VICTORIA FALLS STEAM TRAIN CO (PVT) LTD *v* WANKIE COLLIERY CO LTD

High Court, Harare

Makarau J

Civil application

28 October 2003 and 7 January 2004 Judgment No. HH-3-04

Company — contracts with — validity — contract concluded in violation of company's internal procedures — when valid — mala fides *— whether invalidates contract*

The rule in *Royal British Bank v Turquand* (1856) 6 E & B 327, 119 ER 886, which prevents a corporation from relying on non-compliance with its internal procedures to avoid contractual liabilities towards a third party, applies only where the third party was a genuine outsider acting in good faith, and where the transaction was carried out in good faith and was a legitimate one within the powers of the corporation though lacking completeness in terms of the corporation's internal arrangements. The rule does not apply in cases where there has been a forgery, nor should it apply in the analogous case where the transaction has been carried out in deliberate violation of the internal procedures of the corporation.

The applicant sought to enforce a contract of sale concluded with an official of the respondent company. The official had concluded the sale five days after he went on leave pending retirement, returning to work specially to conclude the contract, and had violated the company's procedures for the disposal of capital assets. The price at which the asset was sold was below its true value. The evidence indicated that the official intended to favour the applicant to the prejudice of the respondent company, and that the applicant should have realised this.

Held that sale was not a genuine sale and the applicant was not a genuine outsider, and the rule in *Turquand*'s case did not apply to it.

Cases cited:

Royal British Bank v Turquand (1856) 6 E & B 327; 119 ER 886

Ruben & Anor v Great Fingall Consolidated [1906] AC 439 (HL)

Uxbridge Permanent Benefit Building Society v Pickard [1939] 2 KB

Walenn Holdings (Pvt) Ltd v Integrated Contracting Engineers (Pvt) Ltd & Anor 1998 (1) ZLR 333 (H)

A P de Bourbon SC, for the applicant

R Fitches, for the respondent

MAKARAU J: The issue that falls for determination in this application is whether the Turquand rule applies in the circumstances of this matter to bind the respondent to a contract of sale with the applicant of one 19th class locomotive.

The facts of the matter are fully canvassed in the affidavit of the applicant and that of Claudius Wabatagore on behalf of the respondent. These can be summarised as follows:

The applicant made an offer for the locomotive to one Murdock-Eaton, then the General Manager (Operations) for the respondent by letter dated 18 October 2002. Correspondence was exchanged between the applicant and Murdock-Eaton before Murdock-Eaton accepted the offer on 5 February 2003, five days after he had proceeded on leave pending his leaving the employment of the respondent on retirement. Payment for the locomotive was tendered on 13 February and was duly receipted. The cheque was however returned later when the respondent refused to tender delivery of the locomotive, citing the fact that other organisations had made an offer for the same locomotive, making it unavailable for sale by private treaty. Aggrieved by this, the applicant approached this court and on the basis of the above facts, obtained by consent, a provisional

order restraining the respondent from disposing of the locomotive pending the determination of whether the respondent should be compelled to deliver the locomotive to applicant in terms of the agreement of sale.

In opposing the confirmation of the provisional order, the respondent has alleged that the purported sale of the locomotive to the applicant by Murdock-Eaton was highly irregular in that the normal procedure for the disposal of excess assets institutionalised by the public company were not followed. The transaction is described in the affidavit of Wabatagore as

> "a deliberate underhand, fraudulent corrupt, improper, unauthorised transaction concocted and engineered between a now former employee of the respondent ….and the applicant's representative who were in cahoots with each other for either their mutual personal benefit or the benefit of one of them to the prejudice of the respondent, well knowing that the respondent would never have accepted to sell one of its 19th Class locomotives for the sum of $2 000 000-00."

To substantiate the allegation that the entire transaction between the applicant and Murdock-Eaton was irregular, Wabatagore detailed in his affidavit, the process through which the respondent could dispose of a capital asset. The procedure starts with the asset being declared redundant in a particular section and a check being carried out by the Chief Engineer as to whether the asset can be used in some other department. The procedure also involves at one stage the asset being removed from the

asset register of the respondent, a function that is carried out by the respondent's Finance Manager on the approval of the Managing Director and on the recommendation of the Chairman of the Committee on Capital Assets. Thereafter, the asset is advertised and sold off.

The above procedure was not followed when Murdoch-Eaton purportedly sold the locomotive to the applicant. This is common cause. Further, the applicant is not disputing that this is the procedure that the respondent had set up for the disposal of its capital assets. Its argument is that in terms of the law, a person dealing with a corporation cannot be prevented from enforcing a contract because of incomplete internal arrangements. The argument advanced on behalf of the applicant proceeds to rely on the Turquand rule that seeks to prevent corporations from relying on its internal procedures to avoid contractual liabilities.

The case from which the rule is coined is *Royal British Bank v Turquand* 119 ER 886. In that case, two directors of the respondent company singed a bond in favour of the plaintiff, binding the respondent. The signature was under the company seal. In terms of its constitution, the directors of the respondent could borrow on behalf of the company, under a company resolution. No such resolution was passed. When pressed for payment under the bond, the respondent raised the absence of a resolution to pass the bond as a defence. It did not succeed. The principle upon which the case was decided (the Turquand rule) was to the

effect that partied dealing with a corporation are not bound to do more than peruse the statutes of the company and if the power to transact is given in the statute, then the party so contracting has the right to infer that the authority to so transact on the part of the corporation has been perfected by the necessary resolutions.

The Turquand rule was applied in this court in the case *of Walenn Holdings (Pvt) Ltd v Integrated Contracting Engineers (Pvt) Ltd &Another* 1998 (1) ZLR 333 (HC). In that case, the court applied the rule to bind the respondent to the purchase of certain shares, the transaction of which had been negotiated and settled by two of the directors who later claimed they had not been authorised by the corporations by resolution to negotiate and conclude the purchase of the shares. In very instructive dicta, the court also proceeded to discuss some of the instances in which the Turquand rule does not apply.

It does appear to me from a reading of the cases in which the rule has been applied and from texts on the subject, that the contracting party must itself be acting in good faith and that the entire transaction must have been carried out in good faith. It must be a genuine transaction in all other respects save the internal formalities necessary to clothe it with the authority laid down in the statutes of the company. The third party must have been a genuine outsider for them to be afforded protection by the rule.

My understanding of the application of the rule is that the transaction must be within the powers of the

corporation and must be legitimate but simply lacking completeness in terms of internal arrangements. The corporation is then stopped or estopped from raising the incomplete internal arrangements to avoid liability on the contract. Where however, the transaction is tainted by mala fides, the rule does not apply[1] to the prejudice of the corporation, to bind it to a transaction that it would not have authorised in the first place.

It is settled law that the rule does not apply in cases where there has been a forgery. (See *Ruben v Great Fingal Consolidated* [1906] AC 439 (HL) and *Uxbridge Permanent Benefit Building Society v Pickard* [1939] 2 KB 248). It would appear to me the correct view to hold that the position where the transaction sought to be enforced has been concluded in deliberate violation of the internal procedures of the corporation appears to me to be similar or analogous to one where there has been a forgery. I have however been unable to find any authority to support this view.

In the application before me, it appears to me that the sale of the locomotive to the applicant by Murdock-Eaton was not a genuine sale that simply lacked authorisation by way of a resolution. It was a transaction carried out in flagrant disregard of the procedure set out by the respondent to enhance trasparency when disposing of capital assets of the company. Murdock-Eaton simply set out to sell the locomotive outside these procedures. In my view, he abused his position of trust to purport to sell a capital asset in violation of the internal procedures that had

1 See charlesworth's company law 13th Ed. P137

been set up to protect the very conduct that he engaged in, that of not being transparent in the disposal of capital assets by a public company. He was part of senior management. He must have been party to the drawing up of the disposal procedure that was aimed at enhancing transparency and accountability. He further took advantage of his leaving the respondent on retirement to purportedly bind the respondent to a sale that he had irregularly conducted. The height of the irregularity of the sale lies in the fact that despite having proceeded on leave pending retirement on 1 February, Murdock –Eaton returned five days later simply for the purposes of accepting the offer by the applicant. He then copied that acceptance to other senior employees of the respondent.

The applicant has further argued that the locomotive was under-priced. This on its own may not have weighed much with me. However, the cumulative consideration of the under- pricing, the fact that the offer to purchase the locomotive was accepted by an officer of the respondent who was supposed to be on leave, and the manner in which that officer bypassed laid down procedures, lead me to two conclusions. Firstly, I have no doubt in my mind that Murdock-Eaton was out to prejudice the respondent in the way he conducted himself. Secondly, I conclude that the applicant was not a genuine outsider and ought to have been put on its inquiry by the suspicious conduct of Murdock-Eaton had it been a genuine outsider. The applicant has not answered to the specific averment that

Murdock-Eaton accepted its offer after he had proceeded on leave. There is no denial of this averment in the applicant's papers, suggesting that the applicant was aware of the irregularity.

I have further considered whether the sell an asset belonging to the respondent is a power that would ordinarily have inhered in a person occupying the position of Murdock-Eaton to establish ostensible authority on the part of Murdock-Eaton. I must confess that this argument was not pressed before me. It must have occurred tot counsel for the applicant that it would not succeed as I cannot see the basis for holding that Murdock-Eaton had ostensible authority to sell the locomotive without outside the laid down procedure.

The applicant has referred me to the irregular manner in which some of the respondent's affidavits were filed. In view of the conclusion I come to in this application, it is unnecessary for me to deal with this issue in detail. Suffice it to say that I have not considered these affidavits in dismissing this application.

In the result, I make the following order:

1. The provisional order issued by this court on 17 March 2003 is hereby discharged.

2. The application is dismissed.

3. The applicant is to pay the respondent's costs.

Ahmed and Ziyambi, applicant's legal practitioners.

Scanlen & Holderness, respondent's legal practitioners.