

NOTES / AANTEKENINGE

CONTRACTING WITH THE BODY CORPORATE OF A SECTIONAL TITLE SCHEME

1 Introduction

The judgment in *Torgos (Pty) Ltd v Body Corporate of Anchors Aweigh* (2006 3 SA 369 (W)) ("*Torgos*") is of great importance to trustees and bodies corporate of sectional title schemes, and to third parties entering into contracts with the trustees. It is respectfully submitted that the ultimate decision arrived at by the court is correct, but that trustees and third parties may well be confused by the court's reasoning in coming to that decision. The effect of the judgment is that when the Sectional Titles Act ("the Act") and rules empower the trustees to bind the body corporate of a sectional title scheme provided certain "preliminaries" are gone through, a third party dealing with the trustees is not obliged to investigate whether those preliminaries have actually been observed but may assume that they have in fact been complied with. Accordingly, the third party may hold the body corporate to a contract entered into by the trustees, even though the "preliminaries" were not met. However, a third party who enters into a contract with the trustees to purchase the body corporate's right to extend the sectional title scheme *cannot* assume that the written consents required for the sale in terms of section 25 of the Act have in fact been obtained. Absent the written consents, the sale agreement entered into by the trustees is void. This begs the question: why cannot third parties also assume that the "preliminaries" referred to in section 25 have been observed? Putting it differently, what can third parties assume and what not?

2 The *Torgos* case

The applicant, a property developer, had entered into an agreement with two trustees of a sectional title body corporate (the first respondent) whereby it purported to obtain a cession of the body corporate's right to extend the sectional title scheme. This brought section 25 of the Act into play. Subsection (1) empowers a developer of a sectional title scheme to reserve the right to extend the scheme from time to time, while subsection (6) stipulates that if no reservation is made or a reservation has lapsed for any reason, the right to extend the scheme vests in the body corporate. In terms of a proviso to subsection (6) "the body corporate shall only exercise or alienate or transfer such right with the written consent of all the members of

the body corporate as well as with the written consent of the mortgagee of each unit in the scheme ...”

The applicant sought an order enforcing the agreement. It contended that the required written consents contemplated in section 25(6) need only be obtained before *registration of transfer* and not before the conclusion of an agreement *giving rise to the transfer*, such as a cession. The contention was that in the context of section 25 “alienate” should be interpreted to mean the same as “transfer”, in that both constitute the same act of registration in the deeds office. A mere sale agreement cannot constitute a transfer of ownership and was merely the underlying contract which gave the purchaser the personal right to claim transfer of ownership. Accordingly, the written consent need only be obtained before *transfer*, not before entering into any *agreement to transfer*. The argument was amplified by the submission that the cession between the applicant and the body corporate comprised two parts: the first portion, which created the binding obligation, did not require the consent of all members to be binding; the second part, namely the transfer in the deeds office, did require such consent.

The first respondent’s defence was that the agreement was void in that the requirements of section 25(6) had not been met: the written consent of the members of the body corporate and the mortgagees of the units had not been obtained prior to the conclusion of the sale agreement.

The applicant’s proposal to purchase the right of extension was discussed at a meeting of the body corporate in November 2002. The body corporate took a decision that the trustees were to appoint a committee to negotiate the contract with the applicant. The minutes recorded that the applicant’s offer was unanimously accepted. However, the members did not each specifically give their *written consent* as such.

In the court’s view two issues were central to the dispute, namely:

- “(a) the authorisation or otherwise of those who purported to enter into the agreement on behalf of the body corporate;
- (b) the applicability or otherwise of s 25(6) of the Act to the agreement and the impact, if any, thereon.”

In respect of the first issue the court held that the applicant had been entitled to believe that the trustees who signed the agreement had been authorised to do so on behalf of the body corporate. The body corporate was therefore liable on the contract even if the signatories had not *actually* been authorised by the body corporate to sign the agreement, since they were *ostensibly authorised* to do so. On the second issue the court held that the written consents required by section 25(6) must be furnished prior to the conclusion of an agreement constituting an act of alienation, such as a cession. This was not done in the present case, with the result that the agreement was void. The application was thus dismissed.

The court’s reasoning in respect of the *first issue* was as follows:

- The body corporate had resolved that a committee be appointed by the trustee to “negotiate” an agreement with the applicant. “Negotiation” is

aimed at achieving a certain result, such as reaching an agreement. However, there is no guarantee that “negotiation” will necessarily be successful and in fact result in an agreement. It could therefore not be said that the body corporate, by empowering the committee to “negotiate”, had impliedly empowered it to enter into an agreement with the applicant. In short: the committee was empowered to do no more than “negotiate” and the conclusion of any resulting agreement was not within its powers.

- The fact that the committee was not empowered to conclude an agreement with the applicant, was not the end of the matter. Section 25(6) empowers the body corporate of a sectional title scheme to exercise, alienate or transfer the right to extend the sectional title scheme, provided the written consents contemplated in the subsection are obtained. Section 39(1) of the Act, read with management rules 25 and 26 prescribed by the regulations promulgated under the Act (“the prescribed rules”), empower the trustees of a body corporate to exercise and perform any or all of the powers of the body corporate. Accordingly, trustees of a body corporate have the power to extend the sectional title scheme on behalf of the body corporate, subject to the provisions in section 25(6).
- The agreement in question was signed by two trustees in apparent compliance with rule 27 of the prescribed rules. This states that “(n)o instrument signed on behalf of the body corporate shall be valid and binding unless it is signed ... by two trustees”. There was no evidence that the powers of the trustees were restricted by any direction given at a general meeting of the body corporate. In the circumstances the applicant was entitled to assume, in good faith, that the trustees had the necessary authority to enter into an agreement on behalf of the body corporate for the sale and cession of the right of the body corporate to extend the sectional title scheme. The *Turquand* rule of company law was of “equal application” in an instance such as the present. People dealing with a sectional title body corporate cannot be expected to know of irregularities that may take place in the internal management of the body corporate; in terms of the *Turquand* rule a presumption arises that those acts of internal management have actually been performed. In the circumstances the applicant was entitled to believe that the trustees signing the agreement were authorised on behalf of the body corporate. The result was that the body corporate was bound by all acts performed by the trustees within the scope of their actual or ostensible authority.

In respect of the *second issue* the court’s reasoning was as follows:

- The purpose of the proviso to section 25(6) (namely that the body corporate may only exercise, alienate or transfer the right of extension with the written consent of all the members of the body corporate and of the mortgagee of each unit) is to protect owners of units from discovering that the value of their undivided share in the common property of the sectional title scheme has been diminished or has disappeared by cession of the right vested in the body corporate to

extend the scheme. Moreover, the proviso aims to protect unit owners from discovering that a scheme, which originally had a limited number of units and an extended expanse of common property and amenities, unexpectedly had the number of units increased and the common property diminished by reason of a developer exercising the right of extension which formerly vested in the body corporate. In short, in so far as the members of the body corporate or the owners of the units were concerned, they were entitled to be protected against a diminution in the value of their units, whether this value was in monetary terms or by way of enjoyment of their units. Similarly, the mortgagees are protected from discovering (or not discovering) that the value of the security upon which they relied when making finance available to the owners of units had been depleted or diminished. The proviso was solely for the benefit of unit owners and mortgagees and none other.

- The legislature had intended in the Act that a distinction be drawn between the words “alienate” and “transfer”. To “alienate” was not the same as to “transfer”. In the context of section 25(6) “alienate” included the disposition of the right to extend the scheme through a sale and cession, while “transfer” referred to the formal act required by statute and which publicly enacted and completed such disposition. One could do neither without the written consent of owners and mortgagees.
- Section 25(6) permits a body corporate to alienate its right of extension *only* with the necessary consents. Absent such consents, the body corporate is not permitted to do so. Generally speaking, consent may be given *ex post facto* by subsequent ratification. In the context of section 25(6), however, it was difficult to envisage that consent could be given by all the members of the body corporate at some stage after the agreement to alienate has been concluded. All the *indiciae* attested to the fact that an agreement made contrary to the provisions of section 25(6) was a nullity. Accordingly, the written consents required by the proviso to section 25(6) must be furnished prior to the conclusion of the agreement, which is the act of alienation.

3 The *Turquand* rule

As stated earlier, the ultimate decision arrived at by the court in *Torgos* cannot be questioned. However, what is confusing, is the court’s reference to the *Turquand* rule and the application of that rule in the context of contracts concluded by trustees of a sectional title body corporate. The court expressed itself as follows:

“The *Turquand* rule, so named after *Royal British Bank v Turquand* ((1856) 119 ER 886 (Ex Ch) (6 E & B 327; [1843-1860] All ER Rep 435), seems to me to be of equal application in an instance such as the present. People who deal with the body corporate cannot be expected to know of irregularities that may take place in the internal management of the body corporate of Anchors Aweigh. *Where the Act and the rules provide that trustees have the power to bind the body corporate of Anchors Aweigh but the Act and rules provide that certain preliminaries should be gone through before that power can be duly exercised, then Torgos, in dealing with the trustees, should not be bound to*

investigate whether such preliminaries have actually been observed. Torgos should be entitled to presume that they have actually been observed. The *Turquand* rule is not simply that Torgos is entitled to assume that the necessary acts of internal management have been performed, but that a presumption arises that they have actually been performed.

Application of the *Turquand* rule, also referred to in applicant's counsel's heads of argument as the 'rule of indoor management', would entitle the applicant to continue to seek to enforce whatever agreement it has entered into with the trustees of Anchors Aweigh should it transpire that the body corporate never gave the necessary authority to the trustees, or the general meeting of the body corporate is not prepared to ratify the action of the trustees or should it transpire that the trustees were acting beyond their delegated powers. The *ratio* for extending this well-known rule to the body corporate of a sectional title scheme is that Torgos cannot be expected to look beyond the public documents regulating the affairs of or empowering the trustees of Anchors Aweigh. Torgos cannot be expected to investigate the internal management arrangements made by the Anchors Aweigh body" (own emphasis).

With respect, much of what is stated here is correct, but the confusion comes in with the statement italicised. The court in *Royal British Bank v Turquand* did not decide that where the Companies Act empowers the directors to bind the company provided certain "preliminaries" (ie requirements stated in the Companies Act) were complied with, third parties dealing with the directors may assume that those statutory requirements have in fact been observed. All that was decided was that "where the directors of a company do an act which under the articles of association they might or could have power to do, persons dealing with them are not bound to investigate the private concerns of the company and to ascertain whether a condition precedent which may exist to the due exercise of that power has in fact been performed ..." (*Paddon & Brock Limited v Nathan* 1906 TS 158 163). This principle (generally referred to as the *Turquand* rule) has been followed and applied by South African courts on many occasions (see *The Mineworkers' Union v JJ Prinsloo*; *The Mineworkers' Union v JP Prinsloo*; *The Mineworkers' Union v Greyling* 1948 3 SA 831 (A); Pretorius *et al Hahlo's South African Company Law Through the Cases* 6ed (1999) 359 361) but our courts have never interpreted it to mean that where *statutorily* prescribed steps must be taken before the directors may enter into a contract, third parties contracting with the directors may in all instances simply assume that those steps have in fact been taken, whether those steps are classifiable as acts of internal management or otherwise. A company is created by statute, and where the legislature prohibits a company from performing a specific act unless certain requirements, preliminaries or internal management formalities have been complied with, it is of cardinal importance to establish what consequences the legislature had envisaged should the act be performed without complying with the statutorily imposed pre-requisites. The legislature's intention may be clearly stated in the empowering provision, but in the absence of such a clear statement the crucial question is: did the legislature contemplate a *Turquand* situation, or was it the intention to invalidate the act where the statutorily imposed requirements, preliminaries or internal formalities have not been complied with?

Section 228 of the Companies Act 69 of 1973 affords a good illustration in this regard. It reads as follows:

“228. Disposal of undertaking or greater part of assets of company

- (1) Notwithstanding anything contained in its memorandum or articles, the directors of a company shall not have the power, save with the approval of a general meeting of the company, to dispose of –
 - (a) the whole or substantially the whole of the undertaking of the company, or
 - (b) the whole or the greater part of the assets of the company.
- (2) No resolution of the company approving any such disposal shall have effect unless it authorises or ratifies in terms the specific transaction.
- (3) ...”

The section does not in express terms spell out the consequences should a contract contemplated in ss (1) be entered into by the directors of a company without the approval of the general meeting. The matter has given rise to much controversy. In an *obiter dictum* in *Levy v Zalrut Investments (Pty) Ltd* (1986 4 SA 479 (W) 487B) the view was expressed that the *Turquand* rule finds application in such instances, with the result that a third party involved in such a transaction would be able to enforce the transaction, provided he is unaware that the general meeting has in fact not approved the transaction. This approach has found some support among academic writers (Von Willich “Die Uitwerking van artikel 228 van die Maatskappywet 61 van 1973 op die *Turquand*-reël” 1988 10 *Modern Business Law* 7; Wunsh “Section 228 of the Companies Act and the *Turquand* Rule” 1992 *TSAR* 545) but has been questioned or rejected by others (Brooks “Section 228 of the Companies Act” 1987 50 *THRHR* 226; and Fourie “Verkoop van die Onderneming van die Maatskappy – Het Artikel 228 van die Maatskappywet nog Betekenis?” 1992 *TSAR* 1). However, in *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* (2004 2 SA 146 (C)) the court held expressly that the *Turquand* rule cannot be invoked so as to negate the provisions of section 228. What has to be sought is the intention of the legislature, and in the context of section 228 it cannot “be established indisputably that the Legislature intended something different from the ordinary meaning conveyed by the words used” (157D). It could never have been the legislature’s intention to curb the authority of directors in section 228, well-knowing that the *Turquand* rule would effectively neutralise the provisions of the section.

It is submitted that the same approach must be followed where the trustees of a sectional title scheme enter into contracts on behalf of the scheme’s body corporate, and statutorily imposed requirements or formalities have not been complied with. The intention of the legislature is paramount, not the *Turquand* rule.

4 Contracting with a sectional title body corporate

The position regarding the enforceability of contracts entered into by trustees of a sectional title body corporate can be stated as follows:

- 1 All contracts entered into by the body of trustees on behalf of the body corporate are valid and binding on the body corporate, where (a) the contract concerns a matter falling within the functions and powers of the body corporate, and (b) the requirements imposed by the Act, the rules and/or the general meeting of the body corporate have been complied with.
- 2 Section 39 of the Act and rule 25 of the prescribed management rules empower the trustees to perform or exercise the powers and functions of the body corporate. Section 39(1) reads as follows:

“The functions and powers of the body corporate shall, subject to the provisions of this Act, the rules and any restriction imposed or direction given at a general meeting of the owners of sections, be performed and exercised by the trustees of the body corporate holding office in terms of the rules.”

Rule 25 is similarly worded. Neither section 39(1) nor rule 25 empower the trustees to do anything *but to perform or exercise the powers and functions of the body corporate*. Accordingly, contracts entered into by the trustees which have nothing to do with the functions or powers of the body corporate, or a specific duty imposed on the trustees by the Act or the management rules, cannot bind the body corporate unless the trustees were specifically authorised by the general meeting to conclude such contract, or if the body corporate can be estopped from relying on the lack of authority. Thus, whether trustees enter into a contract, purportedly on behalf of the body corporate, to rent vacation accommodation for themselves, the third party would not be able to hold the body corporate liable on the contract. Arranging holiday accommodation for the trustees does not fall within the functions and powers of the body corporate stated in the Act, and trustees are not empowered by section 39 or any prescribed rule to enter into such contract on the body corporate's behalf.

- 3 A contract entered into by trustees on a matter within the functions and powers of the body corporate is not necessarily binding on the body corporate simply because the contract concerns the body corporate's affairs. Section 39(1) and rule 25 empower the trustees to perform or exercise the powers and functions of the body corporate subject to (i) the provisions of the Act, (ii) the rules and (iii) restrictions imposed or directions given at a general meeting of the owners of sections. Where the trustees enter into a contract with a third party on a matter within the functions and powers of the body corporate, but the relevant restrictions or prerequisites imposed by the Act, rules or general meeting have not been observed, the question whether the contract binds the body corporate depends in the first place on whether the disregarded

prerequisites or requirements are statutorily imposed or otherwise. The following situations can be distinguished:

(a) Prerequisites or restrictions imposed by the Act have not been met

Neither section 39(1) nor prescribed rule 25 empowers the trustees to do something which the body corporate as such is not permitted or empowered to do. For example, in terms of section 26(1) the body corporate may purchase land to extend the common property if authorised to do so in writing by all the members. In terms of section 39(1) the trustees may exercise the body corporate's powers, but they are not empowered to enter into an agreement to purchase land to extend the scheme without the required consent. The trustees can only do what the body corporate is empowered to do, namely to purchase the land *provided* the written authority of all the body corporate's members has been obtained. Similarly, the trustees are not empowered to let the common property in terms of a long lease unless the owners have by unanimous resolution directed the body corporate to do so (s 17(1)). In all these situations the trustees act outside their powers if they enter into contracts with a third party but the required consents have not been given. Whether a contract concluded by the trustees in such circumstances is valid or void, depends on the legislature's intention. The decisive issue is not whether obtaining the required consent can be classified as an act of internal management. The key question is whether or not the legislature intended to invalidate a contract entered into by the trustees where the statutorily imposed prerequisites for such contract have not been met. Obviously, disputes and uncertainties can arise if the legislature's intention is not clearly stated but is open to debate. Accordingly, from a practical point of view a third party dealing with the trustees on any such matter would be well-advised to make enquiries and to ensure that the required prerequisites have in fact been complied with.

(b) Prerequisites or restrictions imposed by the prescribed management rules have not been met

The prescribed management rules are published in the Government Gazette and are in fact regulations promulgated in terms of the Act. They in effect constitute subordinate legislation. Accordingly, what was stated in paragraph (a) applies equally to a situation where the prescribed management rules impose restrictions on the contracting powers of trustees. For example, in terms of rule 33 of the prescribed management rules the trustees may effect luxurious improvements on the common property only with the unanimous consent of the members of the body corporate. Therefore, the trustees have no authority to effect such improvements without the unanimous consent of the members. Whether a contract entered into by the trustees without such consent is

nevertheless binding on the body corporate depends on the legislature's intention. In some instances the legislature's intention may be easier to determine than in others. For example, rule 27 of the prescribed rules reads as follows:

"No instrument signed on behalf of the body corporate, shall be valid and binding unless it is signed by a trustee and the managing agent referred to in rule 46 or by two trustees or, in the case of a certificate issued in terms of section 15B(3)(i)(a)(aa) of the Act, by two trustees or the managing agent."

The rule is perfectly clear: a contract signed on behalf of the body corporate not in accordance with the provisions of the rule is not valid and is not binding on the body corporate. A third party dealing with a body corporate which manages its complex in terms of the prescribed management rules, cannot therefore be heard to complain if a body corporate denies liability on a contract which has been signed by one trustee only.

Where a particular rule is less clear about the consequences should the requirements stated in the rule not be met, a third party wishing to avoid disputes would be well-advised to make enquiries and to ensure that all required formalities have been observed before he enters into the contract with the trustees.

(c) Prerequisites or requirements imposed by "own" rules have not been met

Difficulties may arise where a body corporate has replaced all or some of the prescribed management rules with its own rules, and restrictions on the trustees' contracting powers are imposed by such "own" rules. Own rules made by a body corporate are not published in the Government Gazette. When a body corporate amends or repeals the prescribed rules, it must notify the Registrar of Deeds on a prescribed form, and changes to the rules take effect only from the date of filing of such notification by the Registrar (s 35(5)(a) and (c)). This raises the question whether a third party is at risk if, for example, a contract is concluded by two trustees contrary to an "own" rule stipulating that a contract above a certain monetary limit is void and does not bind the body corporate unless it is signed by the body corporate's managing agent and at least three trustees.

If "own" rules can be regarded as public documents by reason of the fact that they have been filed with the Registrar, the third party can be expected to be aware of restrictions imposed by the rules on trustees' contracting powers. In other words, in the example given, the third party would not be able to hold the body corporate liable if only two trustees signed the contract. It is submitted that the same would apply even if it could be argued that "own" rules are not public documents in the same sense as the prescribed rules. The position would then be similar to situations where contracts are entered into by the trustees of a trust.

Trust deeds are not public documents and, as was made clear by the Supreme Court of Appeal (*Nieuwoudt NNO v Vrystaat Mielies Edms Bpk* 2004 3 SA 486 (SCA)), persons contracting with the trustees of a trust do so at their risk because it may well be that the trustees in question are not empowered to enter into the contract at all. Third parties dealing with a sectional title body corporate cannot simply accept or take it for granted that the relevant scheme is governed by the prescribed management rules. The Act (s 35(5)) empowers a body corporate to replace and/or amend the prescribed rules, and third parties can reasonably be expected to be aware of the possibility that the body corporate with whom they are dealing has in fact exercised its powers in this regard.

To protect their interests, third parties contracting with a body corporate should therefore insist on obtaining a copy of the relevant management rules governing the scheme and be alert to any restrictions imposed on the contracting powers of the trustees.

(d) Requirements or restrictions imposed by the general meeting of the body corporate have not been met

Where a third party contracts with the trustees of a body corporate in respect of a matter that clearly falls within the functions and powers of the body corporate and in respect of which no specific requirements or pre-requisites are prescribed by the Act or the rules, the third party is entitled to assume that the trustees are authorised to enter into the contract and that all internal requirements that may have been imposed by the general meeting of the body corporate in respect of the contract have been complied with. This is an application of the *Turquand* rule. For example, if a contractor enters into a contract with the trustees to maintain the gardens of the sectional title complex, the contractor may enforce the contract despite the fact that the general meeting may have resolved that the agreement must first be approved by the body corporate's managing agent. A third party contracting with a body corporate is not expected to investigate whether any internal requirements were imposed by the general meeting and, if so, whether the relevant requirement(s) had been met. The protection afforded by the *Turquand* rule would, however, fall away if (a) the third party *knew* that the internal formalities had not been complied with, or (b) the circumstances surrounding the negotiations are of such a nature that any reasonable person would be placed on guard and enquire whether the pre-requisites had been complied with, but the third party failed to make such enquiries (Cilliers and Benade *Company Law* 4ed (1982) 122).

- 4 In terms of rule 27 of the prescribed management rules a contract signed on behalf of the body corporate must be signed by a trustee and a managing agent, or by two trustees. This does not necessarily mean that a trustee who signs the contract is in fact authorised to do so. The Act (s 39(1)) empowers the *body of trustees*, not *individual* trustees, to perform

the functions and powers of the body corporate. Rule 26 of the prescribed rules empowers the trustees to delegate their powers to one or more of the trustees, but a third party dealing with a trustee cannot simply assume that such trustee has delegated authority to conclude the contract. The fact that the trustee is the chairperson of the body corporate makes no difference: neither the Act nor the rules clothe the chairperson with any special contracting authority, and it cannot be assumed that the chairperson has any implied authority similar to the authority of a managing director of a company (on which see: *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* (1978 2 SA 11 (T))). A third party dealing with individual trustees and not the body of trustees should therefore ensure either that those trustees are acting in terms of a delegated authority contemplated by rule 26, or that the body of trustees have approved the contract and empowered the individual trustees to sign.

- 5 Contracts entered into with a third party but which are not binding on the body corporate by reason of the fact that the trustees had no authority to conclude the contract, may in appropriate instances be ratified by the body corporate or the body of trustees, depending on the circumstances. This is an application of the ordinary principles of agency. If the contract is not ratified, the third party may still succeed in holding the body corporate to the contract if the principles of estoppel can be successfully invoked. A detailed discussion in this regard falls outside the scope of this note.

In appropriate instances a third party contracting with the trustees of a body corporate should consider adding a clause to the contract whereby the trustees in question assume personal liability for the due performance of the body corporate's obligations in terms of the contract, should it turn out that the body corporate is not bound to the contract because the trustees had not been empowered to enter into the contract on the body corporate's behalf.

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