ultra vires* is used. The phrase comes from Latin meaning *beyond power"* describing an act by a corporation that exceeds its legal powers. [2] The doctrine states that if a particular company has acted outside the scope of its powers, the particular company is said to have acted *ultra vires* and therefore this act would not be considered legally binding.

This position was drastically changed by section 36 and is supplemented by the rule that the provision of the memorandum[3] and thus its objects clause constitutes a binding contract between the company and each of its members in his capacity as member.

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1 Commission of Enquiry into the Company Act – Main Report : Pretoria (15 April 1970)

2 www.answers.com/topic/ultra-vires (12th May 2007)

3 The memorandum is considered to be the charter of the company, it defines the limits beyond with the company can not go and serves as public notice.

Section 36, basically states that should the company, directors or its members exceed the powers; the act that follows as a result of this would not merely because of this fact be invalid. Although the objects in the memorandum were areas beyond which the action of the company could not go, the court did not interpret the objects in such a way that only powers expressly given in so many words were permitted. Whatever might be fairly regarded as incidental to or consequential upon, the object would not be *ultra vires*.[4]

The result of this section is therefore that if a contract is concluded between the company and X and the conclusion of the contract is *ultra vires* the company, the company can resile from the contract provided that there is no other ground, for example, other than the fact that the conclusion of the contract was *ultra vires* the company – misrepresentation. It should be remembered that the company can not resile if there is no other ground for it doing so.

Under the new Company Act 28 of 2004 it is clearly interpreted without limitation that a company is considered to have the same powers and capacity as a natural person. This is limited only in as far as a juristic person is capable of having these powers and capacities. The use of the word company is merely a legal concept and it has no physical existence but exists only in contemplation of law.[5] By this is meant that the company would not be able to conclude a will or conclude a valid marriage as this is something that is limited to natural persons only.

Due to the particular wording found in section 38 of the Act[6] it can be concluded that the company could be said to have the same capacity and power as a closed corporation as the provision of the Companies Act[7] is exactly the same. It is clearly indicated in the Close Corporation Act, more particularly section 2(4)

> '…that the closed corporation has the capacity and powers of a natural person of full capacity in so far as a juristic person is capable of having such capacity or of exercising such power…'

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[4] The Attorney General & another v The Great Eastern Railway Co. (1880) 5 app cas 473 (HL)

[5] *Madrassa Anjuman Islamia v Johannesburg Municipal Council 1919 AD 439*

[6] The Company Act 28 of 2004

[7] The Company Act 28 of 2004

Whereas the scenario of a company was that its capacity was limited to what is contained in the memorandum and everything beyond the scope of this objective is *ultra vires* the company, the existence of the section merely provides outsiders with the opportunity to nevertheless hold the company to an *ultra vires* contact.[8]

It is clear that the provision regarding powers and capacities in the respective legislation is exactly the same. Therefore it could be said that the new section tries to link the concept of a company with that of a closed corporation. To a certain extent this could be justified as there are numerous similarities between these two business formations, for example perpetual succession.[9]

This would imply that a company would have exactly the same powers and capacities of a close corporation and therefore the *ultra vires* doctrine would no longer find application as a natural person is not capable of acting *ultra vires.* Whether this was the intention of the legislature and what is the effect of eliminating the doctrine is the aim of this particular dissertation.

1.1 Aim of the Dissertation:

The basic idea behind this dissertation is therefore to determine whether or not the *ultra vires doctrine* is still applicable in modern day company law, considering the fact that the newly incorporated Company Act 28 of 2004 granted a company the powers and capacities of a natural person making the companies powers and capacities exactly the same as that of a closed corporation. Based on this the following will be argued

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8 WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition LexisNexis Butterworths – Durban at page 321

9 Traditionally it was that a change in membership had the effect of terminating the partnership, whether the change was from agreement between the partners or membership was reduced or death of a partner. *Standard Bank v Wentzel & Lombard 1904 TS 828 @ 835.* However a company always enjoyed perpetual succession meaning that a company remained in existence even if members changed. *Webb & Co. v Northern Rifles*

- That the usefulness of the *ultra vires* doctrine has been substantially reduced by the wording of the Companies Act 28 of 2004, to the extent that it may be said to be no longer valid.
- That the doctrine of constructive notice which was a complementary extension of the *ultra vires* doctrine has also lost its importance to the subsequent coming into operation of the turquand rule.
- That the extension of the capacities and powers of a company provides it with greater opportunity while at the same time offering more protection to third parties interacting with the company.

1.2 Structure of Dissertation:

This particular dissertation is divided into eight different chapters of which the introduction is chapter one.

- Chapter one is a basic introduction into the legal question that the dissertation is addressing. Together with this, it contains the research methodology used to reach a solution to the legal problem.

- Chapter two is concerned with the historical developments of the doctrine, the reason for the change in the common law position and the effect that the doctrine has in modern day practice.

- Chapter three goes on to explain the common law position of the *ultra vires* doctrine as it was before the enactment of section 36 of the Company Act 61 of 1973.

- Chapter four explains the difference between the turquand rule that was developed in the case of **the Royal British Bank v Turquand**[10] and deals

[10] (1856) 6 E & B 327)

with the internal requirements of a company relating to directors etc, and the *ultra vires* doctrine that deals with the powers and capacity of a company. The importance of this section is that people tend to get confused as to when what is applicable and therefore based on this it finds relevance within this dissertation.

- Chapter five looks at the provision made for the *ultra vires* doctrine in the Company Act 61 of 1973 and the change that it bought about.

- Chapter six focuses on the newly drafted Namibian Company Act 28 of 2004, more particularly section 38 that gives a company the powers and capacities of a closed corporation and what is the ramifications are of this.

- Chapter Seven is a comparison that is drawn between the two sections respectively.

- Chapter Eight, deals with the conclusion that was reach, namely that the ultra vires doctrine could be said to no longer be of any import in company law due to the capacities and powers of a company that has change.

1.3 Research Methodology and Literature Review:

As the existence of the *ultra vires* doctrine and its usefulness within Namibian company law appears to become more vague and ambiguous due to the new powers and capacities that have been awarded to the company under the new company act, it was important to refer back to the beginning of the doctrine and the development therefore. The major methodology employed throughout this particular dissertation was that of literature review, in order to adequately draw a conclusion as to the applicability of the doctrine and whether it should still be considered a vital part of modern day company law.

CHAPTER TWO:

HISTORICAL DEVELOPMENTS OF THE *ULTRA VIRES* DOCTRINE

The *ultra vires* rule has a long and somewhat tangled history. The doctrine played an important role in the development of corporate powers. Though largely obsolete in modern private corporations, the doctrine remains in full force for government entities.[11] It should be remembered that it is not the *ultra vires* doctrine in the strict sense of the word, but more the principle behind the *ultra vires* doctrine.

What is meant by this is that government entities are creatures of statute and therefore the powers and capacities of that particular entity would be contained in the enabling legislation, and as a result a particular government entity would not be able to act outside the powers granted to it by the enabling legislation. Any action that is partaken in would be considered beyond their capacity and therefore could be said to be *ultra vires.*

An *ultra vires* act is one beyond the purposes or powers of a corporation, including its directors and members. The earliest legal view was that such an act was void. Under this approach a corporation was formed for only a limited purpose and could do only what it was authorized to do in its corporate charter.

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[11] *Mbana v Mnquma Municipality 2004 (1) BCLR 83 (Tk)*

The predecessor of the Company Act of 1973 was the Company Act of 1926. Under the 1926 Act, the capacity of the company was determined by the company's objects stated in its memorandum. At common law, an act *ultra vires* a company was void and therefore not binding on either the company or the other party to the transaction.[12] Moreover, an *ultra vires* act was incapable of ratification, even if all the members of the company approved of it.

If a company proposed to enter into an *ultra vires* contract, any member of the company could obtain an interdict to prevent the company from doing so, and the company could sue a director to recover any damages it suffered as a result.[13]

Ashbury Railway Carriage and Iron Co. v Riche (1875) LR 7 HL 653 is the classic authority on the common law doctrine of *ultra vires*

> "…the Company's memorandum permitted it to make and sell railway carriages. The directors caused the company to enter into a contract for the construction of a railway. The court held that the contract was not authorized by the memorandum and was therefore void, even if the shareholders had approved of the contract in advance or had ratified it after the event…"

This particular believe was changed in the case of **Attorney General v Mersey Railways [1907] 1 Ch. D. at page 99** were Buckley, L.J. laid down the following

> "…to ascertain whether any particular act is *ultra vires* or not, the main purpose must first be ascertained, then the special powers for effecting that purpose must be looked for, and then, if the act is not within either the main purpose or the special powers expressly given by the statute, the inquiry remains whether the act is incidental to or consequential upon the main purpose and is a thing reasonably to be done for effectuating it…"

The *ultra vires* doctrine was bolstered by the doctrine of constructive notice which decrees that everyone who deals with the company is presumed to know the contents of its public documents of which the articles and memorandum of association form part.

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12 WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition LexisNexis Butterworths – Durban at page 134

13 *Cohen v Segal 1970 (3) SA 702 (W) @ 706*

The *ultra vires* doctrine however, became a trap for the unwary and a nuisance to the company itself. It was a trap in that people who contracted with the company in good faith might discover that the contract was *ultra vires* and therefore void and unenforceable. It was a nuisance to the company in that it was barred from entering into *ultra vires* contracts even where all its members were in favor of the contract.[14]

Due to the undesirable consequences of an *ultra vires* act[15], lawyers who drafted objects clause of company memorandum adopted the practice of including in the objects clause to cover every conceivable trade or activity. This minimized the risk of an inadvertent *ultra vires* act by the company. The practice led to a situation where every company, no matter how humble, had preposterously extensive objectives.

On the one hand this reduced the hazard of doing business with companies because the risk of a transaction being *ultra vires* was remote, but, on the other hand, the protection of members and creditors was greatly weakened.[16] Basically what is meant with the latter is that the members and creditors would be bound by the transaction that an agent of the company entered on behalf of the company as there has to be a subsequent reason other than the action being ultra vires to have it declared invalid.

As a result, the company would have to engage in activities that were never considered to be within the operational scope of the company and the members are bound. With regards to the creditors, it means that they stand a change to suffer damages as the company is participating in business activities that is not included into is memorandum of association, thereby drastically increasing the risk on the part of the creditors

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[14] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition LexisNexis Butterworths – Durban at page 135

[15] Namely, that the contract was void and that the company's agents were liable to be sued by the third party for breach of warranty of authority.

[16] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition LexisNexis Butterworths – Durban at page 135

Judges were extremely critical of over-lengthy clauses and a drawn out contest ensued between the judiciary, who tried to interpret such objects clauses restrictively and legal draftspersons, who tried to ensure that objects clauses were as extensive as possible.

Acting on the recommendation of the Van Wyk de Vries Commission of Inquiry, the Companies Act of 1973 made radical changes to the law regarding the capacity of companies and the consequence of an *ultra vires* act.

While the question whether an act was or was not *ultra vires* a company was regarded as being purely objective, in other words, as depending on the type of contract, it was reasonably clear whether a particular contract entered into by a particular company was *ultra vires*. At some point confusion and uncertainty entered into the equation when some cases held that the question whether a particular contract entered into by a company was *ultra vires* depended on subjective factors, namely whether the other party to the contract knew that the act was *ultra vires* the company.

Another decision which held that the question whether a contract entered into by a company was *ultra vires* depended on the actual or constructive knowledge of the other party, was in the case of **Re Jon Beauforte (London) Ltd [1953] Ch 131**

> "…the company's memorandum authorized it to carry on the business of gown-makers. It embarked on an *ultra vires* business of making veneered panels and set up a factory for this purpose. The company ordered a consignment of coke on a letter headed '*Veneered Panel Manufactures'*. It was held that the purchase of coke was *ultra vires* because of the letter-head on which they received the order; the suppliers of the coke had actual knowledge that the coke was to be used in a factory which made veneered panels. The suppliers also had *constructive knowledge* of the company's memorandum which states its authorized business and thus had constructive knowledge that the making of veneered panels was *ultra vires*. The court held that the contract for the supply of coke was therefore *ultra vires* the company. If the suppliers had not known that the coke was to be used in an *ultra vires* business, (and they were under no duty to inquire)[17] the supply would not have been considered to be *ultra vires…*"

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[17] *Re David Payne & Co. Ltd [1904] 2 Ch 608*

This decision and similar ones which introduced subjective elements into the concept of *ultra vires* were largely responsible for the amendment of the Companies Act by the enactment of section 36.

In a nutshell section 36 still retains the principle that a company's capacity is limited by the objects stated in the memorandum, but decrees that an *ultra vires* act is no longer void. Since the enactment of section36, the question whether a contract entered into by a company is *ultra vires* s decided on an entirely objective basis.
Where viewed objectively[18] a contract is reasonably capable of realizing the company's objects, it is intra vires. Where a contract is not reasonably capable of realizing its objects, the contract is beyond the company's capacity and therefore *ultra vires.* In simpler form, the previous sentence only means that should a person be capable of deducing certain objects from the companies memorandum of association, the company would be capable of performing this activity. On the other hand, should the particular object not being capable of reduction allowing the company to perform the actions, it would be considered *ultra vires* and therefore not valid.

Section 36 applies to the contract and, moreover, the directors may be liable to the company for any damages it has sustained, on the grounds that they have breached their fiduciary duty in causing the company to enter into an *ultra vires* contract.

[18] For example by looking at the contract and at the company's objects as laid down in its memorandum and disregarding the director's belief or purpose in causing the company to enter into the contract.

CHAPTER THREE:

THE COMMON LAW DOCTRINE OF *ULTRA VIRES*

A company which owes its incorporation to statutory authority cannot effectively do anything beyond the powers expressly or impliedly conferred upon it by its statute or memorandum of association – any purported activity in excess will be void even if agreed to by all the members. [19] In **Cotman v Brougham,[20]** Lord
Parker stated

> "…the statement of the company's object in its memorandum is intended to serve a double purpose. In the first place it gives protection to the subscriber, who learns from the purpose, to which their money can be applied and in the second instance, it gives protection to persons who deal with the company and who can infer from it the extend of the company's power.

The learned judge went on to state further that

> "…the narrower the objects expressed in the memorandum, the less likely is the subscribers risk, but the wider such objects, the greater is the security of those who transact with the company…"

The acts which a company or its directors do or purport to do may be void upon several grounds, which may be summarized as follows:

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[19] GOWER L.C.B (1957) the Principles of Modern Company Law. 2nd Edition. Steven & Sons Limited: London at page 78

[20] Citation unknown

(1) They may be contrary to public policy generally, as for instance, an agreement for compounding a felony

(2) They may be forbidden by statute, as for instance, the holding of lotteries.

(3) They may be contrary to the policy of some particular statute, as for instance, a

reduction of the capital of a joint stock company not carried out in accordance with the provisions of the Companies Act

(4) They may be beyond the powers of the company, or as it is usually expressed, *ultra vires*.[21]

The term *ultra vires* therefore, in its proper sense denotes some acts or transaction on the part of a corporation which, although not unlawful or contrary to public policy, if done by an individual, is yet beyond the legitimate powers of the corporation as defined by the statute under which it is formed or the statutes which are applicable to it, or by its charter or memorandum of association.[22]

Consequently, not only the company itself, but also the other party to the contract may rely on the fact that it is *ultra vires* to escape liability under it. However, it should be remembered that a distinction must be drawn between contracts that are patently *ultra vires* when they are compared with the company's memorandum, and those contracts when compared with the memorandum is not necessarily considered to be outside the company's powers. The former kind of contract is absolutely void, and is enforceable neither by the company nor by the other party to it.[23]

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21 DIEMONT, M.A and BOEHMKE, M.A. (1953) PYEMONT'S Company Law of South Africa 6th Edition. Juta & Company Ltd. Cape Town at page 37

22 HENOCHSBERG J. and FAIRBAIRN W.J.G (1963) Henochsberg on the Companies Act. Butterworths – Durban at page 28

23 PENNINGTON R.R. (1967) Company Law 2nd Edition. Butterworths: London at page 89

The *ultra vires* doctrine was based on the assumption that a person dealing with a company could avail himself of his right to inspect the company's public documents and could simply by reading the company's object clauses; determine whether the transaction in question fell within the scope of the company's object.[24]

When the directors exceeded their powers the company is not bound because the directors as agents have exceeded their authority, but unless the company's own powers are exceeded, no question of capacity arises, and the company may ratify what the directors have done, and may, be unable to set up the directors' lack of actual authority when they have acted within their usual or ostensible powers.[25]

Basically what this particular paragraph means is that even if the director has exceeded his particular power but the action was within the capacity of the company, then the particular action would be able to be ratified by the company, however this is not the case should the capacity of the company have been exceeded.

Notwithstanding the fact that the rule clearly indicates that anything not authorized by the memorandum is *ultra vires* the company, it was held in the case of **Ashbury Railway Co. v Riche (1875) 7 H.L 653,** that the *ultra vires* doctrine ought to be reasonably and not unreasonably understood and applied as is illustrate below from the case extract:

> "…whatever may be fairly regarded as incidental to or consequential upon those things which the legislature or in the case of a company registered under the Companies Act, the memorandum has authorized, ought not to be held by judicial construction to be *ultra vires.*[26]

This was also the point of departure in the case of **Attorney General v Great Eastern Railway (1880) 5 App. Cas. 473 H.L.**

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[24] JOUBERT W.A (founding Editor) (1996) The law of South Africa volume 4 Part 2 Butterworths: Durban at page 313

[25] GOWER L.C.B. (1957) the Principles of Modern Company Law. 2nd Edition. Stevens & Sons Limited: London at page 78

[26] HENOCHSBERG J. and FAIRBAIRN W.J.G (1963) Henochsberg on the Companies Act. Butterworths – Durban at page 28

This briefly is the *ultra vires* doctrine as applied to companies. It should be pointed out that the expression *ultra vires* is also used in practice to describe the situation when the directors of the company have exceeded the powers delegated to them. When the company exceeds its powers it is not bound by its actions because it lacks legal capacity to incur responsibility for it.[27] The rule is self executing in that all contracts made by a company which are not authorized by its memorandum of association, or are not incidental to the carrying out of its object, are void. [28]

It is important to note that a distinction must be drawn between an act *ultra vires* the company and an act *intra vires* the company but perpetrated by the directors in breach of one of their fiduciary duties. Section 36 has no application to act on the latter kind.

The question whether directors or managers have breached their fiduciary duty therefore depends on the answer to the question: '*when they did act, they honestly believed it was in the best interest of the company?'* By contrast the question whether a particular act was *ultra vires* the company, is asked in the following manner: *'Does the act in question fall within the objects of the company as laid down in its memorandum?'* It should be remembered that *ultra vire*s concerns the *capacity of the company* and not the *authority of the company.*[29]

It is submitted that an act of the director which is *ultra vires* the company is *ex hypothesi, ultra vires* the director; and the fact that such act is therefore also inevitably one in breach of their fiduciary duty to exercise their power for a corporate purpose only, does not preclude the application of section 36 to such an act; since the fact that such an act is *ultra vires* the company, the director's lack of authority is immediately the consequence of such fact and therefore by reason of fact only, within the meaning of section 36.[30]

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[27] GOWER L.C.B. (1957) the Principles of Modern Company Law. 2nd Edition. Stevens & Sons Limited: London at page 78

[28] PENNINGTON R.R. (1967) Company Law 2nd Edition. Butterworths: London at page 89

[29] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition. LexisNexis Butterworths – Durban at page 138

[30] DELPORT P.and VOSTER Q. (2006) Henochsberg on the Companies Act- December 2006. 5th Edition. Butterworths at page 64

3.1 Implied Powers and the *ultra vires* doctrine:

Although the *ultra vires* doctrine was applicable every time the company acted outside its capacities and powers mentioned by the memorandum of association, it also recognised that there are certain powers of a company many not be contained in the memorandum of association as they are implied powers, used by the company to pursue it objects.[31] When dealing with implied powers **Re Lee, Behrens & Co. ltd[32],** laid down three pertinent questions

(a) Is the transaction reasonably incidental to the carrying on of the company's business?

(b) Is it a *bona fide* transaction?

(c) Is it done for the benefit and to promote the prosperity of the company?

it was believed that (a) and (c) related to the existence of implied powers and (b) related to the directors duties.[33]

This particular point was expressly highlighted in the case of **Charterbridge Corporation v Lloyds Bank, Ltd[34].** If the directors in exercising the powers take into account circumstances which they were not allowed to take into account, the transaction may be voidable against the third party at the option of the company.[35] It the transaction involved implied power then unless the suggested power is one which would be reasonably incidental to the carrying out of the company's business objects, no such power will be implied and the transaction will be *ultra vires.*

3.2The Doctrine of *ultra vires* and Constructive Notice:

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31 LEIGH L.H et.al. (1981) Northey & Leigh's Introduction to Company Law, 2nd Edition. London: Butterworths at page 74

32 [1932] 2 Ch. 46.

33 *Thompson v J. Brake (Caterers), Ltd. 1975 S.L.T 67*

34 [1969] 2 All ER 1185

35 derived from the judgment of *Hogg v Cramphorn, Ltd. [1966] 3 All ER 420*

The doctrine of constructive notice further complemented the *ultra vires* doctrine in that the doctrine of constructive notice believed that anyone dealing with a company including its members, were fully acquainted with the company' s public documents, one of which is the memorandum containing the objects clause. As a consequence there is then the assumption that ever person contracting with the company has acquainted themselves with the limits imposed on the agents by the article and memorandum of association. [36]This was the accepted norm since 1857 in the case of **Ernst v Nicholls (1857) 6 HL CAS. 401.**[37] Accordingly no person could assert against the company that he was unaware of the limitations placed on the company's capacity by its object as formulated in the memorandum.[38]

Several modern developments relating to corporate formation have limited the probability that *ultra vires* acts will occur, except in the case of non-profit organizations, this legal doctrine is obsolescent. Within recent years, almost all business corporations are chartered to allow them to transact any lawful business.[39]

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[36] CILLIERS, H.S and BENADE M.L. (1982) Company Law 4th Edition. Butterworths – Durban at page 105

[37] CILLIERS, H.S and BENADE M.L. (1982) Company Law 4th Edition. Butterworths – Durban at page 105

[38] *Abrahamse v Connock's Pension Fund 1963 (2) SA 76 (W); Re Jon Beaufort (London) Ltd [1953] 1 All ER 634 (Ch)*

[39] www.answers.com/topic/u;tra-vires (accessed on the 12th May 2007 – ultra vires: definition and much more from answers.com)

CHAPTER FOUR:

THE *TURQUAND* RULE VS. THE DOCTRINE OF *ULTRA VIRES:* THE DECISION IN MBANA V MNQUMA MUNICIPALITY 2004 (1) BCLR 83 (TK) ANALYZED.

As pointed out earlier the doctrine of constructive notice complements the *ultra vires* doctrine, while the full impact thereof is again tempered by the *Turquand Rule*. It has been submitted that it is correct to say that section 36 of the Act[40] protects third parties only in respect of a limitation on the powers of the directors, which follows from them having acted beyond the capacity of the company.

It does not protect third parties where the authority of a director or other organ of the company is limited by some other fact. For example, by the articles or resolution of the company. Where the limitation derives from an act of internal management, the rule of **Royal British Bank v Turquand**[41] may be used.[42]

Therefore, because these two rules are so closely related that it might cause confusion, it is important to distinguish them from each other and the scenarios where they will be used.

4.1 Facts of the case

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40 The Company Act 61 of 1963

41 (1856) 6 E & B 327)

42 PRETORIUS J.T et.al (1999) HAGLO'S South African Company Law through the Cases. 6th Edition. Juta & Co. Ltd at page 65

In this case the executive mayor of the defendant municipality had purported to conclude an employment contract with the plaintiff, appointing the plaintiff as municipal manager of the defendant. The municipal council of the defendant had not made any decision in this regard, or assigned or delegated powers of appointment to the executive major. The latter had nevertheless gone ahead and appointed the plaintiff, purporting to bind the defendant to an employment contract. When the defendant dismissed the plaintiff and removed him from office, the plaintiff sued the defendant for breach of contract.

It was the contention of the plaintiff's counsel that the defendant was bound by the acts of its executive mayor and that it was irrelevant in law that the executive mayor had not been authorized by the defendant municipality. He relied on the *turquand* rule being applicable and argued that, subject to the level of seniority of the official with whom a third party such as the plaintiff is dealing, the rule would simply obviate the fact that such an act was *ultra vires.*

The defendant held that the *turquand* rules finds no application as the parties were dealing with a provision of an act of parliament which was not complied with when the contract was allegedly entered into.[43]

Therefore in order to reach a conclusion an analysis of the *Turquand Rule* and the *Ultra Vires Doctrine* was conducted and the following conclusions where reached:

4.2 The *Turquand Rule* (as laid down in the case of **The Royal British Bank v Turquand (1856) 6 E & B 327)**

The rule states that, when a third party enters into a contract with a company, there is a legal presumption that all acts of the company's internal management have been properly carried out. It is important to note that, in circumstances where the *turquand* rule applies, it is an irrebuttable presumption. Where the *turquand* rule applies, the company will be bound to the contract even if it is proved that the necessary acts of internal management

[43] TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown)

were not carried out or were irregular or defective or that the representative of the company had no authority to bind the company.[44] The presumption arises by operation of law and it becomes irrelevant whether or not a third party has read the company's memorandum or articles of association to find out what the necessary acts of internal management were.[45]

This rule often applies where a person enters into a contract on behalf of a company, professing that authority to represent the company has been delegated to him by a board of directors. If the delegation of authority in question was invalid owing to some defect in the company's internal management, the third party will be protected by the *turquand* rule and the company will be bound by the contract.[46]

Therefore, the main purpose of the establishment of the turquand rule was to protect the third parties against being taken advantage of by the company officials. Its application could never be extended to promote illegality by forcing its application in situations of *ultra vires,* instead of promoting legality.[47]

However there are certain instances where the turquand rule would not be applied, namely

(1) The third party was aware of the fact that the agent of the company had a defective mandate.

(2) The circumstances surrounding the transaction was suspicious that should have had the effect of placing the third party on his guard.

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44 TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown)

45 *Mineworkers' Union v Greyling 1948 (3) SA 831 (A)*

46 TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown)

47 TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown)

It should be noted that not only the turquand rule provides an exception to the common law position that an act outside the scope of the company would be non binding. Another commonly used exception is that of estoppel. If it can be proved that the representation was made by the company and that this representation had authority and induced a person into the transaction and thereby causing prejudice, the company would be bound by that particular act even though it was outside its authority.

4.3 **The Doctrine of *Ultra Vires*:**

The doctrine of *ultra vires* serves as a justification for interfering in administrative decisions. Any such decisions that are viewed as *ultra vires* may be challenged on review and set aside by the courts by way of review. This doctrine, which still plays an important role in our law, is tied to the theory of the separation of powers and to the supremacy of parliament. It is therefore the duty of the court to see that the intention of parliament is carried out within the boundaries of their power.[48]

4.4 Ruling:

Based on what was mentioned above the court came to the following conclusion. The position in **Mbana's case**[49] was where a statute prescribed the procedures to be followed before a municipal manager is employed, and where such statutes are not complied with, the party who subsequently purports to enter into a contract of employment appointing the municipal manager is acting *ultra vires* and such contract becomes invalid. The *turquand rule* in this regard finds no application, based on the fact that the contract could not be allowed to stand even if the third party was innocent.[50]

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[48] TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown)

[49] *Mbana v Mnquma Municipality 2004 (1) BCLR 83 (Tk)*

[50] TSHIKI, P. (2004) The Turquand Rule vs the Doctrine of *ultra vires*. In DE REBUS, April 2004 (Publisher and Place of Publication unknown). See the following cases: (1) *Khani v Premier; Vrystaat en Andere 1999 (2) SA 863 (O); (2) Mathipa v Vista University and others 2000 (1) SA 396 (T)*.

It should be remembered that the *turquand rule* has never been successfully raised where its application would defeat the purpose of a statutory provision. It has been long since established that parties are free to arrange their affairs so as to remain outside the provisions of a particular statute[51], however what they may not do is conceal the true nature of their transaction or in the words of Innes JA in the case of **Zandberg v Van Zyl 1910 AD 302,** at page 309

> '…call it by a name, or give it a shape, intended not to express but to disguise its true nature…'

Fisher AJ, in the present case stated as follows

> "…The *turquand rule* can never be used as a mechanism whereby a court could or would bind an authority such as the defendant municipality to an act which is *ultra vires…'*[52]

Therefore, the *turquand rule* basically means that an outsider is entitled to assume that the internal requirements of the company have been complied with, and therefore the company would be bound even if the internal requirements and procedures have not be complied with.

4.5 Turquand Rule and the Doctrine of Constructive notice:

Prior to the establishment of the *turquand rule*, the doctrine of constructive notice complemented the *ultra vires* doctrine in that any person dealing with the company was deemed to be fully acquainted with the public documents of the company of which the memorandum contains the objects clause was one.

A person was therefore not capable of arguing that they were unaware of the limitations on the company's capacity. [53] The doctrine of constructive notice also had an impact of

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[51] *Zandberg v Van Zyl 1910 AD 302; Dadoo Ltd and Others v Krugersdorp Municipal Council 1920 AD 530; Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd 1941 AD 369*

[52] *Mbana v Mnquma Municipality 2004 (1) BCLR 84 (Tk)* at page 94 paragraph 26

[53] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 190

the application of estoppel. As a result of this doctrine, a third party could not contend that he was misled by the company as to the extent of the agent's authority and therefore he could not rely on estoppel.

The full impact of this was however tampered with by the incorporation of the *turquand rule* which as indicated above clearly states that a third party is entitled to assume that the internal requirements of the company has been complied with.

CHAPTER FIVE:

SECTION 36 OF THE COMPANIES ACT 61 OF 1973

Formally, a transaction couldn't be binding on a company unless *intra vires* the company, in other words within the transactional capacity of that company. Since 1973, this particular restriction no longer exists, and the position has changed in that persons purporting to transact as an organ of the company (usually, the board of directors, the managing director, or a committee of the board) bind the company

(a) when they have actual authority to enter into the transaction

(b) When, even though they do not have actual authority, certain statutory provisions or common principles render the transaction binding on the company.

5.1 Understanding Section 36

Section 36 of the Companies Act 61 of 1973 states that

> '…**Acts not *ultra vires* the company not void**...No act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf on the company by reason only of the said fact and, except as between the company and its members or directors, or as between its members and its directors, neither the company not any other person may in any legal proceeding assert or rely upon any such lack of capacity or power or authority…"

However, there is some controversy with regards to the correct interpretation of this section. It is respectively submitted that the effects of this section are to be described as follows

"…no act of a company shall be void by reason only of the fact that the company was without capacity…'

This phrase could be described as being a contradiction of terms. The effect of this phrase is to give a new meaning to the word capacity, with regard to corporate transactions. An act beyond the capacity of the company is now merely an act beyond the objects of the company.

Prior to the coming into force of the Companies Act of 1973, where a company acted *ultra vires*, the act was void and it was incapable of ratification. Section 36 of the Act, leaves intact the principle that the capacity of a company is limited and that acts, which are beyond its capacity are *ultra vires*. Section 36 laid down the grounds that only certain people are permitted to raise issues of *ultra vires*. In terms of section 36 an *ultra vires* act is valid and enforceable between the company and the other contracting party.

It is considered irrelevant whether or not the outside party knew that the company's act was *ultra vires,* [54] even if the outsider knew that the act was *ultra vires*, the act is not void and the act is as binding on both of them as if it were not *ultra vires.*

"…or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact…"

If the directors of a company had no authority to perform an act solely because the company lacked the capacity to do that act,[55] then the act is not thereby rendered void.

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[54] WILLIAMS, R.C (2003) Concise Corporate and Partnership Law. 2nd Edition. LexisNexis – Butterworths – Durban at page 140

[55] If a company lacks capacity to do an act then it follows that no director of the company can have authority as the company's agent to enter into such act on the company's behalf. An agent's authority cannot be greater than his principle capacity.

However, if the directors of a company had no authority to act on behalf of the company for some other reason, then section 36 does not apply and their lack of authority has ordinary consequences, namely that the company is not bound by the act. Is should be remembered that the company is capable of ratifying the act.[56] If it does not ratify the act, the third party can sue the directors for damage for breach of warranty of authority.

"…except as between the company and its members or directors or as between its members and directors, neither the company nor any other person may in any legal proceedings assert or reply upon suck lack of capacity, power or authority.."

As between a company and it co-contracting party, section 36 has abolished the *ultra vires* doctrine, but internally, section 36 has effected no change to the common law position. Therefore, a member can interdict a company from entering into an *ultra vires* transaction. The company however, should have already entered into the transaction; the members can not prevent it from performing its obligations under the transactions. If the company does enter into an *ultra vires* transaction and loss is incurred, the responsible director could be sued in his/her personal capacity for the damages.[57]

Further, this section did not apply in relation to conduct which is prohibited by the Companies Act or by the common law, or which will *intra vires* the company was considered to be *ultra vires* the powers of the directors under the articles of association or in breach of one or other of their fiduciary duties.

The effect of this section could therefore be described as follows. If a contract is concluded between the company and X (X being a stranger to the company, a member or a director) and the conclusion of a contract is *ultra vires* the company, the company can resile from the contract provided that there is an addition ground for doing so besides the mere fact that the conclusion of the contract was *ultra vires*. Therefore, the company is not capable of resiling from a contract if there is no alternative ground for it wishing to

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[56] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. LexisNexis/Butterworths – Durban at Page 141

[57] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. LexisNexis/Butterworths – Durban at Page 141

do so. In this situation the company as is X are bound by the contract, even if it is one that the company in fact had no power to make at all.[58]

At common law, the principle is that where a wrong has been done to a company, only the company may take proceedings against the wrongdoers.[59] The principle of **Foss v Harbottle**[60], which is a serious and sometimes insurmountable obstacle for the minority shareholders instituting can action on behalf of the company, is partly derived from the consideration that the company is a legal person distinct from its members[61] and partly from the consideration that, if the majority of the company's members by way of ordinary resolution, were to waive or condone the wrongdoing, for the court to intervene at the instance of the minority.[62] It should also be noted that a member of the company has an inherent right to sue for an injunction against the company.[63]

Section 36 however, expressly provides that it is not applicable to internal matters.[64] In terms of the contract that exists between the company and its members in terms of section 65(2) a member may rely on such a contract in order to prevent the company from acting in contravention of its contractual obligations.[65]

However, should be wrongdoers themselves control the company, so they can effectively prevent the taking of necessary proceedings, any one of the other members may bring an action, known as a derivative action. This basically means an action in his/her own name or names against the delinquents and the company for relief to be granted to the

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58 MESKIN (2005) Henochsberg on the Company Act - volume 1

59 *Foss v Harbottle (1983) 2 Hare 461.*

60 (1843) 2 Hare 461

61 *Salomon v Salomon & Co Ltd [1897] AC 22. Dadoo v Krugersdorp Municipal Council 1920 AD 530* where the important company law principle is exemplified that a company on it formation is a separate entity, it acquires the capacity to have its own rights and duties. It acquires legal personality and exists apart from its members.

62 *MacDougall c Gardiner (1875) 1 Ch 13 CA @ page 24-26*

63 PENNINGTON, R.R. (1967) Company Law. 2nd Edition. Butterworths – London at page 89. See the cases of Colman *v Eastern Countries Rail Co. (1846), 10, Beav. I*; *Simpson v Westminster Palace Hotel Co. (1860), 8 H.L. Cas.712*

64 Internal interest here is taken to mean as between the company and its members or directors or as between its members and its directors.

65 CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 186

company, the action effectively being one on its behalf.[66] This particular action is provided for in section 266 of the Company Act of 1973.[67] For the derivative action to be instituted in terms of section 266, preconditions have developed that have to be present

(a) The act complained of must constitute a *wrong or a breach of trust or breach of faith* as a result of with *the company* has suffered damages or loss or been deprived of any benefits, in addition, the company must not have instated legal proceedings against the wrongdoer.[68]

(b) The person against whom such an action can be instituted must be directors or officers who caused the damage or loss or former directors or officers who caused such damage or lost whilst in office.[69]

From this it is evident that section 266 requires that the wrong must have been done to the company. It is not sufficient if the wrong was suffered only by a member of the company. The word *wrong* clearly covers negligence and the phrase *breach of trust or breach of faith* obviously includes a breach of the fiduciary duties which a director owes to the company.[70]

It should be remembered that the derivative action will be defeasible where in the circumstances it would be inequitable to permit the particular member to pursue it where he has obtained and retained a benefit from the very wrong done to the company of which he complains.[71]

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66 *Francios George Hill Family Trust v South African Reserve Bank 1992 (3) SA 91 @ page 97-98)*

67 The enactment of section 266 was done on the recommendation of the Van Wyk de Vries Commission into the company act that recommended for a provision for a statutory derivative action to overcome the difficulties and uncertainties associated with the common law derivative action.

68 WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition. LexisNexis Butterworths – Durban at page 256

69 Ibid

70 WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition. LexisNexis Butterworths – Durban at page 256/257

71 *Towers v African Tug Co. [1904] 1 Ch 558 (CA); Nurcombe v Nurcombe [1985] 1 ALLER 65 (CA)*

It should be remembered that section 36 does not operate to prevent the institution of this action or the section 266 proceedings, nor does it operate to preclude for the purpose of such action or proceedings, the assertion by the plaintiff or the plaintiffs on his reliance on the voidness of the relevant act by the company, except of course, for the purpose of avoiding such act.[72]

In the case of **Smith v Croft**[73] it was held that

> "…the review of many authorities that the derivative action founded on conduct of *ultra vires* the company is defeasible where a majority of the member's independent of the wrongdoers, resolve to abandon or compromise the company's right to action. If it is an expression of the corporate will of the company by an appropriate independent organ that is preventing the plaintiff from prosecuting the action, he or she is not improperly but properly prevented… the appropriate independent organ will vary according to the constitution of the company concerned and the identities of the defendants who will in most cases be disqualified from participating by voting in expressing the corporate will.[74]

A member of a company has a personal right *qua* member, derived from the contractual nature of the memorandum as between himself and the company. Threatened conduct which would be *ultra vires* may be interdicted by him. It is submitted that section 36 does not preclude his doing so, it operates only at the stage when an *ultra vires* act has occurred.[75]

5.2 The importance of Section 36

The common law position was that a company could not act or function beyond its objects and if it did indeed so act, these particular acts were declared to be *ultra vires* and therefore void because the company did not exist for the purpose beyond its capacity. The new statutory regime created by section 36 is still supplemented by the rule that the

72 DELPORT P. & VOSTER Q. (2006) Henochsberg on the Companies Act – December 2006 5th edition – Butterworths at page 66
73 *Smith v Croft [1987] 3 ALLER 909*
74 MESKIN (2005) Henochsberg on the Company Act – volume 1
75 Ibid

provisions of the memorandum and thus of the object clause constitute a binding contract between the company and each of its members in has capacity as a member.

It is evident that there are still numerous aspects concerning section 36 that are in dispute; however the scope of the provision could be summarized as follows

(a) The essence of section 36 is that no act of a company is void merely by reason of the fact that the company was without capacity or power so to act. This section does not abolish the common law *ultra vires*, only the consequences of such an act. For example, where in the past such acts were void, it is now expressly provided that they are no longer void, but they do not become *intra vires.*[76]

(b) The doctrine of constructive notice has lost its importance and relevance as far as the main objects clause in the memorandum of the company is concerned.[77]

(c) The doctrine of constructive notice still operates unimpaired in respect of the other provisions in the memorandum and articles, so the company may still avoid liability by proving that its agent lacked the necessary authority to bind the company.[78]

(d) The main purpose of the *ultra vires* could be said to be that the doctrine was to protect both the members and the creditors of a company by ensuring that corporate funds where applied only in connection with the business that the company was incorporated to conduct.[79]

Most important of all would be the fact that the section has no application at all where an act of a company is capable of being avoided on some other ground other than the fact

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[76] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 185

[77] Ibid

[78] Ibid

[79] JOUBERT W.A (founding Editor) (1996) The law of South Africa volume 4 Part 2 Butterworths: Durban at page 313

that the doing of the act was *ultra vires* the company. Thus the section does not apply to prevent a company from resiling from a contract, whether the conclusion was *intra* or *ultra vires* the company, on the ground that a director or anyone else, who purported to conclude it on the company's behalf, lacked the required authority.[80]

It should be remembered that the intention of section 36 is not to disable the company for asserting the common law right to repudiate a transaction, nor is it the intention to constitute any director of a company as an agent as to cause it to be bound by anything he purports to do on the company's behalf.[81] The provisions of section 36 are concerned with instances falling within or outside the capacity and powers of the company as ascertained by reference to the memorandum and the statutory extensions in terms of section 33 and 34 respectively.[82]

5.3. Criticisms of the *ultra vires* doctrine:

Over the years there has been an extensive attack on the doctrine in the context of company law. It became apparent that the doctrine has outlived its usefulness; because of business practices and legislative changes, it has ceased to be any real protection to members or creditors but remains as great a trap as ever for an unwary third party.[83]

The effect of the section was to abolish the doctrine of *ultra vires* totally in as far as third parties were concerned, whether or not they had actual knowledge of the company's lack of capacity remains necessary that a third party who seeks to hold a company liable on the basis of an act of a director purportedly done on the company's behalf should show

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80 DELPORT P. & VOSTER Q. (2006) Henochsberg on the Companies Act. 5th Edition. Butterworths at page 65

81 DELPORT P. & VOSTER Q. (2006) Henochsberg on the Companies Act. 5th Edition. Butterworths at page 65

82 CILLIERS, H.S & BENADE, M.L (1982) Company Law 4th Edition. Butterworths – Durban at page 109

83 VISSER, C. (2003) Gibson South African Mercantile and Company Law 8th Edition. Juta & Company: Pretoria at page 287

that the director was in some way authorized to perform the act, whether or not it is *ultra* or *intra vires* the company's capacity.[84]

It has been pointed out that certain powers will be implied in order to enable the company to pursue its objects and therefore another major criticism of the doctrine comes into existence. In the case of **Charterbridge Corporation v Lloyds Bank, Ltd [1969] 2 ALLER 1185** it was held that if the transaction involves implied powers then, unless the suggested power is one which would be reasonably incidental to the carrying out of the company's business objects, no such power will be implied and the transaction would be *ultra vires*. [85]

CHAPTER SIX:

84 VISSER, C. (2003) Gibson South African Mercantile and Company Law 8th Edition. Juta & Company: Pretoria at page 288

85 LEIGH L.H et.al. (1981) Northey & Leigh's Introduction to Company Law. 2nd Edition. Butterworths – London at page 73/74

ANALOGY OF SECTION 38 OF THE NEWLY DRAFTED NAMIBIAN COMPANIES ACT 28 OF 2004 AND SECTION 2(4) OF THE CLOSED CORPORATIONS ACT 69 FO 1984

Section 38 reads as follows

> "…subject to this section a company has the capacity and powers of a natural person of full capacity, as far as a juristic person is capable of having that capacity or of excising those powers…"

Subsection of section 38 goes on to state that

> "…the memorandum of the company may state the
>
> (a) objects of the company
>
> (b) the objects of the company where, it is so required by this act or any other law,
>
> but where the objects of the company or where any exclusion or qualification in terms of section 39, with regards to the objects or powers of the company, including an existing company is stated, it only serves to restrict the capacity and powers of the company internally as between the company, its members and its directors, unless a person dealing with the company had actual knowledge or ought to have known of the statement of the company or of any exclusion or qualification in terms of section 39 with regards to the objects or powers of the company stated in the company's memorandum…"

It is clear that when comparing the two sections with each other, namely section 36 of the old Act[86] with the new act[87], it becomes evident that the wording has totally changed and that the new section makes no reference to the acts that a company participates in. It merely states that the capacity of the company is exactly the same as that of a natural person as far as a juristic person is capable of having these powers. The interesting

[86] The Company Act 61 of 1973

[87] The Company Act 28 of 2004

element to note is the fact that the wording of section 38 is exactly the same as that of section 2(4) of the Closed Corporations Act of 1984. (Referred to in the next chapter)[88]

The new section, it could be said, tries to link the concept of a company with that of a closed corporation which to a certain extend can be justified as there exists numerous similarities between these particular types of business formations. For example both enjoy forms of perpetual succession. What this basically means is that traditionally, any change in membership had the effect of terminating the partnership, whether the change was from agreement between the partners or membership was reduced or a death of a partner,[89] however a company always remained in existence irrespective if membership changed.[90]

It should be remembered that the existence of this particular section is relatively new when compared with the old Companies Act that has been in operation since 1973, therefore; as a result there is not much that has been written on this particular section. For practical purposes reference is made to the powers and capacities of a closed corporation.

The legal capacity of a closed corporation is in most cases unlimited and does not form any hindrance to its participation in business. Those having dealings with a closed corporation do not run the risk of finding the validity of transactions being affected by internal limitations in the corporation's legal capacity.[91] This however, does not imply that a closed corporation's capacity and powers are totally unlimited for all intents and purposes.

There are various restrictions limiting a corporation from participating freely in commercial transactions.[92] In the case of **Exparte Donaldson**[93] a company was appointed

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[88] FOUND ON PAGE 34 - 38 of the next chapter

[89] *Standard Bank v Wentzel & Lombard 1904 TS 828 @ 835*

[90] *Webb & Co. v Northern Rifles 1908 TS 462*

[91] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 629

[92] For example the inability of a closed corporation to act as a trustee of a unit trust scheme or to practice as a medical doctor or an advocate.

[93] 1947 (3) SA 170

as the guardians of minor children by the testator who they accepted, however, this was not allowed by the court. By applying the decision of this court in this instance to the wording of section 38 of the Companies Act 28 of 2004 or even section 2(4) of the Closed Corporations Act, it becomes clear that although a company might be formally limited anymore, there are still certain situations were their power and capacity would not extend to.

The power of members to bind the corporation is set out in section 54 of the Closed Corporations Act of 1984. This section provides that each member or the corporation is an agent of the corporation, in relation to a person who is not a member of the corporation and is dealing with the corporation.[94] The act of a member binds the corporation to such a third party, whether the act was preformed for the carrying on of the business of the corporation or not.

If a member so acting in fact had no power to act for the corporation in the particular matter, he will still bind the corporation in respect of a third party dealing with the corporation, unless the outsider has, or ought reasonably to have knowledge of the fact that the member had no such power.[95] Therefore, should the outsider not have had or ought to have had reasonably knowledge of the members lack of authority, a corporation may be bound to a contract falling outside the scope of the corporations business, even if it is not actually or ostensibly authorized or ratified by the corporation.[96]

Since there is no constructive notice required for the provisions of an association agreement, knowledge or internal restrictions on member's powers contained therein is not imputed on outsiders. As stated in the case of **The Royal British Bank v Turquand (1856) 6 E& B 327** they are entitled to assume that each member has the necessary authority to act on behalf of the corporation and that the internal relations of the company has been complied with.

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[94] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 630

[95] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 630

[96] Ibid

It should be remembered that section 54 of the Closed Corporation Act 69 of 1984 deals only with the power of a member to bind the corporation in relation to a person that is not a member of the corporation and who is dealing with the corporation. Therefore, section 54 would not apply for example to the following scenarios

(a) a non-member acting as a agent of the corporation
(b) the person dealing with the corporation is not an outsider but a member, or
(c) the outsider is unaware of the existence of the corporation at the time of the conclusion of the contract
(d) The outsider is aware of the existence of the corporation but deals with the member in his personal capacity and not as an agent of the corporation.[97]

An important question that would then have to be asked is whether the company would be subjected to the same statutory limitations that have been opposed on the closed corporations. For example a closed corporation is not capable of acting as a trustee of a unit trust scheme in terms of section 20 of the Unit Trusts Control Act 54 of 1981 or to practice as a medical doctor or an advocate. On the reverse side would it also mean that the company, having the powers and capacities of a closed corporation can partake in business practices such as pharmacist,[98] estate agents,[99] practice as a quantity surveyor in private professional practice,[100] or render a security service,[101] if the necessary statutory requirements are met?

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97 CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 631
98 Pharmacy Act 53 of 1974
99 Estate Agents Act 112 of 1976
100 Quantity Surveyors' Act 36 of 1970
101 Security Officers Act 92 of 1987

CHAPTER SEVEN:

ANALYSIS OF SECTION 36 AND SECTION 38 OF THE COMPANIES ACT 63 OF 1971 AND 28 OF 2004 RESPECTIVELY

There have been various attempts especially in South African company law to have the doctrine of *ultra vires* totally declared invalid and removing it and its effects from having any legal ramification on contracts entered by a company.

Due to the complexity of the doctrine and the extent to which it has become and integrated part of modern company law, it was decided better merely to alter the consequence of the doctrine. This was done as mentioned above, by changing the law declaring *ultra vires* acts which previously were regarded as being void *ab initio* too voidable at the instance of the parties. This basically meant that even if previously the act would have been regarded as being *ultra vires* it would remain valid at the discretion of the parties.

The Van Wyk de Vries Commission of enquiry into the Company Act therefore recommended in 1970, prior to the enactment of the company act of 1973

> '…that a new section be incorporated in the act to the effect that no act of a company shall be invalid by reason only of the fact that the company was without the capacity or power to perform such an act; or by reason that the directors lacked the authority only because of that fact, and that except as between a company and its members or directors, or as between its directors and its members, neither the company nor any other person may assert or rely upon such lack of capacity, power or authority in any legal proceeding…" [102]

Under the old Company Act of 1973, section 36 basically states that should the company, whether it be the company itself, the directors or its members exceed their powers, the act that follows as a result of this would not merely because of this, be declared invalid.

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[102] Commission of Enquiry into the Company Act - Main Report Pretoria, 15th April 1970 at page 30

Therefore the effect of this particular section, namely section 36, was apparently to abolish the doctrine of ultra vires totally in so far as third parties were concerned, whether or not they had actual knowledge of the company's lack of capacity. Although the section is not worded very clearly, it also seems that the section, by referring to director's lack of authority, is concerned only with his lack of authority to perform acts that are *ultra vires* the company.

However, it is clear that under the new Company Act of 2004, section 38 can clearly be interpreted without any limitation, that a company is considered to have the capacity and powers of a natural person, however only as far as a juristic person is capable of having these powers.[103] Therefore based on this it can be said that a company has the same powers and capacities as a closed corporation as section 2(4) of the Closed Corporations Act[104]

> "… A closed corporation has the capacity and powers of a natural person of full capacity in so far as a juristic person is capable of having such capacity or of exercising such powers…."

What this means is that the company has all the powers and capacities of a natural person however, this capacity is limited to the type of personality of the entity. A company or a closed corporation for example would not be able to complete a will. It should also be noted immediately that a natural person is not capable of acting *ultra vires*. They are considered to have 'unlimited capacity', if it could be called so to enter into any agreement out of their own free will. Therefore, as a natural person is not capable of acting beyond his/her capacity, the *ultra vires* doctrine can not be considered to be applicable in the strict sense of the word.

It should be noted that prior to the enact of the new company act in Namibia, the capacity of the company was limited to the actual or deemed main object stated in the memorandum everything beyond the scope of these objects were *ultra vires* the company,

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[103] For example: this means that the company would not be able to conclude a will or be a party to a marriage as this is something that can only be done by natural persons.

[104] Closed Corporations Act 69 of 1984

although outsiders could nevertheless, by virtue of section36 (of the old company act of 1973) hold the company to the *ultra vires* contract.

When drafting the Closed Corporations Act of 1984 the legislature considered it unwise to burden a closed corporation, its members and third parties with the *ultra vires* doctrine and the doctrine of constructive notice. Stated generally, the Act in effects provides that these doctrines have no application and are not relevant to the question of whether or not a closed corporation is bound by a particular contract made on its behalf.[105]

As mentioned earlier, a closed corporation has the capacity and powers of a natural person in so far as a juristic person is capable of having such capacities and powers. For this reason, the *ultra vires* doctrine has no application in respects of closed corporations and there is no need for an equivalent of section 36 of the Companies act. The statement of the principal business of the corporation in the founding statement does not affect the corporation's capacity and powers. [106]

The scenario with a company is completely different, in that a company's capacity is limited to the main object(s) contained in the memorandum and everything beyond the scope of this memorandums objective is considered to be *ultra vires* the company. The existence of section 36 merely provides outsiders the opportunity to nevertheless hold the company to an *ultra vires* contract.[107]

However, it remains necessary that a third party who seeks to hold a company liable on the basis of an act of a director purportedly done on the company's behalf, should show that the director was in some way authorized to perform the act, whether or not it is *ultra* or *inter vires* the company's capacity. [108]

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[105] CILLIERS H.S et.al (2000) Cilliers and Benade: Corporate Law 3rd Edition. Butterworths- Durban at page 628

[106] Ibid

[107] WILLIAMS R.C (2003) Concise Corporate and Partnership Law. 2nd Edition. LexisNexis Butterworths – Durban at page 321

[108] VISSER C. et al (2003) Gibson: South African Mercantile and Company Law 8th Edition. JUTA & Co.: Pretoria at page 288

It should be remembered that merely because the company has been granted the capacity of a closed corporation, it does not necessarily mean that a company would also be able to enjoy the advantages of a closed corporations.

CHAPTER EIGHT:

CONCLUSION

When a company and a closed corporation are compared, they alike in the fact that they are both corporate bodies having juristic personality distinct from their members with their own rights and obligations, but it is apparent that a closed corporation is much less rigidly controlled and the rules are much simpler.[109] Every member in a corporation is entitled to participate in the carrying on of the business and has equal right in the management of, and in the power to represent the corporation. The complexity of *ultra vires* as mentioned above does not apply to a closed corporation.

Despite section 36 of the Company Act this doctrine continues to bedevil company law, however, the role that the *ultra vires* doctrine plays has been reduced drastically due to the incorporation section 36 of the Companies Act 61 of 1973, which clearly states that acts which are outside the capacity of the company, not considered to be void.

This provides the protection to the third party who enters into contracts with the company, to hold the company liable even if the person did not have the required authority. Therefore it can be said that the existence of section 36 abolished the common law provision of *ultra vires,* as acts that are outside the capacity of the company is no longer considered to be *void ab initio*.

When looking at the Namibian Company Act 28 of 2004, the intention of the legislature becomes evident, n that instead of mentioning that acts *ultra vires* the company were not void, they merely gave a company the capacity of a closed corporation in the sense that their capacity and powers extend to that of a natural person however, there are certain things that a closed corporation and in this case a company would not be able to conclude.

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[109] VISSER C. et al (2003) Gibson: South African Mercantile and Company Law 8th Edition. JUTA & Co.: Pretoria at page 442

As mentioned above the *ultra vires* and doctrine of constructive notice is not applicable to closed corporations. In the strict sense of the word, it could be said that a company can no longer act *ultra vires* as they have the capacities a powers of a natural person. Although, it should be taken into consideration that there are other statutory limitations that can be placed on a company, indicating that they would not be able to act in that particular area.

The major justification behind the current state of affairs could be contributed to the fact that totally removing the *ultra vires* doctrine would result in gaps in the law that would be nearly impossible to fill. Although the doctrine of ultra vires has lost importance, the exceptions of the turquand rule and estoppel are still applicable. The effect of the doctrine of estoppel is that it would prevent a company from denying liability provided that a third party is capable of proving certain elements.

The doctrine of estoppel could therefore be said to support the idea that a company should have the powers and capacities of a natural person and provides a third party with some protection should it be that the company for some particular reason decides to deny liability, provided however, that the third party has discharged his burden of proving the necessary requirements.

It is therefore held that when drafting the new Companies Act 28 of 2004, it was the intention of the legislature to remove the doctrine of *ultra vires* from Namibian Company law and grant them greater powers and capacities to enter into a wide range of activities while in the same instance providing the contracting parties with the protection of the Turquand rule and the doctrine of estoppel which enjoys an complexed relationship. Should a party not be entitled to protection afforded under the one, can as a final instance in the corresponding doctrine or rule in order to hold the company liable.

CHAPTER NINE

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