

Answer Guidance for Chapter 7 Practice Questions

1. 'The legal rules relating to a third party's liability to an undisclosed principal lacks a sufficiently clear justification and, as a result, the law in this area is confused and lacks fairness.'

Discuss the validity of this statement.

Introduction

- As with all essays, you should begin with an introduction that sets out what the question is about, why the topic is an important one, and how your essay will go about answering the question set. By providing an outline structure of the discussion to follow, you will demonstrate to the marker that you have understood what the essay question requires you to discuss and your essay will be clearer and more structured.

A third party's liability to an undisclosed principal

- It will be recalled that where an agent acts on behalf of a disclosed principal, then the usual outcome is that a binding contract will exist between the principal and the third party, and either can sue and be sued on that contract. This is logical as the third party is aware that the agent is contracting on behalf of another.
- Where the principal is undisclosed, then the third party will not be aware that the agent is acting on behalf of another (i.e. the third party will assume that he is contracting personally with the agent). In such a case, one would assume that the undisclosed principal would not be able to hold the third party liable on the contract, as the third party would be unaware of the principal's existence.
- This, however, is not the position that the law takes and, generally, an undisclosed principal can sue and be sued on the contract. This rule is extremely controversial for obvious reasons. As Stone states, such a rule runs counter to the well-established doctrine of privity of contract as '[t]he third party can find that they have rights against, and liabilities towards, a person with whom there was no intention to contract, and of whom the third party was in ignorance.'¹
- Given this criticism, the obvious question to ask is why the courts have taken such an approach. This is not an easy question to answer, as the courts' rationale has never been overtly explained. Numerous theories have been advanced by academics, but many of them have been rejected by the courts. For example, Goodhart and Hamson contended that the principal acquires the right to sue and be sued on the contract because the contract that exists between the

¹ Richard Stone, *Law of Agency* (Cavendish 1996) 94.

agent and the third party is automatically assigned to the principal.² However, the Privy Council has rejected this justification.³

- In *Teheran-Europe Co Ltd v ST Belton (Tractors) Ltd*,⁴ Diplock LJ stated *obiter* that 'it matters not whether [the agent] discloses to the other party the identity of his principal, or even if he is contracting on behalf of a principal at all, if the other party is willing or leads the agent to believe that he is willing to treat as a party to the contract anyone on whose behalf the agent may have been authorised to contract.'⁵
- Cheng-Han contends that this *dictum* indicates that the rationale behind the rule is that, when the third party contracts with the agent, he is implicitly agreeing to contract with the agent and the agent's principal, should there be one.⁶ This rationale is not convincing as the mere possibility that a principal might exist is not a sufficient justification for implying a contract between the undisclosed principal and third party.
- Lord Lindley has offered the following rationale:

The explanation of the doctrine that an undisclosed principal can sue and be sued on a contract made in the name of another person with his authority is, that the contract is in truth, although not in form, that of the undisclosed principal himself. Both the principal and the authority exist when the contract is made; and the person who makes it for him is only the instrument by which the principal acts. In allowing him to sue and be sued upon it, effect is given, so far as he is concerned, to what is true in fact, although that truth may not have been known to the other contracting party.⁷

- Again, this justification can be criticized. It arguably pays little heed to the contractual requirements of agreement and intention to create legal relations. The third party did not agree to, nor did he intend for, legal relations to be created between him and the undisclosed principal.
- There is little doubt that the rule can operate unfairly, especially with regards to third parties who might not wish to contract with the undisclosed principal, or who wish to contract personally with the agent (although a contract will exist between the agent and the third party).
- To avoid injustice, the ability of the principal to intervene is not unfettered and there are a number of instances where the principal will not be able to intervene. You may wish to discuss these and demonstrate how they can serve to prevent an unfair intervention by the principal.

² AL Goodhart and CJ Hamson, 'Undisclosed Principals in Contract' (1932) 4 CLJ 320.

³ *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199 (PC) 210 (Lord Lloyd).

⁴ [1968] 2 QB 545 (CA).

⁵ *ibid* 555.

⁶ Tan Cheng-Hang, 'Undisclosed Principals and Contract' (2004) 120 LQR 480, 502.

⁷ *Keighley, Maxsted & Co v Durant* [1901] AC 240 (HL) 261.

Conclusion

- Do not forget to conclude your essay. Do the arguments presented indicate that the quote in the question is correct or not? If you feel that the arguments for one side of an argument are stronger, then say so (although be careful to voice it objectively in the third person, and not as your own personal opinion).
- It may be the case that there are sound arguments on both sides and so no definitive conclusion can be reached. Again, this is perfectly acceptable. The law is not always clear and it may not be possible to fall on one side of an argument.
- There is little doubt that there is no single, clear justification for the rule that an undisclosed principal can intervene on a contract. This does not necessarily mean that the law is not clear, but there is little doubt that the rule can, if not watched carefully, lead to injustice, especially as regards third parties. The requirements for intervention are therefore to be welcomed.

2. Discuss whether or not a binding contract is created between the principal and third party in the following cases:

- ComCorp wishes to purchase some authentic Chinese art, which it will hang on the walls of the lobby of its corporate headquarters. It locates an agent who acts on behalf of a number of Chinese art galleries, one of whom is willing to sell three paintings. A contract of sale is entered into, but the gallery then states that it does not intend to go ahead with the sale.
- ComCorp wishes to hire more office space and instructs an estate agent to locate a suitable property. The estate agent locates a suitable property for £2,500 per month, with six months rent payable up front. ComCorp agrees to rent the property and provides the estate agent with £18,000. The estate agent absconds with the money. The owner of the property demands payment from ComCorp, but ComCorp refuses to pay.
- ComCorp engages an agent to purchase, on its behalf, a heavy goods vehicle. ComCorp instructs the agent not to pay over £25,000 for the vehicle, but the agent cannot obtain a vehicle at this price. He does find a seller who will sell such a vehicle for £25,100 and so the agent enters into a contract of sale on the principal's behalf. ComCorp refuses to take delivery of the vehicle.
- ComCorp is conducting research on its competitors' products. It instructs an agent to purchase products manufactured by TechBuild Ltd, one of ComCorp's major competitors. The agent is told not to inform TechBuild that he is acting on behalf of ComCorp, and to purchase the goods on his own account, and then ComCorp will reimburse him. The agent enters into a contract of sale with TechBuild but, through the agent's carelessness, he divulges that he is acting on behalf of ComCorp.

TechBuild refuse to sell ComCorp the goods, and ComCorp refuse to pay the agent for his services.

Introduction

- Many students think that only essay questions require an introduction, but this is not so. Answers to problem questions should also begin with a lucid and well-structured introduction that clearly highlights the area (or areas) of law to which the question relates. By doing this, you demonstrate immediately that you have understood the question and have clearly identified the relevant legal topics.

ComCorp wishes to purchase some authentic Chinese art, which it will hang on the walls of the lobby of its corporate headquarters. It locates an agent who acts on behalf of a number of Chinese art galleries, one of whom is willing to sell three paintings. A contract of sale is entered into, but the gallery then states that it does not intend to go ahead with the sale.

- The issue here is whether there is a binding contract between ComCorp and the art gallery. In a case such as this, it is likely that the principal will be disclosed, but you are not told whether this is the case, so discuss both possibilities.
- If ComCorp is a disclosed principal, then it will be able to sue the art gallery (although such litigation may be expensive and costly given that the art gallery is in China).
- Even if ComCorp is undisclosed, it will still have the right to intervene on the contract and sue the art gallery (although this right can be lost – see pp 154-58 of the text). The agent may also have the right to sue on the contract.
- There is one other issue to note that is actually discussed in Chapter 8. If the principal and third party are in different countries, to what extent will this affect the transaction? It used to be the case that where the principal and third party were in different countries, then the law would presume that the agent could not establish privity between the principal and third party and so the agent would be personally liable on the contract.
- The increase in international trade has resulted in this presumption being abolished, and so the agent is free to effect contractual relations between ComCorp and the Chinese art gallery, which can be enforced by ComCorp should the gallery refuse to sell the paintings.

ComCorp wishes to hire more office space and instructs an estate agent to locate a suitable property. The estate agent locates a suitable property for £2,500 per month, with six months rent payable up front. ComCorp agrees to rent the property and provides the estate agent with £18,000. The estate agent absconds with the money. The owner of the property demands payment from ComCorp, but ComCorp refuses to pay.

- The issue to discuss here is whether a binding contract exists between ComCorp and the owner of the property. The key issue to note here is whether ComCorp has actually entered into a contract with the property owner (we are not told that the contract has been entered into). If no contract has been entered into, then ComCorp is clearly not bound.
- If a contract has been entered into and ComCorp was, in accordance with the contract, providing six months rent up front, then the issue is whether ComCorp is still liable to pay the £18,000 to the property owner.
- In a case such as this, it is likely that the principal will be disclosed, but you are not told whether this is the case, so discuss both possibilities.

Disclosed principal

- If ComCorp is a disclosed principal, then the general rule is that a contract exists between the principal and third party, upon which either party can sue and be sued.
- The first issue to discuss is whether ComCorp's payment of £18,000 to the agent settles its liability to the property owner. The answer is probably no. Where the principal is disclosed, then a contract will usually be between the principal and the third party and so the principal will only be discharged from liability if he settles with the third party. Accordingly, a payment to the agent will not extinguish the principal's liability to the third party. There are exceptions to this (e.g. if the third party requests that payment is made to the agent and such payment is made), but there is no indication that any of the exceptions apply here.
- The second issue relates to the agent's authority. Where the agent acts without authority, then the third party will not be permitted to sue the principal, unless the principal first ratifies the agent's actions (which clearly, ComCorp will not do). ComCorp could argue that the agent was clearly not authorized to abscond with the £18,000 and so ComCorp is not liable to the third party.

Undisclosed principal

- If ComCorp is an undisclosed principal, then a contract will exist between the agent and the third party, so the property owner can sue the agent. However, the principal can also intervene and sue, and be sued by, the third party, providing that certain conditions are met. Notably, the undisclosed principal can only sue, and be sued by, the third party if the agent is acting within his actual authority. For reasons noted, above, this may not be the case.
- Another argument that ComCorp could use is that, in paying the agent the £18,000, its liability to the property owner is discharged. In the controversial case of *Armstrong v Stokes*, the court held that an undisclosed principal can discharge his obligation to a third party by settling with the agent.

ComCorp engages an agent to purchase, on its behalf, a heavy goods vehicle. ComCorp instructs the agent not to pay over £25,000 for the vehicle, but the agent cannot obtain a vehicle at this price. He does find a seller who will sell such a vehicle for £25,100 and so the agent enters into a contract of sale on the principal's behalf. ComCorp refuses to take delivery of the vehicle.

- The issue here is whether ComCorp is contractually bound to purchase the vehicle for £25,100. In a case such as this, it is likely that the principal will be disclosed, but you are not told whether this is the case, so discuss both possibilities.
- Before discussing the rules relating to disclosed and undisclosed principals, you might wish to discuss whether the agent has acted outside the scope of his authority or not. Whether the agent has acted outside the scope of his authority can have a significant impact upon the discussion that follows, so it makes sense to discuss this early on.
- It is clear that the agent has acted outside the scope of his actual authority and there is nothing to indicate that he has apparent authority. The agent could try to argue that he had authority due to necessity but, based on the minimal facts provided, it is highly unlikely that such an argument would succeed.

Disclosed principal

- If ComCorp is a disclosed principal, then the general rule is that a contract exists between the principal and third party, upon which either party can sue and be sued.
- However, where the agent is acting without authority (as appears to be the case here), then the third party will not be permitted to sue the principal,⁸ unless the principal first ratifies the agent's actions (which is not going to happen given that ComCorp does not wish to purchase the vehicle).
- Accordingly, if ComCorp is a disclosed principal, then the third party cannot sue ComCorp if ComCorp refuses to purchase the vehicle.

Undisclosed principal

- If ComCorp is an undisclosed principal, then a contract will exist between the agent and the third party, so the seller of the vehicle can sue the agent. However, the principal can also intervene and sue, and be sued by, the third party, providing that certain conditions are met. Notably, the undisclosed principal can only sue, and be sued by, the third party if the agent is acting within his actual authority. For reasons noted, above, this is not the case and so the seller of the vehicle cannot sue ComCorp, but it can sue the agent.

⁸ *Comerford v Britannic Assurance Co Ltd* (1908) 24 TLR 593 (KB).

ComCorp is conducting research on its competitors' products. It instructs an agent to purchase products manufactured by TechBuild Ltd, one of ComCorp's major competitors. The agent is told not to inform TechBuild that he is acting on behalf of ComCorp, and to purchase the goods on his own account, and then ComCorp will reimburse him. The agent enters into a contract of sale with TechBuild but, through the agent's carelessness, he divulges that he is acting on behalf of ComCorp. TechBuild refuse to sell ComCorp the goods, and ComCorp refuse to pay the agent for his services.

- There are two issues to be discussed here, namely:
 1. Is there a binding contract between ComCorp and TechBuild?
 2. Is ComCorp required to pay the agent?
- As regards both issues, the issue of whether the agent has breached his authority will be relevant, so it is worth discussing this first.
- The agent has been specifically told not to inform TechBuild that he is acting on behalf of ComCorp. It is therefore clear that the agent has breached his actual authority. Although not discussed in Chapter 7, you will want to bring up the fact that the agent will also have likely breached the duty to obey his principal's instructions.
- It is also worth discussing whether ComCorp is a disclosed or undisclosed principal. At first glance, it would appear obvious that ComCorp is a disclosed principal, as the agent has revealed that he is acting on behalf of ComCorp. However, whether a principal is disclosed or undisclosed depends on whether his existence was known to the third party at the time of the transaction. The agent may not have revealed that he was acting on behalf of ComCorp until after the contract was entered into, in which case ComCorp would actually be an undisclosed principal. You are not given enough information to make a definitive determination, so discuss both situations.

Is there a binding contract between ComCorp and TechBuild?

Disclosed principal

- If ComCorp is a disclosed principal, then the general rule is that a contract exists between the principal and third party, upon which either party can sue and be sued.
- The fact that the agent has breached his authority will not affect ComCorp's ability to sue TechBuild if TechBuild refuses to supply the machinery. Even if it did, ComCorp could simply ratify the agent's actions.

Undisclosed principal

- If ComCorp is an undisclosed principal, then a contract will exist between the agent and the TechBuild, so TechBuild can sue the agent. However, the principal

can also intervene and sue, and be sued by, TechBuild, providing that certain conditions are met. Unfortunately for ComCorp, in the case of *Said v Butt*,⁹ the court stated that the principal cannot intervene and sue the third party if the third party has some reason for not wanting to deal with the undisclosed principal (as would appear to be the case here).

- Accordingly, it would appear that, in this case, ComCorp could not sue TechBuild if it refused to supply ComCorp with the goods.

Is ComCorp required to pay the agent?

- An agent is not entitled to remuneration in respect of transactions that are outside the scope of his authority,¹⁰ unless the principal ratifies the unauthorized actions. Whilst entering into a transaction with TechBuild on ComCorp's behalf as within the scope of his authority, disclosing the fact that he was working on behalf of ComCorp was outside the scope of his authority. ComCorp could use this to argue that it is not therefore required to pay the agent.
- It is also worth noting that the agent has likely breached his duty to obey the instructions of his principal. This will allow ComCorp to sue the agent for damages, and will also cause the agent to lose the right to any commission he might have earned.¹¹

⁹ [1920] 3 KB 497 (KB).

¹⁰ *Mason v Clifton* (1863) F&F 899.

¹¹ *Salomons v Pender* (1865) 3 H&C 639.