controlled the board and could prevent any investigation into the claims against himself contrary to the best interests of the Company. Mr Butler is a shareholder himself and has the right to seek relief from unfairly prejudicial conduct by the majority shareholder under section 994 of the 2006 Act. Indeed that is the course which he has now taken. …

33 Alternatively, Mr Butler could have brought a statutory derivative action against Mr Smith in accordance with Part 11 of the 2006 Act. Those provisions could be used even if it was necessary to obtain urgent relief. …

➢ Notes

1. In *British Bank of the Middle East v Sun Life Assurance Co of Canada (UK) Ltd* [1983] BCLC 78, HL, it was held that a branch manager of a multinational insurance company had no 'usual' authority to represent to a bank that a subordinate employee had actual authority to execute undertakings to pay moneys to the bank. The evidence was that all such undertakings were in practice executed by insurance companies at their head office.

2. This decision may be contrasted with *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] BCLC 1409, CA. The senior manager in charge of the Manchester office of the defendant bank (as the plaintiff company's representative knew) had no actual authority to sanction a credit facility for the plaintiff. However, he had signed a letter to the plaintiff offering to provide it with finance. He had no actual authority to sign this letter, either; but he was held to have had ostensible authority, by virtue of his position, to communicate such an offer on behalf of the bank—that is, to inform the plaintiff that head office approval had been given for the offer to be made—and so the bank was bound. (Note: it is not possible to rely upon the ostensible authority of an individual if the person transacting with the company knew that the act was beyond the actual authority of the acting official: *Criterion Properties plc v Stratford UK Properties LLC* **[3.13]**.)

3. Also see *Holland* **[7.02]** which discusses the role of *de facto* directors as fiduciary agents of the company.

(p. 123) ***The secretary of a company has usual authority to bind the company in matters concerned with administration.***

[3.15] Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd [1971] 2 QB 711 (Court of Appeal)

The secretary of the defendant company, Bayne, hired cars from the plaintiff, ostensibly for the company's business; but in fact he fraudulently used them for his own purposes. The company was held bound by the contracts to pay the hire charges.

LORD DENNING MR: [Counsel] says that the company is not bound by the letters which were signed by Mr Bayne as 'Company Secretary'. He says that, on the authorities, a company secretary fulfils a very humble role: and that he has no authority to make any contracts or representations on behalf of the company. He refers to *Barnett v South London Tramways Co*[21] where Lord Esher MR said: 'A secretary is a mere servant; his position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all …' Those words were approved by Lord Macnaghten in *George Whitechurch Ltd v Cavanagh*.[22]They are supported by the decision in *Ruben v Great Fingall Consolidated* **[11.13]**. They are referred to in some of the textbooks as authoritative.

But times have changed. A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Act, but also by the role which he plays in the day-today business of companies.

He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having the authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff and ordering cars, and so forth. All such matters now come within the ostensible authority of a company's secretary.

Accordingly I agree with the judge that Mr R L Bayne, as company secretary, had ostensible authority to enter into contracts for the hire of these cars, and therefore, the company must pay for them. Mr Bayne was a fraud. But it was the company which put him in the position in which he, as company secretary, was able to commit the frauds. So the defendants are liable. I would dismiss the appeal, accordingly.

SALMON LJ: I think there can be no doubt that the secretary is the chief administrative officer of the company. As regards matters concerned with administration, in my judgment, the secretary has ostensible authority to sign contracts on behalf of the company. If a company is ordering cars so that its servants may go and meet foreign customers at airports, nothing, to my mind, is more natural than that the company should hire those cars through its secretary. The hiring is part of his administrative functions. Whether the secretary would have any authority to sign a contract relating to the commercial management of the company, for example, a contract for the sale or purchase of goods in which the company deals, does not arise for decision in the present case and I do not propose to express any concluded opinion upon the point; but contracts such as the present fall within the ambit of administration and I entertain no doubt that the secretary has ostensible power to sign on behalf of the company …

MEGAW LJ concurred.

(p. 124) The 'indoor management rule'

The 'indoor management' or 'internal management' rule, also known as the rule in *Royal British Bank v Turquand* **[3.16]**, allows a person dealing with a company to assume, in the absence of circumstances putting him or her on inquiry, that all matters of internal management and procedure have been duly complied with. So, although under the doctrine of constructive notice (see 'Constructive notice and its abolition', p 128) such a person was taken to be aware of the provisions of the company's memorandum and articles, and thus of any procedural restrictions contained in those documents, he was not bound to inquire further. He could take it for granted that its officers had been duly appointed, that meetings had been properly summoned and conducted and that resolutions had been passed by requisite majorities.

The development of the rule, and of various limitations on its application, can be seen in the following cases.

But what is the standing of this rule, and the scope for its application, now that the doctrine of constructive notice has (at least to some extent) been abolished (see CA 2006 s 40(2)(b))? If the rule was itself only a qualification to the doctrine of constructive notice, will it not have been swept away also? For various reasons, it seems not.

First, although the rule did operate to mitigate the effects of the doctrine of constructive notice, that was never its only function. A person dealing with a company is always subjected to uncertainty as to whether its officers have been properly appointed, its resolutions duly passed, etc, whether or not the question arises in connection with a provision in the company's constitution. He simply has to take it for granted that the internal affairs *have* been regularly conducted (and, for that matter, must accept that the company's internal affairs are none of his business). Secondly, although the indoor management rule is commonly regarded as operating only in favour of a person dealing with a company in good faith (see, eg, *Rolled Steel Products (Holdings) Ltd v British Steel Corpn* **[3.17]**), the presumption of regularity in fact applies in a much wider range of situations. It may be necessary to fall back on the common law rule for the protection of someone who is not 'dealing with' a company (s 40), as in the Australian case*Australian Capital Television Pty Ltd v Minister of Transport and Communications* (1989) 7 ACLC 525, where the *Turquand* rule was applied in the context of an application to a government minister for a broadcasting licence.

However, the occasions on which the indoor management rule will be pleaded are likely to be rare:

(i) CA 2006 s 40 largely eliminates the need to raise the rule by way of rejoinder to a contention that the person was affected by the constructive notice doctrine.
(ii) In any case, since the decision in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* **[3.08]**, it is common to use arguments based on ostensible authority rather than rely on the internal management rule to resolve questions in this area.
(iii) Furthermore, there are now a considerable number of statutory provisions designed to protect third parties against possible internal irregularities in a company's decision-making. See, eg, CA 2006 ss 40, 41, 44, 775. The more of these provisions there are, and the more widely they are drafted, the less is the need for the common law rule.

As well as the *Turquand* rule itself, the current scope of the 'exceptions' to the rule must be clarified. It is plain from the *Rolled Steel* case **[3.17]** that a person who knows or has notice of the irregularity in question or has been put on inquiry will continue to be barred from relying on the rule. But a former 'exception' which denied protection to a person who could have discovered the irregularity by inspecting the company's registered documents (*Irvine v Union Bank of Australia* (1877) 2 App Cas 366, PC) has plainly been abolished along with the constructive notice rule.

(p. 125) ***A person dealing with a company is entitled to assume, in the absence of circumstances putting him on inquiry, that there has been due compliance with all matters of internal management and procedure required by the articles.***

[3.16] Royal British Bank v Turquand (1856) 6 E & B 327 (Exchequer Chamber)

Turquand was the official manager of a coal mining and railway company incorporated under the Act of 1844. He was sued on a bond for £2,000 which had been given by the company to the plaintiff bank to secure its drawings on current account. The bond was given under the seal of the company and signed by two directors and the secretary, but the company alleged that under the terms of its registered deed of settlement the directors had power to borrow only such sums as had been authorised by a general resolution of the company, and in this case no sufficiently specific resolution had been passed. The Court of Exchequer Chamber, affirming the judgment of the Court of Queen's Bench, held that even so the company was bound by the bond.

> JERVIS CJ: I am of opinion that the judgment of the Court of Queen's Bench ought to be affirmed. I incline to think that the question which has been principally argued both here and in that court does not necessarily arise, and need not be determined. My impression is (though I will not state it as a fixed opinion) that the resolution set forth in the replication goes far enough to satisfy the requisites of the deed of settlement. The deed allows the directors to borrow on bond such sum or sums of money as shall from time to time, by a resolution passed at a general meeting of the company, be authorised to be borrowed: and the replication shows a resolution, passed at a general meeting, authorising the directors to borrow on bond such sums for such periods and at such rates of interest as they might deem expedient, in accordance with the deed of settlement and the Act of Parliament; but the resolution does not otherwise define the amount to be borrowed. That seems to me enough. If that be so, the other question does not arise. But whether it be so or not we need not decide; for it seems to us that the plea, whether we consider it as a confession and avoidance or a special non est factum, does not raise any objection to this advance as against the company. We may now take for granted that the dealings with these companies are not like dealings with other partnerships, and that the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. And the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorising that which on the face of the document appeared to be legitimately done.
>
> POLLOCK CB, ALDERSON and BRAMWELL BB, and CRESSWELL and CROWDER JJ concurred.

The presumption of regularity cannot be relied on by a person who has notice of an irregularity or has been put on inquiry.

[3.17] Rolled Steel Products (Holdings) Ltd v British Steel Corpn [1986] Ch 246 (Court of Appeal)

For the facts and another part of the decision, see **[3.04]** and **[3.11]**.

SLADE LJ: Mr Shenkman unquestionably had a personal interest in the proposed guarantee and debenture which fell for consideration at the board meeting of the plaintiff on 22 January 1969. Under article 17 of the plaintiff's articles of association he was entitled to vote as a director in regard to these transactions and to be counted in the quorum of two directors required by article 18(a), **(p. 126)** notwithstanding his personal interest, if, but only if he declared his interest 'in manner provided by s 199 of the Companies Act 1948' [CA 2006 s 177] … The judge, as I have said, accepted the evidence of Mr Shenkman that there had been no meeting of the board of the plaintiff before 22 January 1969 at which the desirability of the plaintiff giving a guarantee had been considered; and that he had made no declaration of his personal interest at the board meeting of 22 January 1969. I can see no grounds for challenging either of these findings of fact. Mr Shenkman and Mr Ilya Shenkman were the only two directors present and voting at the last-mentioned board meeting …

[His Lordship accordingly ruled that the directors were acting in breach of the articles in purporting to authorise and in executing the guarantee and debenture. He continued:]

The only remaining questions in this context are whether the judge was right by his judgment to give leave to amend the defence so as to plead that Colvilles[23] was entitled to rely on the resolution as a resolution passed at a properly constituted board of directors at which, Mr Shenkman and Mr Ilya Shenkman having been the only directors present, a proper disclosure of Mr Shenkman's interest had been made …

The possible relevance of the rule in *Royal British Bank v Turquand* **[3.16]** in the present context is obvious.

However … persons dealing with a company registered under the Companies Acts must be taken not only to have read the memorandum and articles of a company, but to have understood them according to their proper meaning: see *Palmer's Company Law*, 23rd edn (1982), vol 1, para 28-02 and the cases there cited.

Colvilles and BSC, therefore, must be taken to have known that, under the articles of the plaintiff, a quorum of two was required for the transaction of the business of its directors, and of the provisions of those articles relating to the declaration of a personal interest. They were well aware of the personal interest of Mr Shenkman in the transactions proposed on 22 January 1969.

The signed minutes of the board meeting of that day, a copy of which was subsequently supplied to Colvilles' solicitors (and indeed had been drafted by them) made no mention whatever of any declaration of a personal interest by Mr Shenkman. Since Colvilles and its legal advisers must be taken to have had knowledge of the relevant provisions of the plaintiff's articles, they must also be taken to have known that the resolution could not have been validly passed *unless Mr Shenkman had duly declared his personal interest at that board meeting or a previous board meeting*.

If, therefore, the defendants are to be allowed both to take and succeed on the *Turquand's* case point, this must mean that, in the circumstances subsisting in late January 1969, they were *as a matter of law* entitled to assume (contrary to the fact and without further inquiry) that Mr Shenkman had duly declared his personal interest either at the board meeting of 22 January 1969 or a previous board meeting of the plaintiff.

This contention might well have been unanswerable if the rule in Turquand's case were an absolute and unqualified rule of law, applicable in all circumstances. But, as the statement of the rule quoted above indicates, it is not. It is a rule which only applies in favour of persons dealing with the company in good faith. If such persons have notice of the relevant irregularity, they cannot rely on the rule …

[His Lordship held that, in any event, the judge had been wrong to allow the amendment to the pleadings.]

LAWTON and BROWNE-WILKINSON LJJ delivered concurring judgments.

➢ Notes

1. The presumption of regularity cannot be relied on by 'insiders', that is, persons who by virtue of their position in the company are in a position to know whether or not the internal regulations have been observed: *Howard v Patent Ivory Manufacturing Co* (1888) 38 Ch D 156 **(p. 127)** (Chancery Division); *Morris v Kanssen* [1946] AC 459. By contrast, therefore, the court was remarkably indulgent in *Hely-Hutchinson v Brayhead Ltd* **[3.09]** in treating as an 'outsider' for the purpose of the rule a person who was a director of a company, though not acting as such in the transaction in question.

2. The presumption of regularity has been held not to apply in the case of forgery: *Ruben v Great Fingall Consolidated* [1906] AC 439, HL. But contrast *Lovett v Carson Country Homes* **[11.14]**, where CA 2006 s 44(5) was deemed to apply despite an outright forgery.

The interaction between the indoor management rule and agency rules

The 'indoor management' rule, or rule in *Royal British Bank v Turquand*, appears in its simplest form in relation to such questions as the due execution of documents, the passing of authorising resolutions and the regularity of elections and appointments. In all these cases, if nothing has occurred which is evidently contrary to the provisions of the company's constitution, the outsider may assume the regularity of all matters internal to the company and its organisation.

Where, however, the issue is whether a single person has, or is deemed to have, authority to represent the company as its representative or agent, these questions of indoor management may become confused with other questions arising from the ordinary laws of agency. The position may be illustrated by various examples. If a person has been appointed to the office of secretary or managing director and acts as such, but there was some technical defect in the procedure by which he or she was appointed, the indoor management rule will apply so as to protect an outsider dealing with the agent. On the other hand, when a person has been appointed as the company's agent either specially, to act in a particular transaction, or generally (eg to manage a branch office), the questions whether he has exceeded the authority conferred upon him and, if so, whether the company as principal is nevertheless bound vis-à-vis a third party, are matters which ought to be determined by the ordinary rules of agency (see the preceding cases and commentary).

A more complex problem arises when a person holding *some* office in the company (commonly a director) purports to act on behalf of the company in a matter which is not within the scope of such an officer's usual activities, but *would* be within the normal functions of another office to which he might have been appointed—for example, a managing director. Such a person may, depending on the evidence, be regarded as either (i) a managing director defectively appointed, (ii) a person held out by the company[24] as a managing director although never appointed as such, or (iii) an officer of limited powers who has without authority simply exceeded those powers. On the first view, the matter is one governed by the indoor management rule;[25] on the second, by the rules of agency;[26] and in either case the third party with whom he deals will be protected. On the third view, the company will not be bound whichever set of rules is applied. It is perhaps not surprising that the cases sometimes fail to keep the*Turquand* and the agency principles distinct.

Many of the older cases seem to have been argued and decided primarily on the basis of the indoor management rule, but they should all now be reconsidered in the light of the judgments in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* **[3.08]**, where the problems raised in cases of this nature were reformulated as issues of agency.

(p. 128) Constructive notice and its abolition

In *Ernest v Nicholls* (1857) 6 HL Cas 401, the House of Lords ruled that a person dealing with a company should be deemed to have notice of that company's registered constitutional documents.

It did not necessarily follow that, because the law gave everyone the *opportunity* to find out about a company's registered documents, there was a corresponding *duty* to do so; and perhaps only an English chancery judge, to whom the notion of constructive notice would have been so familiar, would so readily have run the two ideas together, and disregarded the obvious *non sequitur*. Commercial law generally regards the concept of constructive notice with disfavour; and there is much to be said for the view that, since company transactions (especially as regards outsiders) are mostly of a commercial nature, a rule which deems the world at large to have constructive notice of the registered documents should not have been allowed to gain a footing, still less to have become a central feature of the law.

On the other hand, at the time the doctrine was established, most companies (including the one concerned in *Ernest v Nicholls*) did not have limited liability, so there was some reason to a rule of law that called on those dealing with a company to make investigations. But once limited liability became the norm, and especially after it became the usual practice for shares to be paid up in full, the real trading risk shifted from the shareholders to the creditors, and the constructive notice doctrine ceased to have any proper justification. Businessmen need to make decisions promptly, and for them access to the relevant documents held by the registrar could only be had at too great a cost in time and trouble.

Most jurisdictions have now abolished the constructive notice rule. In England, the argument for reform was first raised by the Jenkins Committee in 1962 as a necessary corollary to that committee's proposal for the reform of the *ultra vires* doctrine. But, as we have seen ('Statutory provisions protecting third parties (outsiders) from the consequences of constitutional limitations on corporate capacity', pp 85ff), no step was taken until the UK's entry to the EU required modifications to domestic company law to comply with the First Directive.

After years of relatively unsatisfactory statutory amendments to comply with this Directive, we have now reached the stage where CA 2006 s 40(2)(b) provides that 'a person dealing with a company is not bound to enquire as to any limitation on the powers of the directors to bind the company or to authorise others to do so …'. In addition, the presumptions in s 40 apply to all those dealing with the company in good faith, and a person 'is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution'. This effectively abolishes the doctrine of constructive notice of the contents of the company's registered documents, and imposes no penalty for failure to take the time to search.

The doctrine of constructive notice might have been challenged much earlier in its history but for the fact that its harshest effects were mitigated by the development, almost contemporaneously with the doctrine itself, of the 'indoor management' or 'internal management' rule, also known as the rule in *Royal British Bank v Turquand* **[3.16]** (see 'The "indoor management rule"', pp 124ff).

Third parties do not have constructive notice of events published in the *Gazette*

The UK has in place an additional disclosure regime of 'official notification': as against third parties, companies may not rely on their implementation of certain specified constitutional changes and other events (eg amendment of articles, appointment of a liquidator) unless they have been properly notified to the registrar and published by the registrar in the *Gazette* (see CA 2006 s 1079 and 'General disclosure obligations', pp 715ff for details). This provision is designed for the protection of third parties (no matter how rarely they might read the *Gazette* !). Given the protective aim, companies cannot rely on the rule as also fixing third **(p. 129)** parties with constructive notice of these events once they are published in the *Gazette*. This emerges from *Official Custodian for Charities v Parway Estates Ltd* [1985] Ch 151, CA.

➢ Question

What is the effect of CA 2006 s 1079 on a resolution such as that held to have been passed in *Cane v Jones* **[4.17]** ?

An amendment of the company's articles will not excuse a breach of contract

A company cannot, by altering its articles, justify a breach of contract.

[3.18] Baily v British Equitable Assurance Co [1904] 1 Ch 374 (Court of Appeal)

The claimant, who was not a member of the defendant company, had taken out a life policy with the company. The company's by-laws (made under the authority of the original deed of settlement) provided that profits from such policies should be distributed to policyholders without deduction. In 1903 it was proposed to register the company under the Companies Act, with articles of association altering the by-laws so as to authorise the transfer of a percentage of such profits to a reserve fund. The plaintiff claimed a declaration that his policy was not affected by the altered articles. Kekewich J and the Court of Appeal granted the declaration.[27]

> The judgment of the Court of Appeal (VAUGHAN WILLIAMS, STIRLING and COZENS-HARDY LJJ) was read by COZENS-HARDY LJ: It is … contended that, as the company was registered under s 209 of the Companies Act 1862,[[28]] it thereby acquired power by special resolution to alter … all or any of the by-laws, and that the plaintiff is seeking to restrain the company from altering by-law no 4 in exercise of this statutory power. And it is said that, apart from the statute, the deed of settlement itself contained a power to alter the by-law, of which power the plaintiff had notice. We cannot assent to this argument. As between the members of a company and the company, no doubt this proposition is to some extent true. The rights of a shareholder in respect of his shares, except so far as may be protected by the memorandum of association, are by statute made liable to be altered by special resolution: see *Allen v Gold Reefs of West Africa Ltd* **[4.22]**.
>
> But the case of a contract between an outsider and the company is entirely different, and even a shareholder must be regarded as an outsider in so far as he contracts with the company otherwise than in respect of his shares. It would be dangerous to hold that in a contract of loan or a contract of service or a contract of insurance validly entered into by a company there is any greater power of variation of the rights and liabilities of the parties than would exist if, instead of the company, the contracting party had been an individual. A company cannot, by altering its articles, justify a breach of contract …
>
> In the present case there was a contract for value between the plaintiff and the company, relating to the future profits of a particular branch of the company's business, and the company ought not to be allowed, by special resolution or otherwise, to break that contract. The appeal must be dismissed.

(p. 130) ➢ Note

A contract may, of course, be construed as incorporating the terms of the articles whatever they may be, and however they may be varied from time to time, just as a person joining a club is taken to agree that he will abide by the club's rules as they may be formulated at any given time. An alteration of the articles would then not be a breach of contract by the company at all (unless it were held to violate an implied term that the company would not alter its articles *mala fide* or unreasonably). *Baily*'s case went to the House of Lords, where the decision of the Court of Appeal was reversed on the basis of such a construction.[29]

[3.19] British Equitable Assurance Co Ltd v Baily [1906] AC 35 (House of Lords)

> LORD LINDLEY: My Lords, this appeal turns entirely on the contracts entered into between the insurance company and its participating policy-holders, represented by Mr Baily … These contracts are to be found in the policies themselves. By each policy the company agree to pay the executors of the assured a fixed sum out of the funds of the company, 'and all such other sums, if any, as the said company by their

directors may have ordered to be added to such amount by way of bonus or otherwise, according to their practice for the time being. Provided always, that this policy is made subject to the conditions and regulations hereon indorsed.' That is the contract between the parties; but the indorsed conditions and regulations are part of it, and the fifth is important. The company was formed as long ago as 1854, and the object of the fifth regulation is to limit the liability of the members of the company. But the regulation throws light on the position of the policy-holders and on what they can claim under their policies. The fifth indorsed condition or regulation in effect provides that the funds of the company, 'after satisfying prior claims and charges according to the provisions of the deed of settlement and by-laws of the company for the time being, shall alone be liable for the payment of the moneys payable under the policy …'.[30] The reference to the deed of settlement and by-laws for the time being is all-important; for the by-laws determine how the profits of the company are to be disposed of, and those by-laws are subject to alteration from time to time by an extraordinary meeting of the shareholders of the company … The policy-holders are not shareholders, and have no voice in making or altering by-laws; but the sum payable under any policy, in addition to the fixed sum mentioned in it, is made by the policy itself to depend upon what the directors may have ordered to be added to such sum, and that depends upon their practice for the time being. The practice of the directors in its turn depends on how the profits are to be ascertained and divided in accordance with the by-laws, which may be altered from time to time, as above pointed out.

My Lords, I am quite unable to adopt the view taken by the courts below as to the inability of the company to alter their by-laws as they have done, and, inter alia, to make a sinking fund without the consent of the policy-holders …

Of course, the powers of altering by-laws, like other powers, must be exercised bona fide, and having regard to the purposes for which they are created, and to the rights of persons affected by them. A by-law to the effect that no creditor or policy-holder should be paid what was due to him would, in my opinion, be clearly void as an illegal excess of power. But in this case it is conceded **(p. 131)** that the alteration contemplated, and sought to be restrained, is fair, honest and business-like, and will, in the opinion of the directors and shareholders of the company, be beneficial as well to the policy-holders as to the shareholders. The sole question is whether such an alteration infringes the rights of the policy-holders. In my opinion it clearly does not.

I am of opinion that the appeal should be allowed …

LORDS MACNAGHTEN and ROBERTSON delivered concurring opinions.

➢ Question

Notice here that the court is expected to ascertain whether an alteration is 'fair, honest and business-like'. Is this comparable to the court's approach in respect of the alteration of a company's articles, as in *Allen v Gold Reefs of West Africa Ltd* **[4.22]** ?

Contracts and the execution of documents

The general rule at common law was that a contract was not binding upon, or enforceable by, a corporation unless it was executed under the company's common seal. But this general rule was subject to exceptions, particularly in relation to routine contracts of relatively minor importance, and it was widely relaxed in favour of trading corporations.

The present position for companies incorporated under the Companies Acts is set out in CA 2006 ss 43–52. The use of a seal is now optional (s 43(1)), and a company may make a contract with no more formality than is required in the case of an individual (s 43(2)). Where the law requires the use of a document and the company's seal is not used, the document is validly executed if signed by two directors or by a director and a secretary

(where the company has a secretary) (s 44(2)(a)). Section 44(2)(b) also adds the option of signature by one director in the presence of a witness who attests that signature. This is especially needed for private companies with a single director.

Section 44 is also protective. For example, a 'purchaser' taking under a document in good faith and for valuable consideration is given very wide statutory protection by s 44(5), wide enough, it would appear, to include a document which is an outright forgery: see *Lovett v Carson Country Homes* **[11.14]**. In *William v Redcard Ltd* [2011] EWCA Civ 466, CA, it was held that the words 'by or on behalf of' were not necessary to invoke s 44(4); it sufficed that 'the reasonable reader would understand the signatures of the natural persons are signatures both on their own account and on behalf of the company' [11].

Pre-incorporation contracts

Before leaving the issue of corporate contracting, one further practical matter deserves mention. It is quite common for negotiations about a contract to take place, and for a contract (or what purports to be a contract) to be made, when one of the parties to this 'contract' is a company which has not yet been formed. Sometimes, the fact that the company has not been incorporated may be known to all concerned and may even be stated in the contract; on the other hand, there may have been some misunderstanding or even a misrepresentation about its existence. Since a 'non-entity' cannot have legal rights or duties ascribed to it, such situations can potentially give rise to all sorts of legal problems. Some of these are resolved by CA 2006 s 51, see following), but not all.

(p. 132) ➢ Questions

1. What business reasons might cause people to make a pre-incorporation contract, rather than form the company first and then conclude the deal?

2. How far would it help to solve the problems to use a ready-made company (Note 2 following *HA Stephenson & Son Ltd v Gillanders, Arbuthnot & Co* **[1.07]**, p 30)?

Companies Act 2006 s 51

> **51 Pre-incorporation contracts, deeds and obligations**
>
> A contract that purports to be made by or on behalf of a company at a time when the company has not been formed has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly.
>
> …

➢ Notes

1. This provision (like its predecessors, CA 1985 s 36C and European Communities Act 1972 s 9(2)) was introduced to implement Art 7 of the First EU Company Law Directive. The aim was to eliminate many of the problems apparent from earlier common law precedents. For example, it seemed that if the purported contract was, on its face, *with* a non-existent company, there could be no contract at all with the company (as it did not exist) and no binding obligations on the promoters (as that was not intended), so third parties were left without a remedy under the contract:[31] *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45, CA 2006. On the other hand, this rule did not protect promoters who acted as principals (clearly), nor, it seemed, promoters who explicitly acted as agents on behalf of their proposed company: see *Kelner v Baxter* (1866) LR 2 CP 174 (Court of Common Pleas), where the promoters were held liable *on the contract* (ie as parties to it).

The contrasting conclusions in these two cases led to some fine distinctions being made by commentators, and to arguments about whether the issue was one of form or substance. In *Phonogram Ltd v Lane* [1982] QB 938, Oliver LJ suggested that the distinction was based on the intention of the parties at the time the contract was formed:[32]

> The question I think in each case is what is the real intent as revealed by the contract? Does the contract purport to be one which is directly between the supposed principal and the other party, or does it purport to be one between the agent himself—albeit acting for a supposed principal—and the other party? In other words, what we have to look at is whether the agent intended himself to be a party to the contract.

This was cited with approval by Dillon LJ in *Cotronic (UK) Ltd v Dezonie* [1991] BCC 200 at 205, on facts which lay outside CA 2006 s 51 and its predecessors. Then all these cases remain relevant.

2. On the other hand, where CA 2006 s 51 applies, many of the difficulties have been settled, for all practical purposes, by the interpretation put on what is now CA 2006 s 51 by the Court of Appeal in *Phonogram Ltd v Lane* [1982] QB 938. In particular, CA 2006 s 51 expressly **(p. 133)** renders the agent personally liable on the contract, 'subject to any agreement to the contrary'. Lord Denning MR said:

> The words 'subject to any agreement to the contrary' mean—as Shaw LJ suggested in the course of the argument—'unless otherwise agreed'. If there was an express agreement that the man who was signing was not to be liable, the section would not apply. But, unless there is a clear exclusion of personal liability, [CA 2006 s 51] should be given its full effect. It means that in all cases such as the present, where a person purports to contract on behalf of a company not yet formed, then however he expresses his signature he himself is personally liable on the contract.

3. The predecessors to CA 2006 s 51 were criticised because, it was said, they focused largely on the liability of the 'agent' and were, at best, ambiguous on the question of what *rights*, if any, were conferred on this person. Those doubts have been largely resolved by the decision in *Braymist Ltd v Wise Finance Co Ltd* [2002] EWCA Civ 127, [2002] Ch 273, CA, which held that the provision not only confers liabilities on the agent, but also rights of enforcement.

This broad interpretation of CA 2006 s 51 leaves the underlying contract subject to all the normal rules of contract. In particular, if a misrepresentation about the identity of the counterparty to the contract (ie the identity of the purported company) induced the other party to enter into the contract, to its detriment, then the other party is entitled to rescind the contract. In *Braymist Ltd v Wise Finance Co Ltd*, the court held that the identity of the vendor (whether it was Braymist or the firm of solicitors) was immaterial to the purchaser, and so the solicitors (the agents who had signed the contract) could enforce the contract of sale.

4. The cases cited previously do not decide the alternative question of whether an agent who has *not* contracted personally might be liable to the opposite party in damages for breach of warranty of authority on the principle of *Collen v Wright*.[33] Parker J at first instance in *Newborne*'s case[34] appears to have doubted this 'because the principal is not in existence', but this begs the question: there are strong *obiter dicta* to the contrary in the Australian case of *Black v Smallwood*;[35] and the well-known case of *McRae v Commonwealth Disposals Commission*[36] plainly establishes that a person may impliedly warrant that what is non-existent exists.

5. A company cannot, by adoption or ratification, obtain the benefit of a contract purportedly made on its behalf before it came into existence. A new contract must be made after its incorporation in the same terms as the old one: *Natal Land Co & Colonization Ltd v Pauline Colliery and Development Syndicate Ltd* [1904] AC 120, PC. CA 2006 retains this rule, in that the contract must be novated; it cannot be ratified. It cannot be ratified, because, at the time the contract was made, the company itself could not have validly entered into the agreement—the company did not exist, and so could have no agents, and cannot now attempt retrospectively to authorise purported agents. Novation may be express or implied.

The Jenkins Committee in its Report (Cmnd 1749, 1962, paras 44, 54(b)) considered the law unsatisfactory and anomalous, and recommended that 'a company should be enabled unilaterally to adopt contracts which purport to be made on its behalf or in its name prior to incorporation, and thereby become a party thereto to the same extent as if the contract had been made after incorporation …'. Many Commonwealth countries have enacted provisions which follow the lines of this recommendation, and a similar reform was projected for the UK in the abortive Companies Bill of 1973, but this proposal was not revived when the First EU Directive was implemented; and so the *Natal Land* case is still good law.

6. The traditional doctrine of privity of contract (which states that a contract cannot confer benefits or impose obligations upon someone who is not a party) could be seen as a further **(p. 134)** obstacle to allowing a company to enforce a pre-incorporation contract. The doctrine has now, in part, been abrogated by the Contracts (Rights of Third Parties) Act 1999, following a recommendation of the Law Commission (Law Com No 242, 1996). This Act allows a person who is not a party to a contract to enforce a term, in certain circumstances, provided that that person is sufficiently identified; and s 1(3) expressly states that the person need not be in existence when the contract is entered into. The Law Commission in its report (paras 8.9–8.16) acknowledged that any change made to the privity doctrine might have some impact on pre-incorporation contracts, but took the view that any considered reform of the latter topic should be dealt with separately as a matter of company law. Of course, since the 1999 Act is concerned only with the enforcement of *rights* by a third party, and not with the imposing of obligations, there is no way in which that Act could be invoked in order to make a company a party in the full sense to a pre-incorporation contract. However, there is scope for its application in a more limited sense—that is, where such a contract includes a term which expressly or purportedly confers a benefit on the unformed company. This could extend to the parties agreeing (for a consideration) that the company, when formed, should have the option of entering into a contract on predetermined terms.

7. As already noted, it is very common for those wishing to incorporate a business to acquire a ready-made company for the purpose, possibly changing its name if the existing name is not thought suitable. In *Oshkosh B'Gosh Inc v Dan Marbel Inc Ltd* [1989] BCLC 507, CA, Mr Craze bought a company named E Ltd 'off the shelf' and later changed its name to DM Ltd. Before the change of name was registered the company, acting through Craze, bought goods from the plaintiff. In an action to make Craze personally liable it was held that s 9(2) of the European Communities Act 1972 [CA 2006 s 51] could not be applied because the company had been formed (albeit under another name) at the time when the contract was made: the issue of an amended certificate of incorporation under CA 1985 s 28(6) [CA 2006 s 80(3)] did not imply that the company had been re-formed or re-incorporated. Again, in *Badgerhill Properties Ltd v Cottrell* [1991] BCLC 805, CA 1985 s 36C was held to be inapplicable where the company was in existence but had been described by an incorrect name. In contrast, in *Cotronic (UK) Ltd v Dezonie* [1991] BCLC 721, CA, a defendant escaped personal liability under CA 1985 s 36C for a different reason. He made a contract in 1986 in the name of W Ltd in ignorance of the fact that W Ltd had been struck off the register under CA 1985 s 652 [CA 2006 s 1000] in 1981 and had ceased to exist. A new company, also named W Ltd, was incorporated in 1989 to continue the business. The court held that he could not be made liable under s 36C because he had purported to make the contract on behalf of the old company and not the new one, which no one had thought about forming in 1986.

➢ Questions

1. Could any or all of the difficulties revealed by the *Natal Land* case have been met by Mrs de Carrey *assigning* her right to the lease to the company after it had been formed?

2. It is possible to create a valid trust for the benefit of an unborn child. Could the problems revealed by the *Natal Land* case have been surmounted by having someone enter into an agreement as trustee, rather than as agent, for the yet to be formed company?

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