

## ***Company Contracting: Lord Neuberger and the Deprecation of Constructive Knowledge***

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*In Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd, Lord Neuberger considered the test governing reliance on apparent authority. His Lordship rejected a reasonable inquiries test, finding that a party will lose the ability to rely on apparent authority only if that party had actual knowledge of the lack of authority or if its belief in authority was dishonest or irrational. However, it is submitted that Lord Neuberger's made three key errors in his reasoning. First, the judge wrongly distinguished a line of cases that appeared to support a reasonable inquiries test on the basis that they were limited to the outdated indoor management rule. Secondly, the judge erred in stating that constructive knowledge has been deprecated in the context of commercial transactions. Finally, while the judge rightly stated that constructive knowledge is no defence in cases of estoppel by representation, apparent authority involves only a weak form of estoppels by representation and is therefore distinguishable. This view of the common law aids interpretation of s 18 of the Companies Act 1993, suggesting that constructive knowledge continues to apply to those engaged in arms' length negotiations.*

### I INTRODUCTION

Sitting on the Hong Kong Court of Final Appeal in *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)*, Lord Neuberger of Abbotsbury considered the state of mind required of a party relying on an agent's apparent authority in order to hold the principle to a contract.<sup>1</sup> Favouring the formulation most consistent with commercial certainty, Lord Neuberger held that the ability to rely upon an agent's apparent authority will only be lost where there is actual knowledge of the lack of authority or if the belief in authority was dishonest or irrational. In reaching this view, his Lordship relied on a line of cases that "deprecated" constructive knowledge in the context of commercial transactions on the basis that it would unreasonably hinder the flow of commerce. Further, he held that apparent authority is a type of estoppel by representation and it is clear that, in the field of misrepresentation, constructive knowledge is no defence to

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1 *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* [2010] HKCFA 63, (2010) 13 HKCFAR 479 at [47]–[62].

an action for rescission.<sup>2</sup> His Lordship then distinguished those cases that appeared to support the inclusion of constructive knowledge within the common law,<sup>3</sup> primarily on the basis that these cases were decided in the context of the outdated indoor management rule set down by *Royal British Bank v Turquand*.<sup>4</sup> Any references to constructive knowledge, therefore, were made insofar as constructive knowledge was an exception to that rule rather than in relation to apparent authority.

Lord Neuberger's reasoning has since been adopted by the English Court of Appeal.<sup>5</sup> However, a close analysis of the authorities cautions against this restrictive interpretation of the common law. Following a brief summary of *Akai* in Part II, Parts III and IV examine each limb of Lord Neuberger's reasoning. Part III scrutinises the case law that Lord Neuberger distinguished and rejects the notion that constructive knowledge is simply a proviso to the indoor management rule. *Houghton and Co v Nothard, Lowe and Wills, Ltd* and *Morris v Kanssen* are particularly clear in stating that constructive knowledge is a feature of apparent authority and parties seeking to rely on the indoor management rule are bound by the ordinary principles of agency.<sup>6</sup> Part IV then explores the cases on which Lord Neuberger placed positive reliance. It is first suggested that the broad pronouncements that "deprecated" constructive knowledge were made erroneously and are based on unsound policy. Properly applied, a reasonable inquiries test is a justifiable limit on the principle of commercial certainty. Secondly, Lord Neuberger's view that constructive knowledge cannot be a feature of apparent authority because of its status as a species of estoppel by representation is problematic. Whilst it is accepted that apparent authority is generally understood as a species of estoppel by representation (and it would seem that there is no better way to characterise it), apparent authority typically involves a far weaker representation and reliance than true estoppel cases. Apparent authority is therefore distinguishable from genuine estoppel cases and has room for constructive knowledge to operate. The combined effect of the analysis in Parts III and IV is that constructive knowledge is, and ought to be, part of the common law proviso to reliance upon apparent authority.

Finally, Part V examines the implications of the preceding discussion on the interpretation of s 18 of the Companies Act 1993. Section 18 sets out a series of presumptions that may be made when contracting with companies unless the party has, or ought to have, by reason of his or her position with or relationship to the company, knowledge of the relevant

2 At [52].

3 At [61].

4 *The Royal British Bank v Turquand* (1856) 6 El & Bl 327, 119 ER 886 (Exch Ch).

5 *Quinn v CC Automotive Group Ltd (trading as Carcraft)* [2010] EWCA Civ 1412, [2011] 2 All ER (Comm) 584. *Quinn* has also been applied by the English High Courts: *Acute Property Developments Ltd v Apostolou* [2013] EWHC 200 (Ch), [2013] Bus LR Digest D22; *Newcastle International Airport Ltd v Eversheds LLP* [2012] EWHC 2648 (Ch), [2013] PNLR 5; and *Gaydamak v Leviev* [2012] EWHC 1740 (Ch).

6 *Houghton and Co v Nothard, Lowe and Wills, Ltd* [1927] 1 KB 246 (CA); and *Morris v Kanssen* [1946] AC 459 (HL).

irregularity. The role of constructive knowledge within this proviso is unclear, with the courts providing a range of views. Adopting the starting point that constructive knowledge is part of the common law, there is room within s 18 for a reasonable inquiries test, with that test applying not only to company insiders but also to those engaged in arm's length negotiations.

## **II *THANAKHARN KASIKORN THAI CHAMKAT V AKAI HOLDINGS LTD***

### **Facts**

This was an action by the liquidators of Akai Holdings Ltd (Akai) against Thanakharn Kasikorn Thai Chamkat (the Bank) following the Bank's enforcement of security on a USD 30,000,000 loan. That debt had originally been owed by a related company (Singer NV) but, owing to insufficient security, the debt was transferred to Akai via what was termed the "switch transaction". Akai claimed that the Bank knew or ought to have known that the switch transaction was entered into without Akai's authority and that it was thus not bound by the terms of that transaction.

The transactions in question took place during the "Asian Financial Crisis", which had particularly severe implications for the Bank, with many of its substantial loans failing to perform. One such loan had been made to Singer NV, with whom the Bank often had dealings through a Mr Ting. At that time, Mr Ting was involved with a group of then-significant companies. Given the nature of the transactions involved, it is useful to briefly outline the relationships between the relevant companies. At the head of this group of companies was Semi-Tech Corp (STC), owned 45 per cent by Mr Ting and 55 per cent by the public. Mr Ting was its chairman, president and chief executive officer. STC owned 43 per cent of Akai (the remainder being held publicly). Mr Ting was the executive chairman and chief executive officer of Akai, which itself owned just over 70 per cent of the shares in Akai Electric Co Ltd (Akai Electric). STC also owned 50 per cent of Singer NV, with the remaining shares held publicly. Mr Ting was the chairman and director of Singer NV, which indirectly owned 48 per cent of Singer Thailand Public Co Ltd (Singer Thailand). The Bank owned eight and a half per cent of Singer Thailand's issued shares and the Bank's chairman, Mr Banyong Lamson, was on its board of directors with Mr Ting.

Since 1992, Singer NV had had a USD 30,000,000 revolving credit facility with the Bank (the Singer Facility), which was secured by 6 million shares in Singer Thailand. By the middle of 1997, the value of Singer Thailand shares had dropped substantially, rendering the Singer Facility's security inadequate. In late 1997, Singer NV repaid the Singer Facility in full but, owing to a mistake, it was allowed to redraw the full USD 30,000,000 less than two months later. When the Bank realised its error, it

entered discussions with Singer NV regarding the problem of its defective security. These discussions resulted in the preparation of an internal credit application, which changed the borrower from Singer NV to Akai, with Akai providing fresh security in the form of shares in Akai Electric (the switch transaction). This application was approved by the Bank's Executive Board in October 1998.

In early December 1998, a Bank employee attended Akai's Hong Kong office to collect the necessary documentation for the switch transaction. He was handed a number of documents. These included, purportedly, the minutes of an Executive Committee meeting of Akai, signed by Mr Ting. The minutes recorded an apparent resolution that the switch transaction be accepted and approved. The minutes also purportedly empowered any one of the directors to approve changes to the relevant agreements prior to execution and to execute, under hand or seal, those documents.

The loan was formally drawn down in December 1998 and was to be repaid within a year. Akai subsequently failed to pay the USD 31,298,906 owing on the due date. When the Bank enforced its security, it realised proceeds of only USD 20,504,295.

Akai's liquidators brought their claim on the basis that the minutes of the Executive Committee meeting were false and were dishonestly prepared by Mr Ting and that the Bank knew or ought to have known that Mr Ting lacked authority to enter into the switch transaction. At first instance, together Stone J held in favour of the Bank. This was overturned by the Court of Appeal. The Bank then appealed to the Court of Final Appeal and Akai cross-appealed on the question of compensation. The Court of Final Appeal had to consider two questions, the pertinent one being whether the Bank was entitled to rely upon Mr Ting's apparent authority to commit Akai to the switch transaction.<sup>7</sup>

### Lord Neuberger's Reasoning

In answering the relevant question, Lord Neuberger considered the state of mind required of a party seeking to rely upon apparent authority. Counsel for the Bank submitted that, unless the Bank had actual knowledge of Mr Ting's lack of authority or its belief in authority was dishonest or irrational, the Bank could rely upon his apparent authority. Recklessness and turning a blind eye would, on this formulation, constitute irrationality or dishonesty. Counsel for Akai argued that this was too low a standard. They submitted that the Bank could not rely upon apparent authority where it had failed to make inquiries that the reasonable person would have made in the circumstances to verify Mr Ting's authority.<sup>8</sup> Lord Neuberger accepted that the distinction between irrationality and unreasonableness

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<sup>7</sup> *Akai Holdings Ltd*, above n 1, at [5]–[40].

<sup>8</sup> At [49].

is a fine one, but concluded that the former has pejorative overtones and sets a “higher hurdle for a party in the position of Akai”.<sup>9</sup> The distinction between turning a blind eye and being put on inquiry is likewise slight, but the Judge accepted that “the former involves a more subjective exercise than the latter”.<sup>10</sup>

Assessing the case law, Lord Neuberger preferred the Bank’s test. The Judge cited *Greer v Downs Supply Co, By Appointment (Sales) Ltd v Harrods Ltd* and *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* as authority for the proposition that constructive knowledge had been deprecated in the context of commercial transactions.<sup>11</sup> Excluding constructive knowledge from commercial transactions might occasionally produce harsh results, but Lord Neuberger concluded that it “enables people engaged in business to know where they stand”.<sup>12</sup> Further, apparent authority is a species of estoppel by representation,<sup>13</sup> and in the area of misrepresentation it is clear that “it is no defence to an action for rescission that the representee might have discovered its falsity by the exercise of reasonable care”.<sup>14</sup> Nor is it any answer that, if the party who relied upon the representation had “thought about it, he must have known that it was untrue”.<sup>15</sup> The representation itself acts to put a person off inquiry and so a person does not have to investigate to determine its veracity. Lord Neuberger cited *Bloomenthal v Ford* and *Jones v Gordon* as additional authority.<sup>16</sup>

The Judge dismissed those cases that appeared to support Akai’s position. He distinguished *AL Underwood Ltd v Bank of Liverpool and Martins* on the basis that its references to negligence and being put on inquiry were made because the defendant needed to rebut an allegation of negligence in order to rely on s 82 of the Bills of Exchange Act 1882.<sup>17</sup> That case did not, according to Lord Neuberger, apply more generally.<sup>18</sup> He dismissed a further tranche of cases, including *Houghton and Co, Morris v Kanssen* and *Rolled Steel Products (Holdings) Ltd v British Steel Corp*,<sup>19</sup> on the basis that they were decided under the indoor management

9 At [50]. See Rebecca Lee and Lusina Ho “Reluctant Bedfellows: Want of Authority and Knowing Receipt” (2012) 75 MLR 91 at 93, where the authors have suggested that irrationality might require a “want of probity or even recklessness”.

10 At [50].

11 *Greer v Downs Supply Co* [1927] 2 KB 28 (CA) at 36; *By Appointment (Sales) Ltd v Harrods Ltd* UKCA, 1 December 1977; and *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* [1995] 1 WLR 978 (Ch) at 1014G–H.

12 *Akai Holdings Ltd*, above n 1, at [52].

13 At [52], relying on *Freeman & Lockyer (A Firm) v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 (CA) at 503; and *Northside Developments Pty Ltd v Registrar-General* (1990) 170 CLR 146 at 173–174.

14 At [52], quoting HG Beale (ed) *Chitty on Contracts* (30th ed, Thomson Reuters, London, 2008) vol 1 at 527.

15 At [52], quoting Lord Mackay (ed) *Halsbury’s Laws of England* (4th ed, reissue, 2003) vol 16(2) at 506.

16 At [53]; *Bloomenthal v Ford (the Liquidator of Veuve Monnier et ses Fils, Ltd)* [1897] AC 156 (HL) at 161–162 and 166–167; and *Jones v Gordon* (1877) 2 App Cas 616 (HL) at 628–629.

17 *AL Underwood, Ltd v Bank of Liverpool and Martins* [1924] 1 KB 775 (CA).

18 *Akai Holdings Ltd*, above n 1, at [57].

19 *Houghton and Co*, above n 6; *Morris v Kanssen*, above n 6; and *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] 1 Ch 246 (CA).

rule — no longer a feature of English law or the law in Hong Kong.<sup>20</sup> He considered that the distinction between the indoor management rule and apparent authority was well explained in *Northside Developments Pty Ltd v Registrar-General* where Dawson J said:<sup>21</sup>

The correct view is that the indoor management rule cannot be used to create authority where none otherwise exists; it merely entitles an outsider, in the absence of anything putting him upon inquiry, to presume regularity in the internal affairs of a company when confronted by a person apparently acting with the authority of the company.

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In other words, the indoor management rule only has scope for operation if it can be established independently that the person purporting to represent the company had actual or ostensible authority to enter into the transaction. The rule is thus dependent upon the operation of normal agency principles ... .

Constructive knowledge was developed to mitigate the harshness of the historic rule that a person dealing with a company was deemed to know the contents of its memorandum and articles. In light of that, there is “no obvious reason” why constructive knowledge should also apply to apparent authority.<sup>22</sup>

Finally, Lord Neuberger acknowledged that *Rolled Steel* might be read as supporting Akai’s case, but said that the state of mind of the person alleging apparent authority was not in issue there.<sup>23</sup>

Thus, Lord Neuberger rejected constructive knowledge; the Bank was entitled to rely upon Mr Ting’s apparent authority unless that belief was dishonest or irrational.<sup>24</sup>

### III THE INDOOR MANAGEMENT RULE AND OTHER DISTINCTIONS

Looking first at the cases Lord Neuberger distinguished, it is accepted that statements made in *Rolled Steel* regarding constructive knowledge were obiter. It is also accepted that *AL Underwood* was properly distinguished as not involving apparent authority. *AL Underwood* is nevertheless relevant to the issue of the proper relationship between apparent authority and the indoor management rule. The statutory defence with which *AL Underwood* was concerned required the defendant Bank to show that it had

<sup>20</sup> *Akai Holdings Ltd*, above n 1, at [58]–[60].

<sup>21</sup> *Northside Developments*, above n 13, at 198.

<sup>22</sup> *Akai Holdings Ltd*, above n 1, at [61].

<sup>23</sup> At [60].

<sup>24</sup> At [62].

received payment for cheques in good faith and without negligence. This defence was, according to Bankes LJ, based upon the indoor management rule.<sup>25</sup> That view of the defence appears to be premised on the assumption that negligence was a particular feature of the indoor management rule, rather than apparent authority. This assumption is shared by many including, apparently, Lord Neuberger.<sup>26</sup> However, although the recent case law lacks clarity, the development of the indoor management rule and instances of its early application clearly demonstrate that constructive knowledge operates as a proviso to reliance upon apparent authority. Therefore, constructive knowledge is not a specially formulated exception to the indoor management rule. Instead it is relevant as part of generally applicable principles of agency.

### Formulation of the Indoor Management Rule

The indoor management rule developed to soften a rule that fixed outsiders with constructive notice of the contents of a company's articles of association.<sup>27</sup> As stated in *Turquand's* case, persons contracting with a company were entitled to assume that acts within its constitution and powers had been properly and duly performed.<sup>28</sup> The formulation of the rule in *Turquand's* case makes no mention of constructive knowledge or negligence. However, negligence does feature in the comprehensive discussion of the rule in *Mahony (Public Officer of the National Bank, Dublin) v The Liquidator of The East Holyford Mining Co Ltd*, where Lord Hatherley famously stated:<sup>29</sup>

[W]hen there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the articles of association, then those so dealing with them, externally, are not to be affected by any irregularities which may take place in the internal management of the company. ... *Outside persons when they find that there is an act done by a company, will, of course, be bound in the exercise of ordinary care and precaution to know whether or not that company is actually carrying on and transacting business, or whether it is a company which has been stopped and wound up, and which has parted with its assets, and the like. All those ordinary inquiries which mercantile men would, in the course of their business make, I apprehend, would have to be made on the*

<sup>25</sup> *AL Underwood*, above n 17, at 785–786.

<sup>26</sup> See, for example, DD Prentice “The Rule in *Turquand's* case” (1991) 107 LQR 14; Andrew Griffiths “The Economic Implications of Validating Unauthorised Contracts made by Corporate Agents” (2003) 4 EBOR 51; and Larelle Chapple and Phillip Lipton *Corporate Authority and Dealings with Officers and Agents* (CCH Australia, Melbourne, 2002).

<sup>27</sup> See, for example, the discussion of the indoor management rule in *Northside Developments*, above n 13, at 155–156; and RP Austin and IM Ramsay *Ford's Principles of Corporations Law* (13th ed, LexisNexis, Chatswood (NSW), 2007) at 772–774.

<sup>28</sup> *Turquand*, above n 4.

<sup>29</sup> *Mahony (Public Officer of the National Bank, Dublin) v The Liquidator of the East Holyford Mining Co Ltd* (1875) 7 LR 869 (HL) at 894–895 (emphasis added).

*part of the persons dealing with the company.*

Whilst the italicised portion of the above quote clearly states that any person dealing with the company must make reasonable inquiries, that statement is not specifically or exclusively linked to the indoor management rule. Rather, the words “of course” suggest that the need for reasonable inquiries is presupposed as part of a broader doctrine rather than as a specific (and new) element of the indoor management rule. This interpretation is consistent with Lindley LJ’s formulation of the rule in *Biggerstaff v Rowatt’s Wharf Ltd*, given more than two decades after *Mahony*.<sup>30</sup> In that case, Lindley LJ stated that:<sup>31</sup>

It is settled by a long string of authorities that, where directors give a security which according to the articles they might have power to give, the person taking it is entitled to assume that they had the power.

Lindley LJ made no mention of constructive knowledge.

### Early Applications

The argument made in this article is not supported merely by the absence of constructive knowledge in early formulations of the indoor management rule. Additionally, cases from the early part of the nineteenth century, *Houghton and Co* and *Morris v Kanssen* clearly state that constructive knowledge is part of the law of apparent authority and that agency principles cannot be circumvented by the indoor management rule.

*Houghton and Co* concerned a transaction between two companies, with an agent (Mr Lowe) acting on the defendant’s behalf. The contract was purportedly confirmed by the defendant’s secretary. That secretary had no authority to confirm the contract, though it was technically possible for authority to be so vested under the defendant’s articles of association. The defendant repudiated the contract as made without its authority. The plaintiff first claimed, unsuccessfully, that Mr Lowe had actual authority to bind the defendant. The plaintiff next claimed that Mr Lowe and the secretary had apparent authority because a delegation of authority *might* have been made and the plaintiffs were entitled to assume that a delegation had occurred in accordance with the defendant’s articles of association. In respect of apparent authority, Bankes LJ stated that the plaintiff needed to prove, first, that he relied upon any established ostensible authority and, second, that he was not put on inquiry as to whether the agent had authority.<sup>32</sup> Bankes LJ thus clearly viewed constructive knowledge as an

30 *Biggerstaff v Rowatt’s Wharf, Ltd* [1896] 2 Ch 93 (CA).

31 At 102. See also *County of Gloucester Bank v Rudry Merthyr Steam and House Coal Colliery Co* [1895] 1 Ch 629 (CA) at 633.

32 *Houghton and Co*, above n 6, at 260.



exception to apparent authority.

Sargant LJ (upon whose judgment Lord Neuberger relied) took a similar approach, but focused upon the argument made by counsel for the plaintiff that a party ought to be able to assert an apparent delegation of authority simply because such a delegation was possible. Sargant LJ rejected that, saying:<sup>33</sup>

They could rely on the fact of delegation, had it been a fact, whether known to them or not. They might rely on their knowledge of the power of delegation, had they known of it, as part of the circumstances entitling them to infer that there had been a delegation and to act on that inference, though it were in fact a mistaken one. *But it is quite another thing to say that the plaintiffs are entitled now to rely on the supposed exercise of a power which was never in fact exercised and of the existence of which they were in ignorance at the date when they contracted.*

...

[E]ven if Mr. Dart, and through him the plaintiffs, had been aware of the power of delegation in the articles of the defendant company, this would not in my judgment have entitled him or them to assume that this power had been exercised in favour of a director, secretary or other officer of the company so as to validate the contract now in question.

Sargant LJ did not discuss constructive knowledge nor did he suggest that constructive knowledge was a by-product of the indoor management rule. Rather, he simply denied that the indoor management rule could obviate the general rules of agency law.

*Morris v Kanssen* is even clearer in this regard. There, the plaintiff, himself a director of the defendant company, sought to claim that a share transfer was valid and that he was entitled to assume that the defendant's internal procedures had been complied with. Lord Simonds rejected that argument by reasoning from the general maxim *omnia praesumuntur rite esse acta*: all things are presumed to be done in due form. That maxim has many applications, one of which his Lordship identified as the doctrine of apparent authority. In that context, the maxim is based upon the proposition that “[t]he wheels of business will not go smoothly round” unless people can assume that that which appears to be in order is so.<sup>34</sup> However, his Lordship stated that “the maxim has its proper limits”, such as the following:<sup>35</sup>

An ostensible agent cannot bind his principal to that which the principal cannot lawfully do. The directors or acting directors or

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<sup>33</sup> At 266 (emphasis added).

<sup>34</sup> *Morris v Kanssen*, above n 6, at 475.

<sup>35</sup> At 475.

other officers of a company cannot bind it to a transaction which is ultra vires. Nor is this the only limit to its application. It is a rule designed for the protection of those who are entitled to assume, just because they cannot know, that the person with whom they deal has the authority which he claims. This is clearly shown by the fact that the rule cannot be invoked if the condition is no longer satisfied, that is, if he who would invoke it is put upon his inquiry. He cannot presume in his own favour that things are rightly done if inquiry that he ought to make would tell him that they were wrongly done.

Lord Simonds thus clearly stated that apparent authority is based upon a maxim intended to protect those who make assumptions regarding authority because they cannot know whether there has been a delegation. Reasoning from the principles underpinning apparent authority (to which the indoor management rule is also subject), Lord Simonds held that a director was not entitled to assume procedural regularity in respect of the very company of which he or she was the director. To allow otherwise would be “to encourage ignorance and condone dereliction from duty”.<sup>36</sup>

Thus, Lord Neuberger erred in distinguishing *Houghton and Co and Morris v Kanssen*. Those cases support the view that constructive knowledge is part of the law on apparent authority. This view is further bolstered by Scrutton LJ’s decision in *Lloyds Bank, Ltd v The Chartered Bank of India, Australia and China* where his Lordship stated:<sup>37</sup>

[I]t is established that a third party, dealing in good faith with an agent acting within his ostensible authority, is not prejudiced by the fact that as between the principal and his agent the agent is using his authority in such a way that the principal can rightly complain that the agent is using his authority for his own benefit and not for that of his principal. ... *But it is otherwise where the third party has notice of irregularity putting him on inquiry as to whether the ostensible authority is being exceeded.*

## Recent Applications

Despite the clarity of the cases discussed above, more recent applications of the indoor management rule appear either to frame constructive knowledge as a specific exception to that rule, or are ambiguous. *Rolled Steel* highlights how ambiguity may creep into discussions of the indoor management rule.<sup>38</sup> As Lord Neuberger acknowledged, Slade LJ’s concluding remarks in this case clearly identify constructive knowledge as a proviso to apparent authority.<sup>39</sup> However, Slade LJ’s main discussion of the indoor management rule could, at first glance, be read as suggesting that

<sup>36</sup> At 476.

<sup>37</sup> *Lloyds Bank, Ltd v The Chartered Bank of India, Australia and China* [1929] 1 KB 40 (CA) at 56 (emphasis added); see also *Jacobs v Morris* [1902] 1 Ch 816 (CA); and *Midland Bank, Ltd v Reckitt* [1933] AC 1 (HL).

<sup>38</sup> Although statements in this case were obiter, it is nevertheless useful to discuss as it highlights the ambiguity surrounding the indoor management rule.

<sup>39</sup> *Rolled Steel*, above n 19, at 296.

constructive knowledge is a specific exception to the indoor management rule. For example, in support of the statement that a party cannot rely on the indoor management rule if put on inquiry, *Rolled Steel* quoted the following from *Morris v Kanssen*:<sup>40</sup>

But the maxim has its proper limits. ... It is a rule designed for the protection of those who are entitled to assume, just because they cannot know, that the person with whom they deal has the authority which he claims. This is clearly shown by the fact that the rule cannot be invoked if the condition is no longer satisfied, that is, if he who would invoke it is put upon his inquiry. He cannot presume in his own favour that things are rightly done if inquiry that he ought to make would tell him that they were wrongly done.

This could give the impression that the maxim discussed in *Morris v Kanssen* was the indoor management rule. However, as demonstrated above, that quote was in fact concerned with a general maxim underpinning apparent authority.

The relationship between constructive knowledge, apparent authority and the indoor management rule is also ambiguous in *Northside*, from which Lord Neuberger quoted extensively. There, the High Court of Australia rejected an argument that because a delegation of authority might have been made, it was in fact made, stating:<sup>41</sup>

The correct view is that the indoor management rule cannot be used to create authority where none otherwise exists; it merely entitles an outsider, in the absence of anything putting him upon inquiry, to presume regularity in the internal affairs of a company when confronted by a person apparently acting with the authority of the company.

The above quote is not clear whether constructive knowledge is an element of the indoor management rule or a feature of the underlying agency principles. Subsequent cases cite *Northside* as a leading authority on the indoor management rule and also seem to view constructive knowledge as an element of that rule.<sup>42</sup> However, those cases generally conflate the requirements of apparent authority with the indoor management rule and are therefore of little consequence. Further, the quoted portion of *Northside* relied upon *Houghton and Co* and so it is reasonable to interpret *Northside* as a restatement of the principles in that case (albeit an obscure one).<sup>43</sup>

40 At 284, quoting *Morris v Kanssen*, above n 6, at 475.

41 *Northside Developments*, above n 13, at 198.

42 See, for example, *Bank of New Zealand v Fiberni Pty Ltd* (1993) 14 ACSR 736 (NSWCA) at 741; *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* [1992] 2 VR 279 (VSC) at 359–361; and *Story v Advance Bank Australia Ltd* (1993) 31 NSWLR 722 (NSWCA) at 731.

43 *Houghton and Co*, above n 6.

## Conclusion

The indoor management rule ought to be confined to the manner in which it was first formulated — allowing persons contracting with a company to presume regularity in its internal management. The rule is dependent upon and subject to apparent authority, the benefits of which may be lost if the party seeking to invoke it has constructive knowledge of the lack of authority. Lord Neuberger thus erred in distinguishing cases involving the indoor management rule on the basis that any references to constructive knowledge were limited to that rule.

## IV THE “DEPRECIATION” OF CONSTRUCTIVE NOTICE AND ESTOPPEL BY REPRESENTATION

The authorities Lord Neuberger relied on in dismissing constructive knowledge fall into two camps: those that deprecated the doctrine in the context of commercial transactions and those that excluded constructive knowledge from estoppel by representation. In respect of the first tranche of cases, it is argued that those cases were erroneously decided and rely upon unsound policy. In respect of the second, it is argued that apparent authority involves only a weak form of estoppel and so the reasons for excluding constructive knowledge from true estoppel cases do not apply.

### The Depreciation of Constructive Knowledge in Commercial Transactions

#### *1 Errors of Law*<sup>44</sup>

##### (a) *Greer v Downs Supply Co*

The first case Lord Neuberger relied upon in respect of the deprecation of constructive knowledge is *Greer*.<sup>45</sup> This case concerned a claim in contract for unpaid timber allegedly supplied by the plaintiff to the defendant. The central area of dispute concerned the identity of the supplier. The defendant denied entering into a contract with the plaintiff, asserting that the timber was supplied by a Mr Godwin. In the alternative, the defendant stated that

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44 It is noted that *By Appointment (Sales) Ltd*, above n 11, could not be located and is not discussed in this section. The author attempted to locate this case by searching the following: The British and Irish Legal Information Institute <[www.bailii.org](http://www.bailii.org)>; Justis <[www.justis.com](http://www.justis.com)>; Westlaw International <[www.westlawinternational.com](http://www.westlawinternational.com)>; Lexis <[www.lexis.com](http://www.lexis.com)>; and Google <[www.google.com](http://www.google.com)>. The author also contacted the Court Recording and Transcribing Unit at the Royal Courts of Justice in London, England. The lack of discussion of *By Appointment (Sales) Ltd* does not undermine the arguments advanced by this article for two reasons. First, *By Appointment (Sales) Ltd* is susceptible to the argument made in Part IV, that policy concerns favour the inclusion of constructive knowledge within the common law. Secondly, the case is a Court of Appeal decision and would have been bound by those House of Lords decisions (discussed in Part III) that clearly view constructive knowledge as a proviso to apparent authority.

45 *Greer*, above n 11.

under any contract with the plaintiff it was entitled to counterclaim for timber it had supplied to Mr Godwin.

Mr Godwin met the defendant (a Mr Chandon, who traded as the Downs Supply Company) in Brighton, at a time when he worked for a firm called White & Co. In February 1925, the defendant sold timber to Mr Godwin personally (rather than as an agent for White & Co), creating a debt of £16 and 19s. Mr Godwin subsequently left his employment and approached the defendant, purportedly as a principal, offering timber for sale. The defendant agreed to buy the timber on the basis that Mr Godwin's debt could be offset against the purchase price. A dispute arose because Mr Godwin was not, in fact, acting as a principal; he was employed by the plaintiff and it was that company that fulfilled the defendant's timber order. Following confirmation of the order, Mr Godwin sent the defendant a letter which he had signed as though he were a principal, but written on paper bearing the name and address of the plaintiff. The defendant asked why the name appeared on the letter and Mr Godwin stated that it was his trade name.

In the following months, the plaintiff demanded payment and eventually issued a writ. In the Mayor's and City of London Court, the Judge found that the defendant honestly believed Mr Godwin's explanation that he traded under the name of the plaintiff. Nevertheless, the Judge held that the defendant was put upon inquiry by the letter and ought to have made further investigations. This was reversed by the Divisional Court.

The Court of Appeal affirmed the decision of the Divisional Court, finding that constructive knowledge did not apply in the context and so the defendant was entitled to believe that Mr Godwin traded under the plaintiff's name. In reaching this decision, Scrutton LJ and Lawrence LJ both relied upon Lindley LJ's finding in *Manchester Trust v Furness* that:<sup>46</sup>

[A]s regards the extension of the equitable doctrines of constructive notice to commercial transactions, the Courts have always set their faces resolutely against it. ... [T]here have been repeated protests against the introduction into commercial transactions of anything like an extension of those doctrines, and the protest is founded on perfect good sense. In dealing with estates in land title is everything, and it can be leisurely investigated; in commercial transactions possession is everything, and there is no time to investigate title; and if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralyzing the trade of the country.

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46 *Manchester Trust v Furness* [1895] 2 QB 539 (CA) at 545, cited in *Greer*, above n 11, at 36.

Bankes LJ reached the same conclusion, but relied upon different authority, noting that:<sup>47</sup>

There is authority for saying that in commercial matters the Court should be loth to take constructive notice as a substitute for actual notice. Bramwell B. in *Boulton v. Jones*<sup>48</sup> correctly states the law on this point.

Interestingly, *Greer* did not discuss the requirements of constructive knowledge. Nor did it discuss the trial Judge's finding that, despite having made inquiries and honestly believing Mr Godwin's explanation that he traded as the Downs Supply Company, the defendant had still been put on inquiry by the latter's use of that name. Assuming for the moment that constructive knowledge is a feature of apparent authority, it is clear that a party will not have constructive knowledge where that party is put on inquiry but makes reasonable inquiries and receives satisfactory reassurance.<sup>49</sup> In this case, it is unclear what further inquiries the defendant ought to have made.

Returning to examine the authority Scrutton LJ and Lawrence LJ relied on, *Furness* concerned a proviso within a charter party to the effect that the captain and crew were the agents of the charterers. The captain signed bills of lading in the ordinary form for goods to be delivered to the holders of the bills of lading, with freight paid and "other conditions as per charterparty".<sup>50</sup> Lindley LJ and Rigby LJ held that the holders of bills of lading were entitled to consider the captain as the agent of the shipowners (and not the charterer). Furthermore, as constructive knowledge did not apply to commercial transactions, the reference in the bill of lading did not give notice of the contents of that charter party.<sup>51</sup> In support of this, Lindley LJ relied upon *The London Joint Stock Bank v Simmons*,<sup>52</sup> stating:<sup>53</sup>

That case had reference to a notice in respect of debentures, but whether commercial documents are negotiable instruments, or whether they are more or less like them, is a matter to my mind of very little importance. Lord Herschell said in that case (at p 221): "I should be very sorry to see the doctrine of constructive notice introduced into the law of negotiable instruments." ... [A]s regards debentures and everything of that kind, and other commercial documents, the protest which I have been making has been made before ...

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<sup>47</sup> *Greer*, above n 11, at 32–33.

<sup>48</sup> *Boulton v Jones* (1857) 2 H & N 564, 157 ER 232 (Exch Ch) at 233.

<sup>49</sup> *The London Joint Stock Bank v Simmons* [1892] AC 201 (HL) at 220.

<sup>50</sup> At 541.

<sup>51</sup> At 545.

<sup>52</sup> *Simmons*, above n 49.

<sup>53</sup> *Furness*, above n 46, at 545–546.

However, Lord Herschell's objection in *Simmons* was not aimed at constructive knowledge where suspicious circumstances required investigation. Instead, he was concerned with the contention that a bank, knowing that the relevant individual was dealing with bonds as an agent, would for that reason alone be bound to make inquiries regarding his authority.<sup>54</sup> This is consistent with Lord Herschell's statement that:<sup>55</sup>

[O]f course, if there is anything to arouse suspicion, to lead to a doubt whether the person purporting to transfer them is justified in entering into the contemplated transaction the case would be different, the existence of such suspicion or doubt would be inconsistent with good faith. And if no inquiry were made, or if on inquiry the doubt were not removed and the suspicion dissipated, I should have no hesitation in holding that good faith was wanting . . .

Furthermore, Lord Herschell and the other Law Lords in *Simmons* did not consistently distinguish between constructive notice and wilful blindness and often spoke in terms that suggest acceptance of the inclusion of constructive knowledge within the law of negotiable instruments. For example, Lord Halsbury LC relied upon *Earl of Sheffield v London Joint Stock Bank*, where Lord Bramwell found that a Bank had “[n]otice of the infirmity of the pledgor's title, or of such facts and matters as made it reasonable that inquiry should be made into such title.”<sup>56</sup> And Lord Watson stated in *Simmons* that “the appellants were entitled to assume, *in the absence of aught to indicate the contrary*”, that the individual dealing with the bonds had full authority to do so.<sup>57</sup> *Furness* was thus wrong to rely upon *Simmons*.

*Furness* also relied on *The English and Scottish Mercantile Investment Co, Ltd v Brunton*, which applied constructive knowledge notwithstanding warnings regarding its application.<sup>58</sup> *Brunton* involved a company that could by its memorandum and articles of association borrow any sum of money on any terms and conditions. These borrowing powers enabled the company to mortgage and charge all or any part of its real and personal property, present or future and issue debentures and debenture stock. The company issued 200 “first mortgage debentures” of £100 each. The debentures issued were accompanied by a condition that the company would not be able to create any mortgage or charge in priority to those debentures. Subsequently, the company borrowed £1900 from the plaintiff, secured by a charge on an insurance claim the company had against the Sun Fire Office. At an interview between the parties, an agent for the plaintiff was informed that debentures had been issued, leading that agent to ask

54 *Simmons*, above n 49, at 216.

55 At 223.

56 *The Right Honourable Henry North, Earl of Sheffield v The London Joint Stock Bank, Ltd* (1888) 13 App Cas 333 (HL) at 346, cited in *Simmons*, above n 49, at 210.

57 *Simmons*, above n 49, at 213 (emphasis added).

58 *The English and Scottish Mercantile Investment Co, Ltd v Brunton* [1892] 2 QB 700 (CA).

whether the debentures were secured by any deed that might cover the insurance policy. He was assured that they were not. The plaintiff's agent made no further inquiries. A few months later, the company went into voluntary liquidation, and the debenture holders claimed the insurance moneys in priority to the plaintiff. In determining priority, Lord Esher MR said of constructive knowledge:<sup>59</sup>

Of late years, ... the Chancery judges saw that it was being carried much farther than had been intended, and they declined to carry it further. ... In *Allen v Seckham* I pointed out that the doctrine is a dangerous one.<sup>60</sup> It is contrary to the truth. It is wholly founded on the assumption that a man does not know the facts; and yet it is said that constructively he does know them. ... [*W*]e have to apply to these facts the doctrine of constructive notice or knowledge, as formerly enunciated by Courts of equity; and we are not to carry it beyond its true and fair meaning as laid down by those who formulated it. I think the doctrine has been accurately deduced from the various cases, and is accurately stated, in the notes to *Le Neve v Le Neve*<sup>61</sup>:—

Although, as we have already seen, where a party has notice of a deed which, from the nature of it, must affect the property, or is told at the time that it does affect it, he is considered to have notice of the contents of that deed ... nevertheless, where a party has notice of a deed which does not necessarily affect the property, and is told that in fact it does not affect it, but relates to some other property, and such party acts fairly in the transaction, believing the representation to be true, he will not be fixed with notice of the contents of the instrument.

His Lordship found that the plaintiff's agent was not put on inquiry as he had been informed of the debentures and told that those debentures did not affect the mortgage's security. His Lordship's issues with constructive knowledge concerned when a party would be found to have been put on inquiry, rather than the fact of the doctrine's application. Therefore, *Brunton* does not provide authority for the proposition that the very existence of constructive knowledge has been "deprecated"; only its extension was warned against.

The previous discussion has focused upon errors in *Furness*, which was relied on by Scrutton LJ and Lindley LJ. Similarly, Bankes LJ ought not to have relied upon *Boulton v Jones*.<sup>62</sup> That case makes no general pronouncement regarding the position of constructive knowledge in the context of commercial transactions.

59 At 708–709 (emphasis added).

60 *Allen v Seckham* (1879) 11 Ch D 790 (CA).

61 *Le Neve v Le Neve* (1747) 6 White & Tud LC 26, 27 ER 893 at 56.

62 *Boulton v Jones*, above n 48.



(b) *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)*

Lord Neuberger also relied on Millett J's decision in *Macmillan* as authority for the deprecation of constructive knowledge. Lord Neuberger summarised Millett J's view as being:<sup>63</sup>

... that constructive notice did not involve “the proper approach” in a normal commercial case, on the basis that “[u]nless and until they are alerted to the possibility of the wrongdoing, [account officers] proceed, and are entitled to proceed, on the assumption that they are dealing with honest men”. He continued by saying that they were entitled to do so until “the facts ... [make] it imperative for [them] to seek an explanation, because in the absence of an explanation it was obvious that the transaction was probably improper” ... .

With respect, Millett J's judgment does not deprecate constructive notice in general but rather elaborates on when a business person would be put on inquiry. This is clear from Millett J's own words:<sup>64</sup>

Macmillan attempted to establish constructive notice on the part of each of the defendants by a meticulous and detailed examination of every document, letter, record or minute to see whether it threw any light on the true ownership of the Berlitz shares which a careful reader — with instant recall of the whole of the contents of his files — ought to have detected. That is not the proper approach. Account officers are not detectives. Unless and until they are alerted to the possibility of the wrongdoing, they proceed, and are entitled to proceed, on the assumption that they are dealing with honest men. *In order to establish constructive notice* it is necessary to prove that the facts known to the defendant made it imperative for him to seek an explanation, because in the absence of an explanation it was obvious that the transaction was probably improper.

It is thus clear that Lord Neuberger has exaggerated the effect of the courts' concerns regarding the extension and content of constructive knowledge. A close reading of the common law reveals that these concerns are insufficiently broad to support a general claim that constructive knowledge has been “deprecated” in the context of commercial transactions.

## 2 Policy: Should Constructive Knowledge Be Excluded from Commercial Transactions?

In any event, the policy underpinning declarations such as those found in *Greer* and *Furness* is unsound. First, the use of the phrase “commercial transactions” is misleading, suggesting that constructive knowledge has no place in transactions between commercial parties as opposed to consumers

63 *Akai Holdings Ltd*, above n 1, at [55].

64 *Macmillan*, above n 11, at 1014 (emphasis added).

or private sellers.<sup>65</sup> In fact, commercial transactions are typically contrasted with transfers of interests in real property — the latter being the origin of the doctrine. Secondly, the reasons given for not extending constructive knowledge to commercial transactions rest upon the erroneous assumption that constructive knowledge would require the same standard of care in such transactions as in conveyancing matters. Instead, constructive knowledge should be understood as a variable standard that may fix business persons with notice according to the standards of ordinary business practices. Constructive knowledge will not unduly constrain commerce if applied in this manner.

Lindley LJ distinguished between property and commercial transactions in *Furness*, stating that in commercial transactions, “possession is everything, and there is no time to investigate title”.<sup>66</sup> However, there is no reason why the standard of inquiry required by constructive knowledge cannot reflect the nature of the relevant transaction. Early cases involving constructive knowledge required a purchaser to investigate title. Constructive knowledge evolved from the equitable jurisdiction to intervene in dealings with land on the basis of fraud.<sup>67</sup> The doctrine fixed persons with knowledge of any charges or encumbrances on the land that they would have discovered by making inquiries.<sup>68</sup> A person would also be fixed with constructive knowledge if he “designedly abstained from [such inquiries] for the ... purpose of avoiding notice”<sup>69</sup> though this was expanded such that only gross negligence was required.<sup>70</sup> However, as Charles Harpum argues, this context reflected, but was not the cause of, the standard of inquiry expected of purchasers.<sup>71</sup> Therefore, in dealings with other types of property, these rules do not apply.<sup>72</sup> In commercial transactions, the yardstick adopted may reflect the ordinary business practices of that context. The point at which someone has been put on inquiry may “be sensitive to the demands of commercial dealing where

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65 David Fox “Constructive Notice and Knowing Receipt: An Economic Analysis” (1998) 57 CLJ 391 at 392.

66 *Furness*, above n 46, at 545.

67 Charles Harpum “The Stranger as Constructive Trustee: Part I” (1986) 102 LQR 114 at 123.

68 See, for example, *Hunt v Luck* [1902] 1 Ch 428 (CA) where Vaughan Williams LJ stated at 433 that “if a purchaser or mortgagee has notice that the vendor or mortgagee is not in possession of the property, he must make inquiries of the person in possession ... and find out from him what his rights are, and, if he does not choose to do that, then whatever title he acquires as purchaser or mortgagee will be subject to the title or right of the tenant in possession”.

69 *Jones v Smith* (1841) 1 Hare 43, 66 ER 943 at 948. See also Harpum, above n 67, at 124.

70 See *Ware v Lord Egmont* (1854) 4 De GM & G 460, 43 ER 586 at 592, where Lord Cranworth famously said that “where he has not actual notice, he ought not to be treated as if he had notice, unless the circumstances are such as enable the Court to say, not only that he might have acquired, but also, that he ought to have acquired, the notice with which it is sought to affect him — that he would have acquired it but for his gross negligence”. See also *Oliver v Hinton* [1899] 2 Ch 264 (CA) at 274; and *Bailey v Barnes* [1894] 1 Ch 25 (CA). Note also that gross negligence requires carelessness of such a degree as to amount to “the neglect of precautions which the ordinarily reasonable man would have observed”: *Hudston v Viney* [1921] 1 Ch 98 at 104. The standard of culpability required is thus greater than ordinary common law negligence.

71 Harpum, above n 67, at 125.

72 *Re Diplock* [1948] Ch 465 (CA) at 478–479.

speed and security of transaction are important”.<sup>73</sup> In particular types of transactions, such as the sale of goods, where possession is everything and there is no time to investigate title, purchasers may not be required to make any inquiries. Or, a duty of inquiry might only arise where the facts point so strongly towards improper conduct that the failure to make reasonable inquiries borders on dishonesty.<sup>74</sup> If constructive knowledge is understood as a broad and flexible principle, the assumption that constructive knowledge will hinder commerce is significantly weakened.<sup>75</sup>

Turning then, to the economic policies underpinning concerns regarding constructive knowledge, an economic analysis of law provides that laws should maximise wealth in the most efficient manner possible.<sup>76</sup> A rule will be efficient where the societal wealth it returns is greater than any costs involved in compliance and administration.<sup>77</sup> The *Furness* policy assessment assumes that, if there is a possibility of being fixed with constructive knowledge, persons dealing with companies via agents will modify their behaviour, making more enquiries of agents.<sup>78</sup> Any precautions taken in making enquiries would both slow the conclusion of transactions and increase the direct costs involved in contracting with companies. The heaviest costs would in all likelihood, be passed on to customers.<sup>79</sup> To quantify such costs is, however, impossible. Furthermore, those costs may be outweighed by benefits flowing from the inclusion of constructive knowledge, such as its potential to deter agents from going rogue owing to the greater chances of being caught.<sup>80</sup>

Finally, common sense supports the inclusion of a reasonable inquiries test. A legal rule that enables commercial actors to behave unreasonably by a standard that reflects the realities of commerce is problematic. There must “be cases where there is no justification on the known facts” for allowing a commercial person to rely upon the authority of an agent.<sup>81</sup> An individual in such circumstances surely ought not to be able to “plead the shelter of the exigencies of commercial life”.<sup>82</sup>

## Constructive Knowledge and Estoppel by Representation

The final reason supporting Lord Neuberger’s rejection of constructive knowledge was that apparent authority is a species of estoppel by

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73 Fox, above n 65, at 395; see also Harpum, above n 67, at 125; *El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717 (Ch); and *Macmillan*, above n 11, at 1000.

74 At 396.

75 At 394–395.

76 At 396–397.

77 Richard A Posner *Economic Analysis of Law* (8th ed, Aspen Publishers, New York, 2011).

78 Fox, above n 65, at 397.

79 At 399.

80 At 399–400.

81 *Westpac Banking Corp v Savin* [1985] 2 NZLR 41 (CA) at 53.

82 At 53, where such observations were made by the Court of Appeal in the context of knowing receipt.

representation. Therefore, constructive knowledge could not apply as:<sup>83</sup>

In the field of misrepresentation, it is clear that “it is no defence to an action for rescission that the representee might have discovered its falsity by the exercise of reasonable care” ... .

Lord Neuberger cited *Bloomenthal* and *Jones v Gordon* as further support for this proposition.<sup>84</sup>

However, there has been some debate about the proper categorisation of apparent authority. *Bowstead and Reynolds on Agency* points to difficulties in characterising apparent authority as involving genuine estoppel. This is because the representation in the context of apparent authority may be very general and the harm caused to the representee may be small. Furthermore, it is, the authors state, artificial to conceive of a principal allowing an agent to act in a certain way as a representation to third parties. This is particularly true where the representation only involves the placing of a person in a position to which usual authority attaches.<sup>85</sup>

Some have instead suggested (or assumed) that apparent authority ought to be based upon an extension of the objective analysis involved in determining whether a contract has been formed.<sup>86</sup> This approach would explain the weak requirements as to representation and reliance, which are otherwise difficult to reconcile with common law estoppel by representation (which requires an unequivocal representation and action in reliance on the representation).<sup>87</sup> Further, explaining apparent authority in this manner allows for the distinction of true estoppel situations.

Nonetheless, there are also difficulties with the alternative theory of contract formation. This theory allows for the conclusion not only that a principal made a representation to a third party by means of an agent, but that the third party then made a representation to the principal. Taken to its logical conclusion this would allow the principal to sue a third party for non-performance (without being subject to the ratification rules) because that third party is able to sue under apparent authority.<sup>88</sup> Consequently, the estoppel justification is preferable, though it ought to be treated “as invoking a special (and weak) type of estoppel relevant only in the agency context”.<sup>89</sup> Adopting that analysis, statements made in the context of true estoppel cases may be distinguished.

83 *Akai Holdings Ltd*, above n 1, at [52], quoting Beale, above n 14, at 527.

84 *Bloomenthal*, above n 16; and *Jones v Gordon*, above n 16.

85 Peter Watts and FMB Reynolds *Bowstead and Reynolds on Agency* (19th ed, Thomson Reuters, London, 2010) at 373.

86 See, for example, Ji Lian Yap “Knowing Receipt and Apparent Authority” (2011) 127 LQR 350 at 354; and Lee and Ho, above n 9, at 93–94.

87 Watts and Reynolds, above n 85, at 374.

88 At 375.

89 At 375, citing *Pole v Leask* (1863) 33 LJ Ch 155 (HL) at 162 where Lord Cranworth referred to “this agency by estoppel, if I may so designate it ...”.

Turning then, to the first case Lord Neuberger relied upon, *Bloomenthal* may easily be distinguished. *Bloomenthal* concerned the placing of Mr Bloomenthal on a list of company contributors by the liquidator of *Veuve Monnier ses Fils Ltd* (the Company). In 1894, Mr Bloomenthal was asked to lend the Company £1,000 upon the terms that he should receive 10,000 of the company's fully paid shares at £1 each as security. If the company wished to pay off any part of the loan, a proportionate number of shares would be returned. The loan was advanced and Mr Bloomenthal received ten certificates. Each certificate stated that Mr Bloomenthal was the registered proprietor of 1,000 seven per cent cumulative preferences shares of £1 each and that those shares had been fully paid. Two months later, Mr Bloomenthal advanced another £600 and received 6000 shares under similar circumstances. A further seven months later £20 of the debt was paid and 200 shares returned. The Company was wound up in 1895 and Mr Bloomenthal was placed on the list of contributories in respect of 16,000 shares. Mr Bloomenthal applied to have his name struck off the list. The application was dismissed at first instance and in the Court of Appeal.

The decisions of the lower courts were reversed unanimously on appeal. Lord Halsbury LC stated that the lower courts had taken an "illogical view",<sup>90</sup> and found that:<sup>91</sup>

... the company who obtained [Mr Bloomenthal's] money upon the distinct representation that what they were about to give him were "fully paid-up shares," obtained it by a misrepresentation of a fact which he had a right to believe and act upon, and in my view he did believe and did act upon, and parted with his money upon the belief that he had got that security. My Lords, it appears to me that it is hopeless to contend that, after a representation made by the company for the purpose of inducing a man to act upon it by parting with his money, it is competent for them to turn round and say, "You should have inquired".

...

... I entertain a doubt whether it is ever true, in a case where one person has been induced to act by the misrepresentation of another, that you can go beyond the fact whether it is so or not.

This case can be distinguished, owing to the context in which the statement was made and relied on. Reliance upon the statement was not argued in order to seek performance of a contract, but instead to *deny* existence of the quite different contract that the claimant was alleging. More important, the statement was not a mere representation (the type of statement generally involved in apparent authority cases) but was

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90 *Bloomenthal*, above n 16, at 160.

91 At 161–162.

instead a promissory statement. The position of a promissory statement is comparable to reassurances a party might receive having made reasonable inquiries, not to the (probably weak) misrepresentation initially made.

*Jones v Gordon* cannot be so easily distinguished. Nevertheless, as will be demonstrated, its comments against the operation of constructive knowledge are obiter and closely tied to the facts of the case being an action upon a bill of exchange. The case concerned whether a purchase of bills of exchange was tainted by fraud and, if so, whether there was notice of that fraud so as to prevent the claimant (Mr Jones) from recovering his money. Mr Jones had purchased bills of exchange having a nominal value of £1,727 and 2s for just £200. That purchase occurred against the backdrop of a series of exchanges of bills between the Gomersalls and their employee, Mr Searby. Mr Searby drew 14 bills on the Gomersalls, being the bills that Mr Jones later purchased. The bills were accepted by the Gomersalls and returned to Mr Searby who then tried to get them discounted. Ten were purchased by a party who did not feature in these proceedings and four were purchased by Mr Jones. Just over a month later, the Gomersalls were adjudicated bankrupt. Mr Jones claimed proof of the bills for their nominal value. The trustee for the Gomersalls' estate, Mr Gordon, objected. Mr Gordon argued that, at the date of bankruptcy, Mr Jones was not the holder of the bills of exchange for value and could not have maintained an action against the Gomersalls had they not been adjudicated bankrupt.<sup>92</sup>

The Court had no difficulty in finding that the transactions were tainted by fraud. But to what extent did this fraud affect Mr Jones? Mr Jones gave evidence that he knew purchasing the bills was very risky, but had taken them without inquiry or explanation. He claimed that although he had been informed that the acceptors of the bills of exchange were in difficulty, he believed that they possessed assets. Lord O'Hagan considered that Mr Jones's speculation on the possibility of rendering those assets available to the detriment of bona fide creditors made it plain that he purchased with no expectation of recovering against Mr Searby.<sup>93</sup> Lord O'Hagan did not believe that any intelligent man, conversant with bill transactions as Mr Jones was, could believe that the offer was not suspicious and suggestive of fraud.<sup>94</sup> Mr Jones had deliberately abstained from making inquiries. Lord Blackburn considered that such a failure constituted wilful blindness and the liquidator's objection was upheld. Lord Blackburn made the following further obiter statements regarding constructive notice:<sup>95</sup>

... if value be given for a bill of exchange, it is not enough to shew that there was carelessness, negligence, or foolishness in not suspecting that the bill was wrong, when there were circumstances

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92 *Jones v Gordon*, above n 16, at 617–618.

93 At 624.

94 At 624.

95 At 628–629.

which might have led a man to suspect that. All these are matters which tend to shew that there was dishonesty in not doing it, but they do not in themselves make a defence to an action upon a bill of exchange. I take it that in order to make such a defence, ... it is necessary to shew that the person who gave value for the bill, whether the value given be great or small, was affected with notice that there was something wrong about it when he took it.

...

[I]f the facts and circumstances are such that the jury, or whoever has to try the question, came to the conclusion that he was not honestly blundering and careless, but that he must have had a suspicion that there was something wrong, and that he refrained from asking questions, not because he was an honest blunderer or a stupid man, but because he thought in his own secret mind — I suspect there is something wrong, and if I ask questions and make farther inquiry, it will no longer be my suspecting it, but my knowing it, and then I shall not be able to recover — I think that is dishonesty.

*Bloomenthal and Jones v Gordon* do not, therefore, prevent the application of constructive knowledge to apparent authority.

## V COMPANIES ACT 1993

The above discussion regarding the position of constructive knowledge within the common law has significant implications for the interpretation of the provision that now governs company contracting: s 18 of the Companies Act 1993. Section 18 lists a series of presumptions of regularity that a person contracting with a company may make. These include a presumption which allows a person to rely upon the agent's apparent authority, unless the person "has, or ought to have, by virtue of his or her position with or relationship to the company", knowledge of the lack of authority.<sup>96</sup>

The inclusion of the phrase "ought to have" clearly allows for the operation of constructive knowledge.<sup>97</sup> However, it is unclear whether the knowledge referred to must always come from the outsider's "position with or relationship to the company", or whether the knowledge must

<sup>96</sup> Companies Act 1993, s 18(1).

<sup>97</sup> Justice Smellie found that "ought to know" (as the predecessor to s 18, s 18C of the Companies Act 1955, was worded) did not include being put on inquiry: *Equiticorp Industries Group Ltd (in stat man) v The Crown (No 47)* [1998] 2 NZLR 481 (HC) at 724–725. However, in that case Smellie J acknowledged that neither counsel addressed the point in submissions, and the more recent decision of French J in *Levin Meats Ltd v Perfect Packaging Ltd* (2011) 10 NZCLC 264,950 (HC) held at [63] that s 18 included "wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make, knowing of circumstances which would indicate the facts to an honest and reasonable person, and knowing of circumstances which would put an honest and reasonable person on inquiry". See also John Farrar (ed) *Company and Securities Law in New Zealand* (Brookers, Wellington, 2008) at 121–122.

only be so sourced if it is constructive.<sup>98</sup> This ambiguity was not present in the equivalent provision in the Companies Act 1955. That provision stated the test as whether the outsider “has, or ought to have, by virtue of his or her position with or relationship to the company, knowledge” of the irregularity.<sup>99</sup> The ambiguity introduced into the 1993 Act may be of little consequence if “relationship” is interpreted broadly, though a broad interpretation would seem to make the inclusion of “position” within the provision redundant.<sup>100</sup> The case law has provided a range of views on the proper construction of this provision and a similar Australian provision.

Justice Kirby’s decision in *Bank of New Zealand v Fiberni Pty Ltd*,<sup>101</sup> and a number of Australian decisions have considered the meaning of “relationship” in the context of a slightly different provision. Under that provision, the test was whether the person dealing with the company knew or by reason of a “connection or relationship with” the company ought to have known of the defect in authority.<sup>102</sup> Justice Kirby took the view that the provision restated the common law which, significantly, he assumed included constructive knowledge.<sup>103</sup> He considered that the “connection or relationship” did not have to be a legal one and could not be limited to membership of the company.<sup>104</sup> Nor did that provision require a pre-existing or ongoing relationship between the company and the outsider.<sup>105</sup> The purpose of the provision was, in his Honour’s view, to “remove the applicability of the various assumptions where the requisite knowledge actually exists”.<sup>106</sup> That purpose is not served by “over-defining” the manner in which that knowledge is received or limiting the types of relationships that knowledge might come from.<sup>107</sup> Thus, Kirby J concluded that the words “connection or relationship with the company” should not be taken to mean some connection or relationship beyond the transaction the subject of the assumptions. The relevant provision was a continuation of the common law, invalidating presumptions of regularity where the outsider is put upon inquiry. When a person is put upon inquiry may be answered by the common law.<sup>108</sup>

In taking that view, Kirby J rejected the views of Nicholson J in *Lyford v Media Portfolio Ltd*. In that case, Nicholson J stated that the relevant proviso referred to knowledge that a person ought to have because of a connection or relationship with the company, but not to knowledge

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98 Peter Watts *Directors’ Powers and Duties* (LexisNexis, Wellington, 2009) at 107.

99 Companies Act 1955, s 18C.

100 Watts, *Directors’ Powers and Duties*, above n 98, at 108.

101 *Fiberni*, above n 42.

102 Corporations Act 1989 (Cth), s 164(4)–(5) (repealed).

103 See *Smith v Peter & Diana Hubbard Pty Ltd* [2006] NSWCA 109 at [74]–[75], where the New South Wales’ Supreme Court similarly assumed that the common law included constructive knowledge.

104 *Fiberni*, above n 42.

105 At 742–743.

106 At 743.

107 At 743.

108 At 743.



arising simply from the particular transaction.<sup>109</sup> Different again is the decision of the New South Wales Court of Appeal in *Story v Advance Bank Australia Ltd*, decided prior to *Fiberi* (though the Court in *Fiberi* does not appear to have been aware of it).<sup>110</sup> The Court in *Story* noted Nicholson J's findings in *Lyford*, but nevertheless refused to rule out the possibility that the relevant connection or relationship might "arise out of the very dealing which is putatively affected by the irregularity".<sup>111</sup> Justice Smellie adopted this view in the New Zealand case *Equiticorp Industries Group Ltd (in stat man) v The Crown (No 47)*.<sup>112</sup> There, the High Court noted three possible interpretations. The first interpretation was that adopted by Nicholson J in *Lyford* and Cynthia Hawes, namely, that the constructive knowledge element of the proviso was limited to company insiders.<sup>113</sup> The second possibility was the approach taken in *Story*, which *Equiticorp* interpreted as extending "relationship" beyond insiders but limiting it to those with ongoing relationships with the company.<sup>114</sup> The third and final option was that provided in *Fiberi*. Assessing those views, Smellie J noted the differences in wording between the Australian and New Zealand provisions and stated that he was not convinced that there was anything in the section limiting "relationship" to insiders.<sup>115</sup> His Honour preferred the approach taken in *Story*.

In light of this case law, it is suggested that s 18 does not prevent the operation of constructive knowledge in arm's length transactions. Reasoning from the starting point that constructive knowledge is a feature of the common law, the words "position with or relationship to" do not suggest any intended limitation on the operation of constructive knowledge. "Connection" (as used in the Australian legislation) might be considered a broader term than "position". But the use of the word "position" does not demonstrate any clear intention to constrain the circumstances in which constructive knowledge could apply. Further, and as previously argued, there are no reasons to justify allowing a person engaged in an arm's length transaction with a company to unreasonably fail to make enquiries when put on notice.<sup>116</sup>

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109 *Lyford v Media Portfolio Ltd* (1989) 7 ACLC 271 (WASC) at 281.

110 *Story*, above n 42.

111 At 735A.

112 *Equiticorp*, above n 97.

113 Cynthia Hawes "Indoor Management and the Companies Amendment Act 1985" (1985) 2 *Canta LR* 343 at 348–349.

114 *Equiticorp*, above n 97, at 722.

115 At 723.

116 See discussion at Part IV.

## VI CONCLUSION

Lord Neuberger is both a non-permanent Judge of the Hong Kong Court of Final Appeal and the President of the Supreme Court of the United Kingdom.<sup>117</sup> Accordingly, his decision in *Akai* may have ramifications for company contracting across a number of Commonwealth jurisdictions. His Lordship's view of constructive knowledge has been adopted in the United Kingdom and his analysis of the common law may inform interpretations of the statutory provisions governing company contracting in New Zealand and Australia.<sup>118</sup> However, Lord Neuberger's reasoning is flawed. His Lordship erred in distinguishing a series of cases that discussed constructive knowledge favourably on the basis that those comments were limited to the obsolete indoor management rule. Constructive knowledge does not feature in formulations of the indoor management rule and early applications of the rule clearly envision constructive knowledge as a proviso to reliance upon apparent authority. The indoor management rule is a subcategory concerned with procedural irregularity and is subject to constructive knowledge as it is subject to the principles of agency generally.

Lord Neuberger further asserted that constructive knowledge has been deprecated in the context of commercial transactions and is not a feature of estoppel by representation (of which apparent authority is a species). The authorities cited, however, do not deprecate constructive knowledge within commercial transactions, but merely caution against its extension. Provided that a reasonable inquiries test is applied flexibly and contextually, common sense requires businesspersons to act reasonably. Further, the categorisation of apparent authority as a form of estoppel by representation does not support the exclusion of constructive knowledge. Apparent authority involves only a weak form of estoppel, sufficiently dissimilar from genuine estoppel cases so as to allow for the operation of constructive knowledge.

Constructive knowledge, therefore, is a feature of the common law and this must inform any interpretation of s 18 of the Companies Act 1993. Section 18 does not depart from the common law and there are no valid policy grounds for excluding constructive knowledge. Therefore, a person engaged in an arm's length transaction with an agent who has apparent authority should lose the ability to rely upon that authority if put on inquiry.

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<sup>117</sup> His Lordship was sworn into the latter position on 1 October 2012: The Supreme Court of the United Kingdom "Lord Neuberger to be sworn in as new Supreme Court President" (press release, 1 October 2012).

<sup>118</sup> *Quinn*, above n 5.