DIRECTORS WITHOUT A COMPANY AND OTHER PROFESSING AGENTS

G. Shapira*

1. *The Problem*

Where A (agent) professes to contract on behalf of P (principal) who is a non-existent person,[1] would A be personally bound by the contract or entitled to its benefits? One specific aspect of this problem relates to the personal liability of a person who purports to contract on behalf of a company prior to its incorporation. The general area of pre-incorporation contracts has been adequately explored elsewhere.[2] Here it is proposed to focus on one of its less canvassed aspects, namely the relationship between the individual who purports to contract on behalf of an unformed company and the other contracting party.

A closely related principle that needs a brief mention is that a company is not bound by a contract made on its behalf prior to its incorporation, and cannot unilaterally ratify it.[3] Consequently it can not sue or be sued on it after incorporation even if the company has in fact adopted the benefits of the contract.[4] This long standing principle has been a source of vexation for all the parties involved in a pre-incorporation contract: the promoter, who seeks to secure property or services for the projected company without incurring personal liability; the company itself, whose formation is often related to pre-incorporation contracts, and which cannot ensure their adoption; and the other contracting party, who may innocently enter into an unenforceable contract.

The need for remedial legislation specifically designed to deal with pre-incorporation contracts has long been apparent.[5] Common law treats the related problems by applying ordinary agency and contractual principles. The position of a company promoter is, therefore,

* LL B., LL.M.(Jerusalem), LL.M.(London). Lecturer in Law, University of Otago.

1 "Non-existent person" includes a person who lacks legal capacity to make the contract; e.g. a minor (see *Equitable Insurance Association of New Zealand, Baillie's Case* (1893) 11 N.Z.L.R. 754, 757) or a company acting outside the scope of its objects. It also includes an unformed company and an unincorporated association. The variety of this species adds to the practical importance of the problem under discussion.

2 See generally, Gross, *Company Promoters* (1972), and "Liability on Pre-Incorporation Contracts, A Comparative Review" (1972) 18 McGill L.J. 512; McKenzie "The Legal Status of the Unborn Company" (1972-73) 5 N.Z.U.L.R. 211; Nugan, "Pre-Incorporation Contracts" in *Studies in Canadian Company Law* (ed. Ziegel, 1967) Ch. 6, 197.

3 *Kelner* v. *Baxter* (1866) L.R. 2 C.P. 174.

4 Unless a fresh contract in the terms of the pre-incorporation contract was made or can be inferred: e.g., *Natal Land and Colonisation Co. Ltd.* v. *Pauline Colliery and Development Syndicate Ltd.* [1904] A.C. 120 (P.C.).

5 On Law Reform see infra, pp. 321-322.

similar to that of other professing agents,[6] with only a slight variation.[7]

Three recent New Zealand decisions[8] make a significant contribution to clarification of the basic principles in this area. Before considering these cases it is proposed to outline the material law and the pertinent problems.

2. *The Rationale of Kelner v. Baxter—A General or a Contractual Principle?*

The locus classicus is *Kelner* v. *Baxter*.[9] In that case certain goods were purchased on behalf of a company yet to be formed. The contract of sale was signed by the three defendants "on behalf of the proposed Gravesend Royal Alexandra Hotel Company". Shortly afterwards the company was incorporated. The goods were delivered and consumed in the business. The company collapsed before the money was paid, and the vendor sought to recover from the three signatories. The Court of Common Pleas held in favour of the plaintiff.

The rationale of the decision has been the subject of considerable debate, at the root of which are the following widely quoted passages. According to Earle C. J.:[10]

> The cases referred to in the course of the argument fully bear out the proposition that where a contract is signed by one who professes to sign 'as agent' and who has no principal existing at the time, and the contract would be altogether inoperative unless binding on the person who signed it, he is bound thereby.

Willies J., expressing himself to be of the same opinion, concluded that[11]

> [C]onstruing this document *ut res magis valeat quam pereat*, we must assume that the parties contemplated that the persons signing it would be personally liable. Putting in the words "on behalf of the Gravesend Royal Alexandra Hotel Company", would operate no more than if a person should contract for a quantity of corn "on behalf of my horses".

Byles J. stated the principle in the broadest terms:[12]

> I am of the same opinion . . . the true rule . . . [i]s that persons who contracted as agents are generally personally responsible where there is no other person who is responsible as principle.

6 The term "professing agent" is hereafter used, unless the context implies otherwise, to describe an "agent" of a non-existent principal. It should be noted that this position differs from that of an agent who is sometimes described as "being his own principal": see Bostwead, *Agency* (13th ed. 1968) art. 126. While a professing agent genuinely intends to act for another the latter merely pretends to be an agent, while, in fact, acting for his own purposes.

7 The source of which is the decision in *Newborne* v. *Sensolid (G.B.) Ltd.* [1954] 1 Q.B. 45. See infra, pp. 314-316.

8 *Hawke's Bay Milk Corporation Ltd.* v. *Watson* [1974] 1 N.Z.L.R. 236; *Rita Joan Dairies Ltd.* v. *Thomson* [1974] 1 N.Z.L.R. 285; *Marblestone Industries Ltd.* v. *Fairchild* [1975] 1 N.Z.L.R. 529.

9 (1866) L.R. 2 C.P. 174.

10 Ibid., 183.

11 Ibid., 185.

12 Id.

These apparently similar, though by no means identical, propositions have led later courts and writers to conflicting conclusions as to the true ratio of the case which can be summarised in three alternative propositions:

(a) As a matter of law, a person professing to contract for a principal who does not exist is bound personally.[13]

(b) The personal liability of a professing agent depends on the intention of the parties expressed in the agreement.[14]

(c) There is a legal presumption that a professing agent has intended to contract personally unless contrary intention is proved.[15]

(a) Rule of Law

The problem of the agent's personal liability normally arises where a contract, executed nominally on behalf of a principal, turns out to be unenforceable against the principal due to the agent's lack of authority or to the principal's incapacity or non-existence. While an existing principal may ratify a contract entered into on his behalf without authority, no ratification is possible where the principal lacked legal capacity[16] or did not exist at the time when the contract was made.

The development of the law on this topic is marked by an attempt to strike a proper balance between the interests of the agent and the third party, by protecting the agent against unwittingly incurring personal liability, and the third party from the consequences of lack of authority which would normally render a contract void against the principal. At an early stage the courts allied themselves with the third party by holding the agent personally bound by a contract which

13 *Newborne* v. *Sensolid (G.B.) Ltd.* [1957] 1 Q.B. 45, 48; *Summergreene* v. *Parker* (1950) 80 C.L.R. 304, 317 per Latham C.J., 318, per Williams J.; *Vickery* v. *Commissioner of Stamp Duties* (1950) 51 S.R. (N.S.W.) 79; affirmed sub. nom. *Vickery* v. *Woods* (1952) 85 C.L.R. 336, 343 per Dixon J., 347-348 per Williams J.; *Smallwood* v. *Black* [1964-5] N.S.W.R. 1973, 1976 per Walsh J. where the authorities for this proposition are collected. See also *The Equitable Insurance Ass. of New Zealand, Baillies Case* (1893) 11 N.Z.L.R. 457 per Williams J.; *Halsbury's Law of England* (7th ed. 1973) Vol. 1, 514; Pennington, *Company Law* (3rd ed. 1973) 89-90; Gross, "Pre-incorporation Contracts" (1971) 87 L.Q.R. 367, 380; Note (1963-64) 6 University of West. Australia L.R. 400. Cf. *Hollman* v. *Pullin* (1887) Cab. & E. 254, 257 per Vaughan Williams J.; *Smallwood* v. *Black* supra, 1779 per Asprey J.

14 *Hollman* v. *Pullin* ibid., 257; *Smallwood* v. *Black* ibid., 1987, per Hardie J., 1998 per Asprey J.; affirmed *Black* v. *Smallwood* (1966) 38 A.L.J.R. 405, 406, 409; *Hawke's Bay Milk Corp.* v. *Watson* [1974] 1 N.Z.L.R. 236, 239.

15 *Smallwood* v. *Black* [1964-5] N.S.W.R. 1973, 1978 per Walsh J.; *Summergreene* v. *Parker* (1950) 80 C.L.R. 304, 323-324 per Fullager J., approved *Black* v. *Smallwood* (1965) 38 A.L.J.R. 405, 406; Bowstead, *Agency* (13th ed. 1968) Art. 125: "Where a person professes to contract on behalf of a principal, and the principal is a fictitious or non-existent person, the person so professing to contract may sometimes be presumed to have intended to contract personally." *Black* v. *Smallwood* has caused the learned editors to qualify the bolder statement appearing in Article 121 of the 12th edition. *Rita Joan Dairies* v. *Thomson* [1974] 1 N.Z.L.R. 284, 291; *Marblestone Industries Ltd.* v. *Fairchild* [1975] 1 N.Z.L.R. 529.

16 E.g. *Ashbury Railway Carriage and Iron Co.* v. *Riche* (1875) L.R. 7 H.L. 653 (a contract outside the legal powers of a company); *Equitable Insurance Ass. of New Zealand, Baillie's Case,* supra (a contract on behalf of a minor).

was not binding on the principal.[17] A departure point was reached in the middle of the last century, in two cases[18] which highlighted the conceptual difficulty of fixing the agent with an intention to step into the principal's shoes if the latter is not bound. It was observed[19] that the agent's personal position was often incompatible with an intention to perform the contract. As illustrated by a later court,[20] it would be absurd to attribute to a theatrical agent, purporting to act, though without authority, on behalf of a prima-donna for a season at Covent Garden, an intention to take the stage himself in case his client would repudiate the contract.

Releasing the agent from a direct contractual liability following from his lack of authority has put the other contracting party in a rather vulnerable position. While a wilful misrepresentation of authority is actionable in deceit, a bona fides mistake by the agent as to the limit of his authority or as to his principal's willingness to ratify the contract would leave the other person with no recourse to either principal or agent. To close this gap the common law has evolved the related concept of implied warranty of authority. Though the agent was no longer bound by the main contract, he was deemed to have implicitly warranted his power to bind the principal, and was liable for damages resulting from the fact that the principal was not bound.[21]

The shift from the actual contract to an implied warranty as the source of the personal liability of the agent was recorded in cases dealing with unauthorised agents of existing principals. Would it equally apply to professing agents? Analytically, the idea that the agent has negated personal liability turns on the assumption that such liability is incompatible with the apparent intention to bind the principal. The assumption is still valid where the agent has acted without authority, as long as the act can be subsequently ratified by the principal. However, where there is no existing principal at the time of the contract and therefore no ratification is possible, the case for excluding altogether an intent to contract personally becomes less persuasive. On the strength of this analysis, it was suggested[22] that *Kelner* v. *Baxter*[23] indicated a distinction between professing and other unauthorised agents, by holding that the former were prima facie still personally bound by the contract. The proposition is reinforced by existing doubts as to whether a professing agent is accountable for a breach of implied warranty of authority.[24] If he is not, then any action against him can only be based on the main contract.

17 *Downman* v. *Williams* (1857) 7 Q.B. 103; *Thomas* v. *Hewes* (1834) 2 C.M. 519, 530; *Randell* v. *Triman* (1856) 18 C.B. 786. See also the judgment of Cockburn C. J. (dissenting) in *Collen* v. *Wright* (1857) 8 E & B 647.

18 *Lewis* v. *Nicholson* (1852) 18 Q.B. 503; *Jenkins* v. *Hutchinson* (1847) 13 Q.B. 744.

19 In *Lewis* v. *Nicholson* ibid., 551 where Lord Campbell C. J. pointed out the absurdity of the proposition that if A, professing to have, but not having, authority from B, made a contract that B should marry C, C might sue A for breach of promise of marriage, even though they are of the same sex!

20 *Black* v. *Smallwood* [1965] 39 A.L.J.R. 405, 406 (High Court of Australia).

21 *Collen* v. *Wright* (1857) 8 E & B 647; and see infra, p. 320.

22 *Smallwood* v. *Black* (1964-5) N.S.W.R. 1973, 1977 per Walsh J.

23 Supra, footnote 9.

24 Infra, p. 320.

(b) Parties' Intention

The more modern view emphatically rejects a general proposition which imposes personal liability on an agent merely because of the non-existence of his principal, and resolves the question solely on the terms of the contract. The leading authority is *Black* v. *Smallwood*[25] where the signature at the foot of a contract for a sale of land displayed the name of a company as purchaser followed by the signatures of two persons as directors. All the parties shared the mistaken belief that the company existed, while, in fact, it had not yet been formed. The vendor subsequently sued the so-called directors for specific performance upon the ground that merely by signing the contract on behalf of a non-existent company they became personally liable. The High Court of Australia refused to read *Kelner* v. *Baxter* in this light. The only source for a possible personal liability was the actual contract, and in the circumstances there was no evidence that the parties had intended to impose personal liability on the persons who signed as directors.

It is submitted that the decision in *Small* v. *Blackwood* was a retrogressive step, since by stating the obvious it obscured the real issue. Doubtless, the common contractual intention is the ground rule. However, to treat it as the *only* rule suggests a lack of insight into the problem. For we are not concerned with the situation where the parties' intention as to whether the agent would be personally liable is indeed common and effectively expressed. The result in this case is free of doubt.[26] Nor are we dealing with an extreme proposition, that a professing agent is personally bound in spite of a clear contrary agreement.[27] The typical feature of the problem (as in *Black* v. *Smallwood* itself) is the absence of a clear common intention in regard to the pertinent question of the agent's personal liability. In normal circumstances the consequences of want of an agent's authority are hardly ever contemplated by the parties, let alone expressed in the agreement.[28] Therefore, to base the result on the "parties' intention" would be a fiction which necessarily resolves the issue in favour of the professing agent and against the third party. As illustrated by *Black* v. *Smallwood* itself, the reference to the "common intention of the parties" means no more than the agent's apparent intention to avoid personal liability which is inferred from the very fact that he had professed himself to act merely as an agent.

(c) Legal Presumption

By this view, where no common intention as to the tentative personal liability of the agent was actually expressed it would be inferred in law. The choice appears to be between implying to the other party

25 (1965) 39 A.L.J.R., 465; affirming *Smallwood* v. *Black* [1964-5] N.S.W.R. 1873; reversing [1964] N.S.W.R. 1121.

26 E.g. *Harper* v. *Vigers* [1909] 2 K.B. 549; *Coventry's Case* [1891] 1 Ch. 202.

27 Such a proposition, which was never seriously considered, was rejected in *Dairy Supplies Ltd.* v. *Fuchs* (1959) 18 D.L.R. (2d) 48.

28 The difficulty is compounded in the case of a written agreement the document being conclusive evidence as to the parties' intention: *Kelner* v. *Baxter* supra, 183-185, *Smallwood* v. *Black* [1964-5] N.S.W.R. 1973, 1977-1978, 1991; *Bowstead*, op. cit. Art. 122. Where no reference is made in the document to the personal liability of the agent, evidence of the actual intention of the parties is inadmissible: *Smallwood* v. *Black*, ibid., 1987.

the understanding that a person who professes to act as an agent declares his intention to avoid personal liability or proceeding on the basis that[29]

> In every contract there is a legal presumption that the parties thereto intended that it shall be an enforceable obligation. The agent enters into a contract which as a matter of legal presumption he intends can be enforced, and it being manifestly impossible to enforce the contract against the principal who has no existence, it is assumed that the agent intended that the contract should be enforced against him.

Therefore[30]

> Where A purporting to act as agent for a non-existing principal, purports to make a binding contract with B and the circumstances are such that B would suppose that a binding contract had been made that must be a strong presumption that A has meant to bind himself personally.

The legal presumption is a workable synthesis of the first and second propositions. The subjective formulation, which preserves the consensual basis of the liability, establishes a flexible rule that yields to an unequivocal contrary intention. At the same time it avoids a stereotyped result whereby the mere declaration of agency amounts to relief from personal liability. The requirement that a professing agent should prove an actual discharge from liability is, it is submitted, much more in line with the equities of the situation than to impose on the other party the burden of proving that such liability was actually undertaken.

The approach is not without support in authority. In fact, it provides a neat solution to the *Kelner* v. *Baxter* enigma by providing a minimum proposition which all three judgments support. However, the tenor of *Black* v. *Smallwood* is emphatically contractual, and at least by implication leaves no scope for the operation of a legal presumption which reverses the order of proof.

3. *Newborne v. Sensolid (G.B.) Ltd.—a separate rule?*

The next question relates to the scope and effect of the decision in *Newborne* v. *Sensolid (Great Britain) Ltd.*[31] Leopold Newborne, acting ostensibly on behalf of a company, sold certain goods to Sensolid Ltd. The contract was signed "Leopold Newborne (London) Ltd. . . . Leopold Newborne". Sensolid broke the contract and refused to take delivery. Mr Newborne sued personally as it was discovered that at the time of the sale the company had not yet been registered.

Parker J. interpreted *Kelner* v. *Baxter* as having established that "if a person contracted obstensibly as agent for a non-existent principal for example a company which is not yet formed, he can be held to be himself personally liable"[32] and is, therefore, entitled to sue on the contract. The defendant, however, managed to sway the decision his way by distinguishing *Kelner* v. *Baxter*. It was argued that the signature showed that it was the principal himself and not an agent that had signed. Parker J. found the argument compelling[33]

29 *Hagan* v. *Ash G. Candler Inc.* 189 Ga. 250, 5 S.E. 2d 739 (1939).
30 *Summergreene* v. *Parker* (1950) 80 C.L.R. 304, 323-324, per Fullager J.
31 [1954] 1 Q.B. 45.
32 Ibid., 47.
33 Ibid., 50.

> [The signature] seems to me to purport to be the Company's signature. The company can only sign by a servant and it is exactly the same, it seems to me, as if the words Leopold Newborne were there as managing director, or as director, or on behalf of the company. The whole thing being the company's signature and not the signature of an agent who agrees to do certain things on behalf of the company.

This point was amplified by the Court of Appeal:[34]

> The company makes the contract. No doubt the company must do its physical acts and so forth, through the directors, but it is not the ordinary case of principal and agent. It is the case in which the company is contracting and the company's contract is authenticated by the signature of one of the directors. The contract purports to be a contract by the company. It does not purport to be a contract by Mr Newborne.

Though the *Newborne* decision has drawn a fair amount of academic criticism,[35] it has been accepted uncritically by subsequent cases.[36] It is submitted that the decision is unsound both in logic and in principle. To treat Mr Newborne as an integral part of a non-entity is inconceivable. The execution of a document, obstensibly on behalf of a company, was carried out by Mr Newborne and the issue of his personal rights and liabilities *arises from* the fact that the purported contract was a nullity as between the obstensible principal and the third party. To dismiss it on this very ground is a form of circular reasoning which avoids the main issue.

Moreover, the concept of a company contracting directly, the director's signature being merely an authentication of the company's signature, goes against the grain of company law.[37] It is trite law that, essentially, the relationship between a company and its officers is governed by ordinary agency principles[38] for both internal and external purposes,[39] which apply also to the personal liability of a corporate officer who purports to act for his company without authority.

34 Ibid., 51.

35 "The [*Newborne*] decision is anomalous because it puts the now quite settled rules to an abnormal use to achieve a different result and one approaching the absurd": Nugan, op. cit. footnote 2, 199. See also Bowstead, op. cit. Art. 125. *The Jenkins Report* (commd. 1749; 1964) para. 44 describes the *Newborne* result as "obviously undesirable" and its basis as "anomalous", turning on "subtle differences in the terminology employed".

36 With the notable exception of Walsh J. of the N.S.W. Supreme Court in *Smallwood* v. *Black* (1964-5) N.S.W.R. 1973, 1980-1982.

37 Cf. *Smallwood* v. *Black* ibid., 1982 per Walsh J.; *Motel Marine Pty. Ltd.* v. *I.A.C. (Finance) Pty. Ltd.* [1964] 37 A.L.J.R. 425, 427.

38 For a recent reiteration of the principle see *Northern Counties Securities Ltd.* v. *Jacksons Steeple Ltd.* [1974] 2 All E.R. 625, 635.

39 Reference, perhaps, should be made here to the "Organic Theory" by which directors and other officials are sometimes regarded as corporate organs, as opposed to mere agents, and accordingly are considered to have acted "as" the company rather than on its behalf: see generally, Gower, *Company Law* (3rd ed. 1969) 144-149. The doctrine however, was invoked for specific purposes, namely to attach to the company direct liability in respect of certain tortious (e.g. *Lennards Carrying Co.* v. *Asiatic Petroleum* [1915] A.C. 705), and criminal acts (e.g. *Tesco Supermarkets* v. *Natrass* [1972] A.C. 153), and to establish the independence of the board's jurisdiction in exercising its constitutional powers (e.g. *Automatic Self-Cleansing Filter Syndicate Co.* v. *Cunninghame* [1906] 2 Ch. 34). It was never intended, and has never been applied, to relieve a corporate officer from his personal liability either to the company or to a third party, as the case may be.

The *Newborne* rationale is irreconcilable with the cases that exemplify this proposition.[40]

At its narrowest, the *Newborne* rule holds that a particular form of signature executed by a corporate officer is identifiable as the corporate's act; in other words, the officer has signed "as" the company, rather than on its behalf. At its widest, it introduces an ambiguous new form of company/officers relationship from which the ordinary agency basis is omitted. In both cases it eliminates any framework of reference by which the personal liability of an unauthorised officer can be assessed.

The judgments that followed *Newborne* do not seem to have always fully appreciated its scope. For, on any analysis, the *Newborne* rationale is incompatible with the *Kelner* v. *Baxter* principle, and the two, therefore, cannot operate simultaneously. *Kelner* v. *Baxter* is clearly founded on agency, while *Newborne* is premised on an effective elimination of agency relationship. This point, which is often glossed over,[41] is important as it forces a deliberate choice between two diverging concepts which may not lead to the same result.

4. *Three Recent Cases*

Hawkes Bay Milk Corporation Ltd. v. *Watson*[42]

A contract was entered into between the plaintiff and the defendants, who purported to act as directors of a company, under which the company would become a distributor of the plaintiff's products. The two defendants obtained, before the completion of the agreement, their solicitor's assurance that the company be incorporated forthwith. It turned out, however, that the company was not incorporated until well after the date of the agreement. The plaintiff sued the so-called directors for the balance owing for goods supplied in pursuance of the agreement.

In view of the fact that both plaintiff and defendants believed at all material times that the company had been registered, Wild C. J. found that "there was no intention or understanding on the part of any person involved that the first defendants, or either of them, was under personal liability". On the basis of this finding of fact the action was dismissed rather summarily:[43]

> [The] principal submission for the plaintiff is that the first defendants are liable as principals on the authority of *Kelner* v. *Baxter* (1886) L.R. 2 C P. 174. It has often been thought and sometimes said that that case established a rule of law that where a person contracts for a non-existent principal he is himself liable on the contract, but I respectfully adopt the view of the High Court of Australia in *Black* v. *Smallwood* (1966) 117 C.L.R. 52, that no such proposition can be extracted from the judgments in that case. The decision there, reached after an examination of the document and the circumstances, was that a binding contract was intended and that the defendants intended to bind themselves personally. That question as to what the parties intended is always the fundamental enquiry and it

40 *Cherry & McDougall* v. *Colonial Bank of Australia* (1896) 38 L.J.P.C. 49, 51; *Fairbank's Exors* v. *Humpreys* (1886) 18 A.B.D. 54; *West London Commercial Bank* v. *Kitson* (1887) 13 Q.B.D. 360.

41 E.g. *Hawke's Bay Milk Corporation Ltd.* v. *Watson* [1974] 1 N.Z.L.R. 236, 239. See infra.

42 Ibid.

43 Ibid., 239.

> is a question of fact on which in the present case, I have already stated my conclusion. Following *Black* v. *Smallwood* (supra) I therefore hold that the first defendants are not liable on any contract with the plaintiff because they did not contract with the plaintiff as agents or otherwise. The "contract" was made by a non-existent company.

The *Watson* decision is a replica of *Black* v. *Smallwood* which goes yet further in confusing the *Kelner* v. *Baxter* and the *Newborne* propositions. While the legal analysis flows from *Kelner* v. *Baxter,* the final conclusion is unmistakably *Newborne.* We are left to wonder whether the "unfortunate plaintiff" lost his money because of a lack of a stipulation in the agreement or because no agreement could have ever existed. The marked absence of the factual analysis of the agreement compounds the difficulty of establishing the underlying legal principle. It is clear, however, that the crucial factor in the *Newborne* case—the particular form of the signature—did not play the same decisive role in *Watson.*

The result in *Watson* clearly illustrates the unsatisfactory aspects of *Black* v. *Smallwood.* Such little evidence as is contained in the report suggests that the plaintiff company had conducted the negotiations having full faith in one individual defendant and trusting him personally to be the prospective other side of the bargain. The introduction of a company at a later stage made very little difference in this respect. In such circumstances, to deny the plaintiff a remedy merely because "there was nothing to excite any concern" seems plainly unjust. Preferably, the risk should lie with the defendants who (admittedly in good faith) led the plaintiff to enter into, and execute, what the plaintiff believed to be a good contract. The fact that the learned Chief Justice did not even refer to the legal presumption of personal liability is probably due to the restrictive force of *Small* v. *Blackwood.*

Rita Joan Dairies Ltd. v. *Thomson*[44]

The decision in this case provides a welcome contrast to the *Watson* case. The plaintiff entered into a written agreement for the sale of certain premises with the first defendants who were described therein as "trustees for a company to be formed". The company was later incorporated and took possession of a premises through the two individual defendants. Having failed in its attempts to raise the necessary capital, the company vacated the premises a short time later. Subsequently the plaintiff resold the premises at a loss and claimed damages.

After finding that no fresh agreement was entered into between the plaintiff and the company after its incorporation, Wilson J. proceeded to examine the personal liability of the defendants under the pre-incorporation contract[45]

> There can be no doubt that a person who contracts for the intended benefit of a company *may* himself become liable to perform that contract, and in general does so. In that case he can escape from such liability only if and when he is released by the other party to the contract. He may avoid becoming liable by express provision to that effect in the contract or the contract may provide for his release from liability if and when the company is registered and itself contracts with the other party. In addition,

44 [1974] 1 N.Z.L.R. 285.
45 Ibid., 288.

> if it is clear from the contract itself and/or the surrounding circumstances, that it was intended by him and the other contracting party that he should not in any event be bound, he cannot be made liable on it.

His Honour then quotes extensively from *Black* v. *Smallwood*,[46] with which he professes to agree, while noting[47] that the analysis of *Kelner* v. *Baxter* in that case was obiter as the decision rested on the *Newborne* proposition. But, Wilson J. adds, in examining the contract in order to establish whether[48] "[i]t was not intended by the parties that those purporting to sign on behalf or as trustees for the company to be formed, should be bound":

> [O]ne must have regard to the presumption that persons do not execute a document which purports to confer and impose responsibilities without intending it to have binding effect except to the extent that that intention is negatived by express words or necessary implication. This presumption is expressed in the rule of construction that a document should be construed ut res magis valiat quam pereat and it is clear that the decision in *Kelner* v. *Baxter* rested substantially on its application. It applies in the instant case because the [company] was not bound by it, and, if it was not intended that the first defendants would be bound, the parties would have entered into a document which bound nobody—and that is a conclusion from which reason recoils.

After a careful examination of the terms of the agreement in light of the surrounding circumstances, His Honour concluded[49] that there was nothing in the contract "[t]o show any intention that the [first defendant] should not be personally responsible for the performing of the obligation".

Although the shift from *Black* v. *Smallwood* appears only slight, it is far reaching. Consistently through his judgment, Wilson J. looks at the terms of the contract for a *release* from personal liability—not for its *source*. The liability is created by a legal presumption, which arises from the non-existence of the ostensible principal. The issue, therefore, is not "did the parties actually agree that if the proposed company did not become liable, those purporting to sign on its behalf should be bound", but rather "did the parties actually agree to release the professing agent from such liability"?

Marblestone Industries Ltd. v. *Fairchild*[50]

The facts are relatively unimportant as, for the most part, they did not reflect directly on the problem at hand. Mahon J., however, addressed himself[51] to the submission that the defendant had contracted "only as an agent for [a] proposed company and that it was never the intention of the plaintiff and defendant that anyone except the proposed company be liable for payment of the goods supplied". An extensive review of the authorities led the learned judge to adopt the view that an agent who knowingly contracts for a non-existent principal is prima facie personally liable. *Black* v. *Smallwood* came in for express criticism[52] for having decided that the mistaken belief

46 Supra.
47 [1974] 1 N.Z.L.R. 285, 291.
48 Id.
49 Ibid., 293.
50 [1975] 1 N.Z.L.R. 529.
51 Ibid., 536.
52 Ibid., 541-542.

of the parties as to the company's existence precluded any imputed intention that the persons signing as directors should be personally liable. The better view, according to Mahon J., is what he considered to be the ratio decidendi of the *Watson* case, namely the "separate ground" that "no contract was ever made".[53] It follows that[54]

> where it is known to the contracting parties that the unformed company does not yet exist, I suppose it is immaterial whether the agent for such company signs in the capacity as agent or trustee for the company to be formed, or whether he signs as 'director' or other officer of the company itself. In either case there is or should be, a presumption of personal liability so long as a presently binding contract is intended, because all parties know that the company is not yet in existence. But where the company is mistakenly believed to exist, as occurred in both the cases in question, then the mutual intention of all signatories is to make a contract with the company alone and the persons signing on behalf of the company cannot be liable on a 'contract' which in fact is a nullity.

For the first time, the mutual ignorance of the parties of the non-existence of the principal is clearly singled out as being decisive of the legal result. The nullity of the contract in these circumstances is due to a common mistake as to the identity of one party—a much more solid ground than the illogical *Newborne* approach under which it was the non-existent company itself that had signed. As Mahon J.'s comments on this point in *Fairchild* were clearly obiter, it remains to be seen whether the concept of common mistake would prove self-sustaining in a fact situation which directly raises the issue.

The ratio decidendi of the *Fairchild* decision is accurately summarised in the heatnote:[55]

> "(i) Where a party contracts on behalf of a non-existent principal there is a strong presumption that he is personally bound by the contract.
>
> (ii) The above presumption can be rebutted by express words in the contract or by a contrary intention derived from the construction of the document or as a fact from the evidence of oral terms.
>
> (iii) Where a defendant knowingly contracts as agent for a non-existent principal the presumption that he is personally liable is almost irresistible."

It is submitted with respect that in the *Fairchild* decision the principle has been given its best expression yet. Mahon J. was careful to maintain what might be termed "the negative role of the agreement", namely treating the agreement as negating, rather than creating, personal liability. The learned judge drew the distinction between the *Kelner* v. *Baxter* and the *Newborne* principles, revised the latter and pointed out their respective application. And finally, he stated the policy ground for holding a company's promoter initially personally liable—perhaps a better guide to a satisfactory result than the legalistic approach based on the imputed intentions of the parties:[56]

53 Id. It is submitted, however, that no such distinction is made in the *Watson* judgment itself. However Mahon J. offers a way of resolving the ambivalence of *Watson*: see supra p. 317.

54 Ibid., 542.

55 Ibid., 529.

56 Ibid., 541.

It may well be that the formulation of the principle in those terms[57] in truth expresses the requirements of business necessity. In some cases the person contracting with the agent for the proposed company may be content to release the agent from any liability if the company, when formed, either cannot or will not adopt the transaction, but there will be many cases where the person so contracting may suffer financial loss or other detriment if no binding contract with the proposed company is completed, and pending the incorporation of the company he may and often will require the interim protection of personal liability on the part of the agent. In other words, he contracts with the professed agent as a principal.

5. *Breach of Warranty of Authority*

It was already mentioned in passing[58] that it is doubtful whether a professing agent can be made accountable for breach of implied warranty of authority. There is no direct authority on the point, and existing dicta[59] are in conflict. Logically, there is no reason why the agent should not be deemed to have warranted his principal's existence as well as his own authority. However certain difficulties arise. First, in order to recover damages the other party must prove that he actually relied on the agent's representation of authority and was induced to enter the contract on this basis; this would be difficult to establish where the third party knew that the principal did not exist. Secondly, damages for breach of warranty of authority are awarded on the basis of the value of the third party's recourse to the principal, namely the amount payable by the particular principal had he been bound.[60] It follows that where the principal is insolvent,[61] or, it is submitted, non-existent, as a claim against him would have proved valueless, the third party is deemed to have suffered no loss resulting from the agent's incompetence. And finally, where the *Newborne* principle is applied there appears to be no ground for inquiring into the agent's authority, as the gist of *Newborne* is the abrogation of agency relationship in favour of a concept of a direct act by the principal.

As a result the direct contractual liability of the professing agent is of more than academic importance. Indeed, binding the agent by the main contract provides the only basis for remedy to a third party where the nominal principal did not exist at the time of the contract.

In *Hawkes Bay Milk Corporation* v. *Watson,* Wild C. J. brushed aside an alternative submission of breach of warranty of authority, as

57 Referring to Pennington, *Company Law* (3rd ed. 1973) 89-90: "Although a contract made before a company's incorporation cannot bind the company, it is not wholly devoid of legal effect. It takes effect as a personal contract with the persons who purport to contract on the company's behalf, and they are liable to pay damages for failure to perform promises made in the company's name, even though the contract expressly provides that only the company's paid up capital shall be answerable for performance."

58 Supra p. 312.

59 In *Newborne* v. *Sensolid Ltd.* [1954] 1 Q.B. 45, 47, Parker J. regarded a claim for breach of warranty of authority as not sustainable where the principal is not in existence; referred to in *Hawke's Bay Milk Corporation* v. *Watson,* supra, 239. Cf., however *Smallwood* v. *Black,* supra, 2002 per Asprey J. *Black* v. *Smallwood,* supra, 409 per Windyer J.

60 *Re National Coffee Palace Co., ex parte Panmure* (1883) 24 Ch. D. 367; *Randall* v. *Trimmer* (1856) 18 C.B. 786; *Hughes* v. *Greene* (1864) 33 L.J.Q.B. 335; *Collen* v. *Wright,* supra; *Godwin* v. *Francis* (1870) L.R. 5 C.P. 295; *Snedding* v. *Newell* (1869) L.R. 4 C.P. 42. Bowstead, op. cit. 404-407; Stoljar, *Agency* (1961) 265-266.

61 *Re National Coffee Palace Co.* ibid., 372 per Brett M. R. and 375 per Bowen L. J.

"the action in this case [was] founded in contract and not in damages for breach of warranty. . . ."[62] The prevailing opinion, however, regards liability for breach of warranty of authority as contractual,[63] although based on an implied collateral guarantee rather than the express contract. It is regretable that due to the failure to appreciate this point, the opportunity was lost in *Watson* for a direct ruling on whether the guarantee extends to the existence of the principal.

6. *Reform*

After describing the present legal position in relation to pre-incorporation contract as "highly unsatisfactory", the Macarthur Committee[64] proposed legislation in the terms of section 13 of the Ghanian Companies Code 1963 which is based on E. C. B. Gower's recommendation in his *Report on Company Law in Ghana*:[65]

> (a) Any contract or other transaction purporting to be entered into by the company prior to its formation or by any person on behalf of the company prior to its formation may be ratified by the company after its formation, and thereupon the company shall become bound by and entitled to the benefit thereof as if it had been in existence at the date of such contract or other transaction and had been a party thereto.
>
> (b) Prior to ratification by the company, the person who purported to act in the name of the company or on its behalf shall in the absence of express agreement to the contrary be personally bound by the contract or transaction and shall be entitled to the benefit thereof.

The recommended legislation appears to provide a satisfactory solution to the problems related to pre-incorporation contracts. Considering how poorly the present law caters for the interest of all the parties involved, it is remarkable how amenable these problems are to a rational and simple solution. One can only reflect on the pace of legislative reform[67] in view of the fact that the above proposal was first advanced by Professor Gower in 1961, and that its implementation in New Zealand, although recommended in March 1973, is by no means imminent.

One aspect of the problem seems now to have reached a satis-

62 [1974] 1 N.Z.L.R. 236, 239.

63 E.g. *Edwards* v. *Parker* 1925 A.C. 1, 21; *Benton* v. *Campbell* [1925] 2 K.B. 410, 415. Stoljar, op. cit. 262-263.

64 *Final Report of the Special Committee to Review the Companies Act (Macarthur Report)*, March 1973, paras. 105-107.

65 *Report of the Commission of Inquiry into the Working of and Administration of the Company Law of Ghana* (1961).

66 *The Macarthur Report*, para 107.

67 Promoters' liability on pre-incorporation contracts was recently legislated in the United Kingdom. Section 9 (2) of the European Communities Act 1972 provides:

> Where a contract purports to be made by a company, or by a person as agent for a company, at a time when the company has not been formed, then subject to any agreement to the contrary the contract shall have effect as a contract entered into by the person purporting to act for the company or as agent for it, and he shall be personally liable on the contract accordingly.

Surprisingly the English legislation does not deal with the inconvenience caused by the inability of the company to ratify the contract after its incorporation; in this respect the *Macarthur Report* recommendations are to be preferred. See further on the subject of proposed reforms McKenzie, "The Legal Status of the Unborn Company" (1972-73) 5 N.Z.U.L.R. 211, 212-215.

factory solution through the courts. The decision in *Marblestone Industries Ltd.* v. *Fairchild*[68] is on all fours with subclause (b) of the reform proposal. However special notice should be taken of Professor Gower's remark[69] that "the wording of both subsections is designed to abrogate the highly technical distinction drawn in *Newborne* v. *Sensolid Ltd.*". Until this is achieved by legislation, the effect of *Newborne* will continue to introduce uncertainty into this area and might still lead to unpredictable results.

7. *Conclusion*

A person acting for a company prior to its formation, just like any other professing agent of a non-existent principal, undertakes a risk of being personally bound by the contract. It has now been clearly established that to avoid such liability the professing agent must procure an effective discharge.[70] This is a result of a legal presumption which, following the non-existence of the nominal principal, imputes to the agent the intention to contract personally. The presumption may be displaced by the terms of the agreement.

Allowing the third party who sues the agent the advantage of a presumption in his favour is of considerable importance as the question of the agent's personal liability in case of non-performance by the principal hardly ever arises in the negotiations and is therefore unprovided for. Holding a professing agent initially liable as a matter of law thus provides the other contracting party with significant protection, without which he may have no redress.

A person who acts for an unformed company may still, in certain circumstances, avoid personal liability through the escape route opened up by the decision in *Newborne* v. *Sensolid Ltd.*[71] It is submitted, however, that the decision is anomalous and that in New Zealand its effect has now been restricted to the relatively rare situation where the promoter was unaware of the non-existence of his "company".

Current proposals for reform point to the same result, and would rid the law of the last vestige of the *Newborne* principle. While promoters' liability to third parties would soon, one hopes, be statutory, along the lines proposed in the Macarthur Report, the effect of the *Thomson* and *Fairchild* decisions bases the liability of other professing agents on the same sound footing.

68 Supra, footnote 50.
69 *Report on Company Law in Ghana* (1961) 32.
70 *Rita Joan Dairies Ltd.* v. *Thomson* [1974] 1 N.Z.L.R. 285; *Marblestone Industries Ltd.* v. *Fairchild* [1975] 1 N.Z.L.R. 529.
71 Supra, footnote 31.