THE POWER OF A CONSTITUTIONAL ORGAN OF A REGISTERED COMPANY TO BIND THE COMPANY BY ITS CONTRACTUAL ACTS*

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Introduction

Although similar in result, an "indoor management rule" is distinct from the "agency secret restriction or limitation rule". The latter operates between two legal persons whereas the former operates on the internal activities of one. An indoor management rule may be explained as a rule that where an outsider proves certain facts he will be taken to have proved a corporate act and that the company cannot repudiate that act by setting up an irregularity of indoor management unless it can prove that the outsider knew of or was put on inquiry as to the irregularity, or that inspection of the company's public documents would have shown conclusively that the facts appearing could not compose a corporate act. Although it has now been appreciated that the rule in *Royal British Bank* v. *Turquand*[1] is not the "agency secret restriction or limitation rule" and that the latter rule will operate only where an outsider can prove that he relied at the time of contracting on an appearance of "authority" in an "agent" for which the company as "principal" was responsible,[2] there has been no attempt to define the "certain facts", other than the appearance of the common seal, which an outsider must prove before he can invoke an indoor management rule. The question is, What are the indicia of a

* This article is the last of a series extracted from the author's Ph.D. thesis on the topic, "The Sources and Some Aspects of the Historical Development of the Law Governing Contracts by Registered Companies". The earlier articles are "The Positive Corporate Seal Rule and Exceptions Thereto and the Rule in *Turquand's Case*" (1973) 9 *M.U.L.R.* 192 ("The Positive Corporate Seal Rule"); "The Negative Corporate Seal Rule and Exceptions Thereto" (1974) 9 *M.U.L.R.* 411 ("The Negative Corporate Seal Rule") and "History of the Rule in *Royal British Bank* v. *Turquand*" (1975) 2 *Mon. L.R.* 13. The present article, like each of the others, stands alone well enough though it draws on and develops lines of thought presented in its precursors.

The expression "contractual acts" signifies those acts by a person which the law recognises as significant, *viz,* acts of *contracting* themselves, acts of *delegation* (of authority to an agent), acts of *representation* (including holding out or acquiescence in an agent's holding himself out) and acts of *ratification.*

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1 (1856) 6 E. & B. 327.

2 *Cf.* the abortive attempt by Slade, J. in *Rama Corporation Ltd.* v. *Proved Tin etc. Ltd.* [1952] 2 Q.B. 147 to read early statements of the *Turquand* rule as presupposing that the successful outsider had read the articles.

corporate *parol* act which will substitute for the appearance of the common seal?[3]

It may be safely assumed that an outsider must prove *some* appearance of corporate assent otherwise he could "construct" a corporate act virtually out of an indoor management rule alone — an approach which has been rejected in the agency context. Just as a third party must prove apparent authority before he can invoke the "agency secret restriction or limitation principle", so an outsider must prove that he relied on *some* appearance of a corporate act, even if it be as little as an act by one director or one shareholder, before he can invoke an indoor management rule. The only contractual act excepted from this generalization is that of ratification. It appears that a purported but technically deficient resolution to ratify cannot be sustained by an indoor management rule. Ratification is a unilateral act after contract and is distinguishable from acts of contracting, delegation or representation which the outsider has relied upon at the time of contracting.

The irregularities which were overcome by the positive corporate seal rule were divisible into two classes: "non-seizure of power" situations and "irregularity of functioning" situations,[4] and they represent the irregularities to be overcome in the context of parol contracts. A moment's thought will show that an indoor management rule will apply at least to some corporate parol contracts. Obviously if it is admitted or proved that "the directors" have borrowed money by parol without a prior shareholder sanction required by the articles, the principle of *Turquand's Case* will by analogy be applicable.[5] Expressed in general terms, the rule operating there

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[3] Section 9(1) of the European Communities Act, 1972 provides that "In favour of a person dealing with a company in good faith, any transaction decided on by the directors shall be deemed to be one which is within the capacity of the company to enter into, and the power of the directors to bind the company shall be deemed to be free of any limitation under the memorandum or articles of association; and a party to a transaction so decided on shall not be bound to enquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and shall be presumed to have acted in good faith unless the contrary is proved". The subsection's modification of the *ultra vires* doctrine operates on a "transaction decided on by the directors" and the subsection modifies the doctrine of constructive notice only insofar as "the powers of the directors" are concerned. Whilst the latter provision clearly deals with the "non-seizure of power" problem in relation to the directors, neither touches on the other area of difficulty adverted to in this article, *viz* what human acts purporting to be a decision by "the directors" will be sufficient to activate some indoor management rule for the benefit of the outsider. (As well, the subsection attempts to deal with the doctrine of *ultra vires* and subsection (4) modifies the doctrine of constructive notice as it would normally apply to changes made in the information contained in the company's public documents.) For a discussion of the section see Prentice (1973) 89 *L.Q.R.* 518, Farrar and Powles (1973) 36 *M.L.R.* 270 and Markensis (1976) 35 *Camb. L.J.* 112.

[4] See "The Positive Corporate Seal Rule" (* *ante*) at 202 and "History of the Rule in *Royal British Bank* v. *Turquand*" (* *ante*) at 48-49.

[5] In *Turquand's Case* and many of its applications, it has not been disputed that "the directors" have acted (*cf.* the directorial borrowings without shareholder sanction in *Agar* v. *Athenaeum Life Assurance Society* (1858) 3 C.B. (N.S.) 725; *Re Tyson's Reef Co.* (1866) 3 W.W. & a'B. 162 (L.); *Colonial Bank of Australia* v. *Willan* (1874) L.R. 5 P.C. 448 and *Gillies* v. *Craighton Garage Co. Ltd.* [1935] S.C. 423), though it appears that in all except *Willan's Case*, the seal has also appeared.

is this: there being no question but that a certain constitutional organ has performed a certain contractual act, the company cannot set up the fact that the organ had not become seized of actual power to do the act due to internal non-compliance with a "preliminary".[6] Since it can be taken that there is an indoor management rule operating to cover non-seizure of power situations even in the absence of the seal, it will be referred to as the "second indoor management rule".[7] It will have to be considered to which acts by which constitutional organs this rule applies.

This leads to the first question to be dealt with in this article: In what circumstances will the company not be allowed to repudiate what is admitted or proved to be a contractual act of one of its constitutional organs, on the ground that the organ had not become actually seized of power to perform the act? The second major question to be pursued later is this: In what circumstances will the company not be permitted to repudiate certain human acts as not being the act of one of its constitutional group-organs on the ground of internal non-compliance with manner and form requirements?

Terminology

"Actual power" is an uncomfortable term. According to agency theory there is only one kind of power, i.e. legal power. What may be "actual" (or alternatively "apparent") is "authority".[8] One is indoctrinated by agency principles not to speak of either actual or apparent power.

In corporate-constitutional law "authority" terminology is prohibited. Yet it is necessary to have words to distinguish between constitutional power which is possessed and exercised so as to make the resultant act an act of the body corporate *for all purposes,* and something which is less than that but which, by virtue of a rule such as the second indoor management rule, will be made into a corporate act *for the benefit of a particular outsider.* The former will be called "actual constitutional power"; the latter, "usual constitutional power". The "apparent" or "ostensible" terminology is avoided because it may easily suggest dependence on a representation by the company.[9] Doubtless where a constitutional organ performs an unusual act the outsider will be put on inquiry and that fact will, on corporate-

[6] Wood, V.-C. expresses the *Turquand* principle clearly in such terms in *Fountaine* v. *Carmarthen Ry. Co.* (1868) L.R. 5 Eq. 316 at 322.

[7] The "first indoor management rule" was the positive corporate seal rule developed in cases concerning chartered and statutory companies which was applied to the registered company in *Turquand's Case*: see "The Positive Corporate Seal Rule" (* *ante*). That rule overcame both "non-seizure of power" and "irregularity of functioning".

[8] The distinction between "power" signifying only a legal concept and actual authority as the paradigm factual situation which gives rise to it in an agent is akin to the distinction between the legal and natural personalities of the individual.

[9] This would be the case only where there was a holding out by shareholders of persons as directors, and the "usual constitutional power" of directors of the type of company in question would be the measure of those persons' collective power to bind the company.

Stiebel did not balk at using the expression "The Ostensible Powers of Directors" as the title of his article at (1933) 49 *L.Q.R.* 350 though it is doubtful that he had constitutional power in mind.

constitutional law principles as on agency principles, defeat him if he fails to inquire. This may be thought to render otiose the "usual constitutional power" terminology suggested, but the term will be found convenient. Although "usual constitutional power" does not arise from a representation by the company, yet the general requirement that a corporate contractual act be within a constitutional organ's "usual constitutional power" is an obvious point of similarity between agency and corporate-constitutional law principles.

Difficulties of terminology also exist in relation to the second question to be examined. The expression "actual act" will be used to refer to human acts which the law constitutes an act of a constitutional organ *for all purposes,* whereas a human act which purports to be an act of a constitutional organ but which falls short because of some irregularity of manner and form may be called simply a "purported act of a constitutional organ". An "actual act" is an absolute; a purported act is a relative concept and is effective, if at all, only for limited purposes and as between a company and a particular outsider.

Since most principles discussed will apply equally to both constitutional group-organs, *viz* "the shareholders" and "the directors", the directors will, at times, be taken as the illustrative case. Further, references to "directors" or to the "constitutional organ" which they form, will include a reference to *de facto* directors and to a *de facto* board, and the same principles will apply, for example, to the definition of actual and purported contractual acts by directors *de facto* as to the definition of such acts by directors *de jure.*

Although the expressions "members", "shareholders" and "corporators" are, as ever, used to indicate the company's *general* constitutional organ, of course the expression "member of a constitutional organ" also refers to a director.

The Power of a Particular Constitutional Organ to Bind the Company by Its Contractual Acts[10]

On common law principles the general constitutional organ (the corporators) may bind the body corporate by any contractual act unless (as happens in the common form of management article) the constitutive documents vest the relevant power exclusively in another constitutional organ (the directors). In that event only the directors can bind the company since the doctrine of constructive notice will defeat an outsider who contracts with the shareholders. Similar remarks will apply to a delegation of authority; i.e., if it is not *ultra vires* for the company to act through agents then the corporators will bind the company by a delegation unless either the constitutive documents prohibit it or vest constitutional power to make the contract in question in the directors to the exclusion of the share-

[10] In some respects acts of ratification are considered separately *post.*
It may be assumed in this section of the article that any contractual act being discussed is an *actual* contractual act of the constitutional organ in question.

holders.[11] Almost universally, power to make and to delegate authority to make ordinary business contracts is vested exclusively in the directors. So, although at common law power to exercise the contracting and delegating capacity of the company itself vests in the corporators, it is within the usual constitutional power of the directors to make and to delegate authority to make ordinary business contracts.

The foregoing propositions have not embraced the third basis of a company's contractual liability; *viz,* that of apparent authority. Who may *represent,* on behalf of a company, that an individual has authority? In particular, who, on its behalf, may *hold out* an individual as the company's agent of a particular class? Unlike powers of contracting and of delegating, a power of representing or holding out will not usually be vested expressly by the constitutive documents. On principle one would think that a constitutional organ or an agent which could have delegated or appointed *de jure* would have the power in question.

The question raised had rarely been dealt with until *Freeman and Lockyer* v. *Buckhurst Park Properties (Mangal) Ltd.*[12] which has now been followed by the High Court of Australia in *Crabtree Vickers Pty. Ltd.* v. *Australian Direct Mail Advertising and Addressing Co. Pty. Ltd.*[13] Lord Diplock in *Freeman and Lockyer* said at one place that a representation of authority must be made by "some person or persons who have 'actual authority' from the corporation to make the representation"[14] and at a later place that it must be made by "a person or persons who have 'actual' authority to manage the business of the company either generally or in respect of those matters to which the contract relates".[15] As Trebilcock has observed,[16] the latter is not a paraphrase of the former though Diplock, L.J. seems to have treated it as such. In the context of organs (as distinct from agents), the former seems to be intended (in spite of the "authority" terminology) to refer to a constitutional organ; the latter to an organ in the sense developed in and since *Lennard's Carrying Co. Ltd.* v. *Asiatic Petroleum Co. Pty. Ltd.,*[17] i.e. a "functional" organ.

The former signifies either a constitutional organ acting within its actual constitutional power (under the normal articles, the directors or the managing director) or an agent or sub-agent with actual authority (i.e., as between him and the company) to make the representation. This seems

[11] *Cf. Mercantile Bank of India Ltd.* v. *Chartered Bank of India etc.* [1937] 1 All E.R. 231.

[12] [1964] 2 Q.B. 480 (C.A.). It has since been dealt with by Trebilcock in "Company Contracts" (1966) 2 *Adel. L.R.* 310 at 316-327.

[13] (1975) 50 A.L.J.R. 203.

[14] [1964] 2 Q.B. 480 (C.A.) at 504-505.

[15] *Id.* at 506.

[16] Trebilcock, *loc. cit.* n. 12.

[17] [1915] A.C. 705. His Lordship's language is similar to that which occurs in cases on corporate acquiescence decided as exceptions to the negative corporate seal rule (see "The Negative Corporate Seal Rule" * *ante,* at 439-444). It may be difficult to say in advance who will be classified as functional organs by the courts other than "the directors" who are, after all, a constitutional organ anyway. What can be said is that like an actual or apparent agent, a functional organ derives power only by virtue ultimately of a delegation, or more commonly a representation (particularly by acquiescence), by a constitutional organ.

to accord with the conclusion reached earlier on general principle since it is the constitutional organ possessed of actual constitutional power to delegate authority and to appoint agents which will have, in Lord Diplock's terminology, "actual authority from the corporation" to make representations and to hold out. Where, as universally happens, power of management is vested in the directors exclusively, the doctrine of constructive notice should prevent an outsider from successfully relying on a representation by the shareholders of authority in any agent,[18] though he should be able to rely on their representation as to who are the directors since they have actual constitutional power to appoint them. Where (as under the common form of article) the directors appoint the managing director, the outsider can safely rely on a representation by them (but not by the shareholders) as to who is the managing director. It is submitted that once a constitutional organ makes a representation of an appointment which it could have made *de jure,* the outsider should be able in all respects to treat and deal with the *de facto* appointee as if he were a *de jure* appointee, and should, for example, be able to rely on a representation by the *de facto* appointee of a delegation of authority by him which he would have had actual authority to make if he had been appointed *de jure.* To this extent it is submitted that there is no good reason why an agent should not be capable of having an apparent authority to make a representation, and that Lord Diplock's statement that only an agent with "actual" authority can effectively do so seems to be too restrictive. However the Australian High Court has now clearly followed Lord Diplock in *Crabtree-Vickers Pty. Ltd.* v. *Australian Direct Mail Advertising and Addressing Co. Pty. Ltd.*[19] The injustice of the result in the *Crabtree-Vickers Case,* virtually acknowledged by their Honours,[20] perhaps lends some support to the writer's submission to to what the law should be on this point.[21]

[18] Subject to what is said in n. 21 as to the default powers of the members and as to the exclusive vesting in the directors being itself imposed or retained by the consent of 75% of the voting members.

[19] (1975) 50 A.L.J.R. 203. " . . . a person with no actual, but only ostensible authority to do an act or to make a representation cannot make a representation which may be relied on as giving a further agent ostensible authority. Hence the stress by Lord Diplock on the need that the person or persons making the representation must have actual authority to make the representation" *id.* at 206.

[20] *Id.* at 207.

[21] There are two possible qualifications to the proposition that under the normal management article, an outsider who deals with the shareholders rather than the directors is defeated by the doctrine of constructive notice. The first is based on the inherent residual power of the shareholders and the default power of the shareholders; the second on the shareholders' power to alter the management article so as to restore power to themselves. As to the former, it is submitted that to argue that an outsider should be entitled to assume that the shareholders had become seized of their residual or default powers is in reality to invoke the discredited "might have had power" approach. The second potential qualification proves to have no sound basis except perhaps where *all* the shareholders participate in the contractual act in question; *cf. Ho Tung* v. *Man On Insurance Co. Ltd.* [1902] A.C. 232 (P.C.) and *Royal Bank of India's Case* (1869) 4 Ch. App. 252. In this situation the question seems to resolve itself into whether the special resolution procedure by which statute permits registered companies to alter their articles is exclusive of an inherent power of alteration. Expressed in another way, the question resolves itself into whether the Companies Act has made the articles as they exist for the time being, a delimitation of the capacity of the company itself.

A Contractual Act by a Constitutional Organ

In view of the construction placed upon the contracting sections in the 1856 Act and later Acts[22] the modern company can express its contractual acts in the same modes as an individual. A difficulty in the contracting section not noted previously is that even as interpreted to embrace apparent authority, it does not contemplate that parol contracts may be made by constitutional organs having "power" not based on "authority". But the word "authority" in the section would certainly be construed to refer also to constitutional power.[23]

Subject always to the doctrine of constructive notice, a company will therefore be bound by a contract which can be said to have been (1) made *by the company itself;* (2) made by an agent to whom *the company has delegated* actual authority;(3) made by an agent acting within an ostensible authority arising from a *representation* (*including a holding out*) *by the company;* or (4) *ratified by the company.* But what must be proved before it can be said that the company itself has performed an act of contracting, delegation, representation or ratification?[24] It is with this question that the remainder of this article is concerned.

One might have expected an early answer in the cases falling within exceptions to the negative corporate seal rule but as noted in an earlier article,[25] there was in those cases no theorizing as to the nature of a corporate contractual act. The most that can be concluded from those cases is that the courts usually found such an act when they inferred that "the directors" or "the individuals in charge of the company's affairs" had performed it.[26] This is too pragmatic and imprecise to assist a theoretical inquiry.

What human acts are necessary to constitute an actual contractual act of a constitutional organ of the registered company?

In the attempt to answer the question posed, it will be irrelevant whether or how the constitutional organ is seized or treated as being seized of power to bind the company; it will be assumed that the common seal does not appear to "cover" irregularities; it will be assumed that the directors are competent to act (e.g., that if the company's articles require

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[22] *Cf.* s. 35 of the Australian uniform Acts and s. 32 of the U.K. Act of 1948. And see the writer's article "History of the Rule in *Royal British Bank* v. *Turquand*" (1975) 2 *Mon. L.R.* 13 at 41.

[23] *Cf.* Diplock, L.J. in *Freeman and Lockyer, ante cit.*: "Such 'actual' authority may be conferred by the constitution of the corporation itself, as, for example, in the case of a company, upon the board of directors . . . " [1964] 2 Q.B. 480 at 505.

[24] Although the common seal is not such an act, its appearance is conclusively presumed to express such an act and, unless one of the exceptions to the positive corporate seal rule can be proved, its appearance estops the company from denying that such an act has been committed.

[25] "The Negative Corporate Seal Rule", (* *ante*) *passim* but esp. at 447.

[26] For an illustration of the drawing of the first kind of inference see *Reuter* v. *The Electric Telegraph Co.* (1856) 6 El. & Bl. 341 and for illustrations of the drawing of the second kind of inference see *Laird* v. *Birkenhead Ry. Co.* (1859) Johns 500; *Wilson* v. *West Hartlepool Ry. Co.* (1864) 34 Beav. 187 esp. *per* Lord Romilly, M.R. at 191; *Crook v. Seaford Corporation* (1871) 6 Ch. App. 551 esp. *per* Lord Hatherley at 554.

appointment of a minimum of three directors, at least three have been appointed); and it will be assumed, at least for the time being, that the question posed is capable of being answered uniformly in respect of all four classes of contractual act.

The manner and form requirements compliance with which is necessary to constitute human acts an actual act of a constitutional organ are implied by the common law but are usually specified in the articles. Of course the following general statements are subject to the provisions of the articles of any particular company including the provisions of Table A where they apply. The requirements are notice of meeting; a meeting; presence of a quorum; and procedural regularity in the functioning of the meeting. In this abbreviated treatment special mention will be made of the second requirement alone. The "meeting" required is usually thought of as a gathering of humans though conceivably a meeting of minds on television or over the telephone may suffice if it can be said that all the members of the constitutional organ who wished to participate have had the opportunity of doing so simultaneously. An assent participated in by less than all members of the organ otherwise than in a meeting is objectionable because (a) dissentients may dissuade the others; and (b) where those assenting number less than half the total membership of the organ, it is possible that two or more groups of equal size may take a different decision contemporaneously.[27] The requirement of an opportunity for the meeting of all minds simultaneously is considered further below, but it may be noted now that the requirement is displaced where all members of the constitutional organ join, even if not simultaneously, in doing the act in question.

It is easy to say that an outsider should not be affected by irregularity touching any of the four matters mentioned unless he knows of it, just as a person contracting with a competent but mentally irregular individual should not be affected by the mental irregularity unless he knows of it. But in the latter situation two things are clear: (1) that the contract has been made with the individual; and (2) that the individual has given *some* assent. But what does it mean to say that a contract has been made with a "constitutional organ functioning irregularly" and what is "*some* assent" of a constitutional organ? A possible answer to the last question would be "the assent of at least one member of the constitutional organ" and whether the law will in fact operate on that minimal amount of assent to make it an effective assent of the organ in favour of a particular outsider will be considered below.[28]

An "actual act" of a constitutional organ occurs (1) where it emerges as a joint act of all the members of the organ; (2) where (in the absence of modifying constitutional provisions), after notice to all members of the organ and a major part meet, it is the act of a major part of that

[27] *Cf. D'arcy* v. *The Tamar Kit Hill & Callington Railway Co.* (1867) L.R.2 Ex. 158 esp. Bramwell, B.

[28] See *infra* at 353 *et seq.*

major part so assembled; or (3) where (in the presence of constitutional provisions) there is total compliance with constitutional manner and form requirements.[29] The second proposition is only the common law's provision in the absence of express provision in the articles,[30] and marks a distinction between the body corporate and the unincorporated body where, as a general rule, unanimity rather than a bare majority is required at common law.[31] The effect of the foregoing propositions is that an actual act of a constitutional organ (and therefore *prima facie* of the company itself) is one which emerges as either (1) a single act purporting to be that of the organ and participated in by all its members (a "unanimous act"); or (2) a single act purporting to be that of the organ participated in by less than all its members but complying with manner and form requirements either as imposed by the constitution or by the common law (a "constitutionally regular act").

The significance of certain expressions in this statement should be considered. The act referred to "emerges as a single act". Although the directors may participate in the act at different times (e.g., by each signing a document independently of each other) it purports when completed to be a "group-act", a "collective act", a "joint act", an "organic act", and so affects the outsider.[32] "Joint act" situations must be distinguished from other possible situations which will be considered below and which may now be noted: (1) identical individual acts performed by all directors independently of each other; (2) a joint act by some only of the directors not complying with manner and form requirements; and (3) identical individual acts by some only of the directors.

The significance of the phrase "purporting to be that of the organ" is illustrated by *Barber's Case*.[33] Articles provided that no person not recommended by the board should be a director and an individual was elected unanimously as a director at a general meeting attended by six of

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[29] For these propositions see the following cases decided in the context of chartered and statutory companies: *dicta* by Rolphe, B. in *Ludlow Corporation* v. *Charlton* (1840) 6 M. & W. 815 at 823 and by Parke, B. in *Ridley* v. *Plymouth etc. Co.* (1848) 2 Exch. 711 at 717; *A.-G.* v. *Davy* (1741) 2 Atk. 212 (election of a chaplain by three corporators); *A.-G.* v. *Scott* (1750) 1 Ves. Sen. 413 (presentation and election of minister by twenty-five parishioners pursuant to Lord Chancellor's decree); and *cf.* Com. Dig. tit. Franchise, F. 11 (the act of "the major part of the corporators corporately assembled"); and *R.* v. *Windam* (1776) 1 Comp. 377. "A major part of the corporators" was the phrase used by the 33 Hen. VIII, C. 27 in a purported statement of the common law. That would make it clear that a major part of the members must assemble. It was so decided in *Hascard* v. *Somany* (1693) 1 Freem. K.B. 504 and affirmed to be the law by Lord Mansfield in *R.* v. *Monday* (1777) 2 Cowp. 530 at 538. These authorities were cited with approval by Wills, J. in *Mayor of the Staple* v. *Bank of England* (1887) 21 Q.B.D. 160 (C.A.) at 165 and are taken as representing the law in *Halsbury's Laws of England* (3rd Ed.) Vol. 9, pp. 48-49.

[30] It seems that the common law quorum may be less than a bare majority if it can be shown that there is a course of dealing by which a lesser number has been accustomed to act in right of the whole: *In re Tavistock Ironworks Co.* (1867) L.R. 4 Eq. 233. This is an unusual situation and will be ignored henceforth.

[31] The distinction is made, e.g., in *Australian Auxiliary Steam Clipper Co.* v. *Mounsey* (1858) 4 K. & J. 733 *per* Wood, V.-C. at 740.

[32] *Cf. Collie's Claim* (1871) L.R. 12 Eq. 246.

[33] (1877) 5 Ch.D. 963 (C.A.).

the seven directors, those seven being also the only shareholders. It was held,

> Six directors out of seven met in a different capacity and for a different purpose, and such a meeting does not make them a board of directors.[34]

and,

> It cannot be said that there was, either in substance or in form, a recommendation by the board . . . .[35]

It seems clear that an act performed by persons met in one capacity (e.g., as the members of one company) should not be held to have been performed by them in another capacity (e.g., as members of another company).

But where a joint act is *unanimous,* it may be held that the participants have waived the requirement that they be convened as the organ in question and have converted their meeting into a meeting of that organ. This seems to be the explanation of *Re Express Engineering Works*[36] in which it was held that a resolution which was passed at a meeting of directors, attended by all the directors, who were also all the shareholders, and which was beyond the constitutional power of the directors to make because of their "interest" in the contract, must be taken to have been ratified *or made* by "the shareholders" who must be taken to have converted the meeting into a meeting of shareholders. This notional conversion seems to be unrealistic and potentially dangerous. The special considerations applicable to acts of acquiescence and ratification which will be noted below[37] would seem to justify the decision itself in *Re Express Engineering Works,* but the judgment does not appear to turn on ratification.

The definition offered of an "actual act" is supported by considerations first, of principle, and second, of precedent. What is the purpose of the manner and form requirements which were noted earlier and may compendiously be described as "a meeting duly convened, constituted and functioning"? In the case of the shareholders it is only that each member of the organ be given the opportunity of participating in decision-making. In the case of the directors it is this and the intention that the company should have the benefit of the directors' "combined wisdom". *Prima facie* these purposes are served as well by a joint act participated in by all as by compliance with manner and form.[38]

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[34] *Id. per* Jessel, M.R. at 967.

[35] *Id.* at 968.

[36] [1920] 1 Ch. 466 (C.A.).

[37] See *post* at 349 *et seq.*

[38] Table A impliedly now recognizes this by equating a resolution signed by all directors with one duly passed at a meeting: U.K. Act, 1948, Table A, arts. 5, 106; Australian Uniform Companies Acts, 1961-1962, Table A, art. 90.

The statements in the text are not contradicted, indeed they are supported, by the fact that a director cannot waive his right to notice: *Re Portuguese Consolidated Copper Mines* (1889) 42 Ch. D. 160; *Young* v. *Ladies' Imperial Club* [1920] 2 K.B. 523.

There is one special possibility however, which deserves mention. It may be that each director knows something different from what his co-directors know and that this, when but only when combined in the course of discussion with the knowledge contributed by the others, will give rise to a totally different picture from what any one of the directors could have imagined individually. A mere unanimous act by all directors, whether achieved simultaneously or otherwise, might not confer this potential benefit on the company.

But the cases have equated unanimity with constitutional regularity. This is the result of *Hallows v. Fernie;*[39] *Collie's Claim;*[40] *Barber's Case;*[41] *Kennedy's Case;*[42] *Salomon* v. *Salomon & Co. Ltd.;*[43] *Re Express Engineering Works;*[44] *Re Oxted Motor Co. Ltd.*[45] and *Re Bailey, Hay & Co. Ltd.*[46] In *Collie's Claim,* for example, all four directors signed a letter of retainer on which their company was later sued. They signed it independently of each other[47] and not following a joint discussion. The company was held liable on the retainer.[48] The common sense in equating unanimity with compliance with manner and form was expressed by Wood, V.-C. in *Hallows* v. *Fernie*[49] in which the subscribers all, though not together, signed an appointment of the company's first directors:

> If any one of the subscribers to the contract raises a question, he may be entitled to say, "I will not have this decided without a meeting of us all"; but if they all concur (as in this case), is seems to me hypercritical to say the appointment was irregular.[50]

A unanimous joint act is equivalent to a constitutionally regular act for all purposes:

> If you are satisfied that the persons whose concurrence is necessary to give validity to the act did so concur, with full knowledge of all that they were doing, in my opinion the terms of the law are fully satisfied, and it is not necessary that whatever is done by directors should be done under some roof, in some place, where they are all there assembled.[51]

Since all members of a constitutional organ may be taken to be aware of the minor dangers of unanimity without joint discussion, they may embrace

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[39] (1867) L.R. 3 Eq. 520 esp. at 537.
[40] (1871) L.R. 12 Eq. 246.
[41] (1877) 5 Ch. D. 963 esp. *per* Jessel, M.R. at 967.
[42] (1890) 44 Ch. D. 472 esp. at 481.
[43] [1897] A.C. 22 (H.L.): " . . . the company is bound in a matter intra vires by the unanimous agreement of its members" *per* Lord Davey at 57.
[44] [1920] 1 Ch. 466 (C.A.).
[45] [1921] 3 K.B. 32.
[46] [1971] 1 W.L.R. 1357 at 1336.
[47] At least two signed it independently of the other two.
[48] The case illustrates another difficulty in equating unanimity with procedural regularity. One of the directors was somewhat loath to sign but fell in with the majority. If there had been a meeting he might have dissuaded them for it cannot be said how tenaciously a majority's point of view is held.
[49] (1867) L.R. 3 Eq. 520.
[50] *Id.* at 537.
[51] *Collie's Claim* (1871) L.R. 12 Eq. 246 at 258.

with impunity the risk of participating in a joint act without simultaneous exchange of information.

The decided cases also support the corollary that in the absence of unanimity an actual act of a constitutional organ will exist only if manner and form requirements are complied with.[52] In *Howbeach Coal Co.* v. *Teague* a company registered under the 1856 Act sued for unpaid calls. Under the articles power was vested in five directors and the first five were to be determined by "the subscribers" to the memorandum and articles. The question "What is a determination by the subscribers?" was at large and was to be governed by the common law. On the principles noted earlier this could be satisfied by a joint action by all seven subscribers or a resolution by majority vote at a meeting attended by four of the seven after notice to all seven and this was the view taken by Martin, B.[53]

To reiterate, a contractual act of any of the four kinds mentioned will be an actual act of constitutional organ (and hence may be an actual act of the company itself) if it is a joint act which is either unanimous or constitutionally regular.

Corporate "Mindlessness" or "Incompetence"

At the other end of the scale of corporate "mental" regularity is the "mindless" company. What is the corporate equivalent of the individual who is totally incapable of assent — of the idiot or the individual whose mental faculties have been totally destroyed? Such an individual cannot perform a contractual act of any kind — not an act of contracting, delegation, representation (including holding out) or ratification. Clearly if a company has neither members nor directors it will be in this situation.[54] Further, unless the "default power of the shareholders" concept is invoked, it seems that under the common article vesting contracting power exclusively in "the directors", where "the directors" do not exist the company cannot perform a contractual act.

There does seem to be a principle that a company must have "competent directors" if a parol act purporting to be that of "the directors" is to bind the company. By "competent directors" is meant a number of directors which will satisfy the company's constitution. Like a competent human mind, competent directors *could* act regularly though they might not do so on a particular occasion. According to this terminology, having a "competent" constitutional organ means no more than having that organ. By contrast questions of "regularity" are not questions of the organ's

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[52] *Howbeach Coal Co.* v. *Teague* (1860) 5 H. & N. 151; *In re London & Southern Counties Freehold Land Co.* (1885) 31 Ch. D. 223; *Kennedy's Case* (1890) 44 Ch. 472; *Barber's Case* (1877) 5 Ch. 963; *E.B.M. Co. Ltd.* v. *Dominion Bank* [1937] 3 All E.R. 555 (P.C.).

[53] Watson, Channell and Pollock, BB. expressed no opinion on what would have satisfied the article.

[54] Unless perhaps an individual had been recognized as a "functional organ" by virtue of an acquiescence etc. of a constitutional organ when it had existed.

Professor Gower notes a case where all the members of a company were killed by a bomb: L.C.B. Gower, *The Principles of Modern Company Law* (3rd ed. 1969) p. 76, n. 45.

existence but of its *functioning*. "Competence" is a static condition; regularity is dynamic.

In numerous cases where a company did not have the minimum number of directors required by its articles, acts purporting to be those of the board have been held ineffective: *Kirk* v. *Bell*;[55] *Howbeach Coal Co.* v. *Teague*;[56] *Re Alma Spinning Co.*;[57] *Faure Electric Accumulator Co.* v. *Phillipart*;[58] *Re The British Empire Match Co. Ltd.*;[59] *In re Sly Spink & Co.*[60] Admittedly, in all except one the dispute was an "internal" one (i.e., between the company or its liquidator and a member) as to the validity of a purported making of calls or allotment or forfeiture of shares. Typically the articles provided for appointment of between a minimum and maximum number of directors and when there were less than the minimum the incumbents purported to act as a board.[61] The cases establish that a number of incumbent directors less than the constitutional minimum is not a "board" at all;[62] that the fixing of a quorum presupposes and operates only on an adequately composed "board";[63] and that a "continuing directors may act" clause also presupposes that not less than the minimum number of directors was appointed before the reduction in question.[64]

The exceptional case referred to earlier was in fact the leading case in the series, *Kirk* v. *Bell*.[65] In that case a deed of settlement vested power

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[55] (1851) 16 Q.B. 290.
[56] (1860) 5 H. & N. 151 (*"Howbeach"*).
[57] (1880) 16 Ch. D. 681 (*"Alma"*).
[58] (1888) 58 L.T.R. 525 (*"Faure Electric"*).
[59] (1888) 59 L.T.R. 291.
[60] [1911] 2 Ch. 430.
[61] In *Howbeach* the articles required appointment of a *fixed* number, five, of which three were to be a quorum. None were appointed and a call made by three out of seven "subscribers deemed directors" (to whom the said express quorum provision was held not to apply) was held invalid. In *Alma* articles vested power in not less than five nor more than seven directors and when the number of incumbents fell to four they purported to make a call and forfeit shares. In *Faure Electric*, the articles provided for a board of from three to seven directors and when there were only two, they purported to elect three others and the five purported to make a call and forfeit shares. In *Re The British Empire Match Co.* the articles required appointment of a minimum of three directors and the only two incumbents purported to allot shares.
[62] *Cf.* all the cases cited but esp. Neville, J. in *In re Sly Spink & Co.* [1911] 2 Ch. 430 at 435-436.
[63] *Kirk* v. *Bell* (1851) 16 Q.B. 290 (see *post*); *Howbeach; Alma* (in this case the quorum was fixed internally by a board properly appointed originally); *Faure Electric* ("The word 'quorum' in its ordinary significations, has reference to the existence of a complete body of persons, of whom a certain specified number are competent to transact the business of the whole" (1888) 58 L.T.R. 525 at 527); *Re The British Empire Match Co. Ltd.;* and *In re Sly Spink & Co.*
[64] *In re Sly Spink & Co.;* but where the number of incumbents is reduced from above the constitutional minimum to below it, the clause is applicable: *Wallace's Case* (1883) 2 Ch. D. 413. esp. *per* Baggallay, L.J. at 431. One reason why Baggallay, L.J. rejected an argument that the "continuing directors clause" could not be construed as presupposing a reduction to no less than the minimum was that the articles of the company concerned themselves appointed the bare minimum. But any doubt on this point must be regarded as having been dispelled in *Owen & Ashworth's Claim* [1900] 2 Ch. 272 (affirmed [1901] Ch. 115), where Wright, J. held that a similar article empowered less than the minimum to "continue to act" even though the articles themselves appointed more than the bare minimum number originally.
[65] (1851) 16 Q.B. 290.

in not less than five nor more than seven directors; constituted three or more a quorum competent to transact all "ordinary" business; and vested a power of compromising debts in "the directors". When the number fell to four those four executed a deed compromising a large debt due to the company. The company was held not bound on the ground that the agreement was "extraordinary" and that not less than five directors could make it.[66]

The explanation of the case is that with anything less than five directors, the company had no competent mind and that the quorum provision, presupposing the existence of a competent mind, had nothing on which to operate. Accordingly, one must sympathize with the query raised by Coleridge and Wightman, JJ. whether three out of four directors could have transacted even "ordinary" business. On the other hand, once five directors existed, at common law only the major part thereof need meet (after notice to all) to constitute a quorum of the five for *any* purpose. A meeting of three could have compromised the debt and a general suggestion that action by all five was necessary can be sustained only if the terms of this deed[67] were held to displace the common law rule.

Where a constitutional organ is competent it will be at least possible for irregularities in its functioning to be overlooked. In *Browne* v. *La Trinidad*[68] it was alleged that proper notice of a board meeting had not been given but it was held that "it cannot be said that the board was not so summoned as to be able to act as a board"[69] since the board could have reconstituted itself and acted properly:

> I think it is most important that the Court should hold fast to the rule upon which it has always acted, not to interfere . . . where the irregularity complained of can be set right at any moment.[70]

Against the foregoing line of cases on what constitutes corporate mental competence, certain other authorities must be considered. The first is *Thames Haven Dock & Railway Co.* v. *Rose.*[71] The Act of a statutory company provided that "the business of the company shall be carried on under the management of twelve directors"; it named the first twelve directors; provided for rotation, election etc. of directors; and fixed a quorum of five. When the company had only seven directors, those seven made calls. It was held that the Act did not require that at all times there should be twelve directors and that the section was "directory" only. The

[66] It was argued that the common seal was necessary if the company was to be bound at law. Even if this had not been so (e.g. because of the terms of the Act), at least it seems correct that if the seal had in fact appeared the first indoor management rule noted in "The Positive Corporate Seal Rule", (**ante*), would have operated.

[67] E.g. the express vesting of power to transact only "ordinary" business in a quorum of three coupled with application of the *expressio unius* principle.

[68] (1887) 37 Ch.D. 1 (C.A.).

[69] *Id. per* Cotton, L.J. at 9.

[70] *Id. per* Lindley, L.J. at 17. Admittedly in this case there had been a previous course of calling meetings informally, verbally and on short notice in which the plaintiff had acquiesced; no length of notice was fixed by the articles; and no judge held that the short verbal notice given was inadequate.

[71] (1842) 4 M. & G. 552 (*"Thames Haven"*).

Court reached this conclusion on a construction of the Act and in particular of a provision that remaining directors *may* (not *must*) fill up vacancies. The issue of paralysis of the company through mental incompetence was discussed explicitly *in arguendo,* the view of the Court being simply that this was unthinkable.

The decision can be explained as one of construction. The view seems to have been taken that non-compliance had the consequence that power to exercise the total corporate capacity vested in the members who, so long as they agreed, might exercise it through any number of directors however few. Maule, J. suggested *in arguendo* that the maintenance of twelve incumbents was a matter of internal management which could not be relied on by the defendant so long as all the shareholders waived the irregularity.

Neither of these propositions is objectionable. The former is an illustration of the default power of the shareholders; the latter of ratification by the shareholders. In either case it is a contractual act by the company's other constitutional organ which becomes vital.

But a difficulty which remains is the suggestion by the use of the word "directory" that it might be possible to have competent directors of less than the number fixed. The argument that a constitutional specification of a numerical *range* of directors was merely directory was later expressly rejected in *Kirk* v. *Bell*[72] and *Thames Haven* was distinguished in *Alma* on the footing that the clause specified a *single* number of directors, whereas in *Alma,* as in *Kirk* v. *Bell,* the clause specified a range. It is difficult to see the validity of this distinction, i.e. to appreciate why a number of directors less than a *single number* fixed by the articles should, without any acquiescence by the shareholders, be competent to bind the company, whilst a number less than the minimum of a *numerical range* should not.

The confusion introduced in *Thames Haven* was confounded in *York Tramways Co.* v. *Willows.*[73] Articles provided for a board of not less than three nor more than seven directors. The seven subscribers, when they were the only corporators, were summoned to a meeting; four (the common law quorum) attended and they elected three directors; those three, under a power in the articles, elected a further three; the three original directors resigned and later so did one of the others; the remaining two, purported as a board to allot shares to the defendant, to appoint him as a director and to accept the resignation of the director who had last retired.

One might have thought that if there were found to be three directors in office at the time of the allotment and all had notice of meeting, the two would have been a quorum; but that if there were found to be only two directors at that time, the company could not have

[72] Discussed at 345-46 *ante.* Counsel there did not cite *Thames Haven* but relied on *Smith* v. *Goldsworthy* (1943) 4 Q.B. 430. However, Coleridge, C.J. said that that case had decided no more than that such a clause in a deed of settlement was alterable.

[73] (1882) 8 Q.B. 685 (*"York Tramways"*).

acted.[74] But Lord Coleridge, C.J. seems to have considered the difference inconsequential. It is submitted that if there were only two incumbent directors at the moment of the purported allotment, then it was invalid,[75] unless the "continuing directors may act" clause saved it. Whilst Coleridge, C.J. mentions "casual vacancy"[76] his judgment taken as a whole does not seem to have turned on this.

In spite of the suggestion in *Thames Haven* that the fixing of a number of directors may be directory and the general suggestion by Coleridge, C.J. in *York Tramways* that a board does not cease to exist where its number falls below the minimum stipulated, it is submitted that the fixing in articles of association either of a single number, or of minimum and maximum numbers of directors is mandatory. This means that where individuals purport to perform a contractual act (of any kind) as a board, in the absence of a "continuing directors may act" clause, appearance of the common seal,[77] or shareholder acquiescence or ratification in right of the shareholders' default power, they may be deemed to have done so only if a constitutionally appropriate number of individuals to compose that organ have been appointed or held out as appointed.

Less than a Unanimous or Constitutionally Regular Joint Act of a Constitutional Organ

The definition of an "actual act" of a constitutional organ offered earlier required that the participants intend to perform an act *of the organ* in question. More difficult are the situations where all or some members of a constitutional organ perform individual acts or where less than all perform irregularly a joint act.

Individual Acts by All Members of a Constitutional Organ

It is difficult to conceive of individual acts of contracting of delegation or of express representation by all directors since those acts are

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[74] It is assumed that the power of allotment was vested exclusively in the directors and that no question of shareholder acquiescence or ratification arose.

[75] Holker, L.J., dissenting, took this view. Brett, L.J. relied on the action by the two directors as a majority of three incumbents. This is also unobjectionable.

[76] *York Tramways, supra* n. 73 at 695. " . . . if there were three directors, the two acted as a majority of the board. If there were two directors only, the two were acting during a casual vacancy. The board does not come to an end because a casual vacancy occurs".

[77] It is appropriate to stress again that when the seal appears different principles apply. In *Owen and Ashworth's Case* [1901] 1 Ch.115 (C.A.) articles provided for appointment of not less than three directors who might determine their own quorum. When the number of incumbents fell to two, those two, in the name of the company, issued debentures under the company's common seal. The company was held bound (see esp. Lord Alverstone, C.J. at 120).

The company differs from the "mindless" individual to whom the plea *non est factum* would be available. It is suggested however that the effect of the exceptions to the positive corporate seal rule considered in the article at (1973) 9 *M.U.L.R.* 192 is that at least one director must have participated in the sealing if the plea is to be unavailable to the company, for without that minimal amount of corporate mental activity the circumstances will almost certainly be held to have put the outsider on inquiry or will constitute a counterfeit forgery.

deliberate and positive and if all have contracted, delegated or expressly represented, their acts are certain to have been a joint act.

In the leading case, *Re George Newman & Co.*[78] the Court of Appeal held that

> Individual assents given separately preclude those who have given them from complaining of what they have sanctioned; but for the purpose of binding a company in its corporate capacity individual assents given separately are not equivalent to the assent of a meeting.[79]

The recent case of *Freeman and Lockyer* v. *Buckhurst Park Properties (Mangal) Ltd.*[80] supports this proposition. The defendant company had four directors, Messrs. Kapoor and Hoon and a nominee of each. The quorum of directors was fixed by the articles at four. At all relevant times Hoon was out of the country and it seems clear that no regular board meetings were ever held because, at most, only three directors were ever present. The trial judge found that Kapoor "although never appointed as managing director, had throughout been acting as such . . . and that this was well known to *the board*"[81] and his finding for the plaintiff was interpreted by the Court of Appeal as based not on a delegation of actual authority but on ostensible authority.

The plaintiffs contended on appeal as at the trial that Kapoor had had actual authority. This contention was rejected by Willmer, L.J. on the ground that there was no resolution delegating authority expressly or appointing Kapoor to a position which carried an implied authority.[82] Diplock, L.J. acknowledged that there might be a delegation by the directors without a formal minuted resolution but considered in a crucial passage that,

> to confer actual authority would have required not merely the silent acquiescence of the individual members of the board, but the communication by words or conduct of their respective consents to one another and to [Kapoor].[83]

For an actual act of delegation to be proved there must be either an act regular as to manner and form or a *joint* act by *all* the directors.

Yet it seems that whilst nothing less than a constitutionally regular or a unanimous joint act of contracting, delegation, or express representation will be actual acts of those classes, something other than regularity or unanimity may be an actual act of acquiescence or of ratification. In many cases a company has been held to have acquiesced or ratified where all the voting shareholders or all the directors have acted (or not acted)

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[78] [1895] 1 Ch. 674.
[79] *Id.* at 686.
[80] [1964] 2 Q.B. 480.
[81] *Id.* at 488 *per* Willmer, L.J. (italics supplied).
[82] He concluded, *ibid.* "In these circumstances I think that it is hopeless to contend that the second defendant was ever clothed with authority to do what he did."
[83] *Id.* at 501.

independently of each other, i.e., without a meeting even of minds.[84]

In the leading case, *Parker & Cooper Ltd.* v. *Reading*[85] Astbury, J. said forcefully of the independent assents of all the shareholders to a debenture issued by the directors beyond their power, "I do not think it matters in the least whether that assent is given at different times or simultaneously".[86] Not only in registered company cases but in all those cases falling within the common law exceptions to the negative corporate seal rule where it was said that "the directors" or "the members of the corporation" had acquiesced or ratified, what seems to have been recognized as binding on the body corporate was an acquiescence or ratification made up of the individual, independent and unconnected awarenesses, silences, approvals and acts of the directors or members.[87] Indeed, if unanimity or constitutional regularity had been insisted upon, corporate acquiescence and ratification would have proved hollow exceptions to the negative corporate seal rule since those alternatives are little if any less formalistic than a sealing itself.

The distinct approach to the definition of corporate acquiescence and ratification may be illustrated by comparing in some detail the decisions in two recent cases. In *Hely-Hutchinson* v. *Brayhead Ltd.*[88] Roskill, J. at first instance declined the plaintiff's invitation to find that the individual (Richards) who had acted as managing director had had actual authority from the directors, though he conceded that the question whether actual authority could exist without total regularity was "one of considerable difficulty and one on which there appears to be little or no relevant authority."[89] But his Lordship was able to find a holding out by acquiescence of "the directors":

> I have no doubt that the board knew that he was doing this sort of thing all the time and that whenever he thought it necessary he assumed, or purported to assume, authority to bind Brayhead and the board allowed him to do it and acquiesced in his doing it.[90]

Having found such a holding out Roskill, J. purported to apply the *Turquand* rule to relieve the outsider of the effect of the absence of actual authority but in fact he was applying the "agency secret restriction and limitation rule".

Roskill, J. may have used the term "board" advisedly since the directors had, at board meetings whose regularity was not questioned,

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[84] *Ho Tung* v. *Man On Insurance Co.* [1902] A.C. 232 (P.C.); *Phosphate of Lime Co.* v. *Green* (1871) 25 L.T.R. (N.S.) 636; *Parker & Cooper Ltd.* v. *Reading* [1926] Ch. 975; *Re Duomatic Ltd.* [1969] 2 W.L.R. 114; *Freeman and Lockyer; Hely-Hutchinson* v. *Brayhead Ltd.* [1967] 2 All E.R. 14 (Roskill, J.). And *cf.* "Informal Ratification of Corporate Acts" (1959) 228 *Law Times* 216.

[85] [1926] Ch. 975.

[86] *Id.* at 984.

[87] See the cases referred to in the writer's article at (1974) 9 *M.U.L.R.* 411 at 439-444.

[88] [1967] 3 All E.R. 98 (C.A.) affirming [1967] 2 All E.R. 14 (Roskill, J.).

[89] [1967] 2 All E.R. 14 at 20.

[90] *Id.* at 21.

acknowledged Richards' actions as managing director. Seizing on this the Court of Appeal in turn found that he had had actual authority. This actual authority was not given expressly (there was no express appointment or delegation minuted or otherwise) but was implied from the recognition which Richards had received at board meetings. Whilst the word "board" is sometimes used loosely to mean "the directors", it is believed that in this case the word denoted board meetings.[91]

There is no objection to a finding of either actual or apparent authority in *Hely-Hutchinson* because the company was implicated through board meetings.[92] It may be asked why actual authority was not found in *Freeman and Lockyer*. Certainly Herbert, J. at first instance and all three judges in the Court of Appeal evinced no doubt that there had been a holding out by "the directors". Herbert, J. had found that Kapoor was acting as managing director "with the knowledge of the directors".[93] Willmer, L.J. spoke loosely of "the knowledge of the board"[94] and noted the plaintiff's reliance on the fact that Kapoor, "to the knowledge of the defendant company's board, was acting throughout as managing director, and was therefore being held out by the board as such."[95] Pearson, L.J. found "a holding out of the second defendant by the defendant company"[96] and found that

> the defendant company has known of and acquiesced in the agent's professing to act on its behalf and thereby impliedly representing that he has the company's authority to do so. The company is considered to have made the representation, or caused it to be made, or at any rate to be responsible for it.[97]

Diplock, L.J., pehaps surprisingly in view of his thoroughgoing analysis in other respects of how the apparent authority of a company's agent arises, simply relied on the judge's finding that "the board knew"[98] though he

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[91] Certainly the word was often used; *cf.* " . . . the board by their conduct over many months had acquiesced in his acting as their chief executive and committing Brayhead to contracts without the necessity of sanction from the board". [1967] 3 All E.R. 98 at 103 *per* Lord Denning. And " . . . Mr. Richards, with the consent and acquiescence of the board, was allowed to act as chief executive and to make decisions relating to these financial questions." [1967] 3 All E.R. 98 at 104 *per* Lord Wilberforce. His Lordship also found that Richards had implied authority to do the acts in question on the ground that they were part of the task of concealing certain arrangements which the board had earlier expressly authorized him to make.

Lord Pearson found actual authority on the grounds first, that Mr. Richards as *de facto* managing director and chief executive would enter into large transactions and would sometimes merely report them to the board and not seek prior authority or subsequent confirmation and that the board acquiesced in this course of dealing; and second, that the two contracts in question were within the scope of Brayhead's business.

[92] Nock misses this point in his note on the case at (1967) 30 *M.L.R.* 705. He wrongly charges the Court of Appeal with having applied *Turquand* in its original form and with confusing "power" with "authority".

[93] [1964] 1 All E.R. cited by Pearson, L.J. at 641.

[94] *Id.* at 635.

[95] *Id.* at 640.

[96] *Id.* at 641.

[97] *Ibid.*

[98] *Id.* at 648.

seems to endorse it with, "They permitted [Kapoor] to do so, and by such conduct represented . . . ."[99]

The only difference between the facts in *Hely-Hutchinson* and those in *Freeman and Lockyer* is that in *Hely-Hutchinson* the knowledge and non-repudiation essential to acquiescence took place at board meetings whereas in the latter they were individual acts of the directors. In *Freeman and Lockyer* either Kapoor had actual authority by virtue of the individual acquiescences of all directors[100] or such acquiescences, whilst sufficient to constitute a corporate holding out, are insufficient to constitute a corporate delegation. Since the Court of Appeal in *Freeman and Lockyer* expressly rejected the former proposition, the latter must be accepted as explaining the case. In early cases on the registered company, holdings out by acquiescence seem to have consisted in the knowledge and silence of the individual members of the constitutional organ in question.[101]

The possibility that different principles might govern a corporate act of holding out by acquiescence or of ratification is consistent with commercial reality. Acts of contracting, of delegation and of express representation are by nature "deliberate" acts. But an acquiescence requires merely knowledge and inaction. For example, an agent has held himself out, it is inferred that "the directors" knew of this, and of course there has been no repudiation by them. If all directors knew, there was a duty on each of them to convene a meeting to consider the usurper's actions. If none has so acted it seems proper to hold that the company itself "knew" and "failed to repudiate" even though the reception of the knowledge has not been a "joint act of reception" and there has been no deliberate decision not to repudiate. Similar considerations apply to ratification; i.e., where all directors have learned individually of an agent's contractual act on behalf of the company.

This reasoning supports the result that in *Freeman and Lockyer,* although there was a holding out, there was no delegation; there was no consensus between the company itself and Kapoor. It must nonetheless seem odd to say that whilst all four directors had acquiesced in Kapoor's holding himself out as managing director, yet the company could sue him for exceeding his actual authority. Should not the agent also be able to take advantage of the individual acts of acquiescence of all the directors?

The question arises how the conclusion reached as to corporate acquiescence and ratification should be described. The individual acts of the directors do not purport to be a joint act of a constitutional organ. Does the law, notwithstanding this, convert them into an actual acquiescence or ratification of such an organ? It seems to do so for there is no distinction

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[99] *Ibid.*

[100] The trial judge inferred that Mr. Hoon as well as the three directors in England had acquiesced (*id.* at 643 *per* Diplock, L.J.).

[101] As in *Mahony* v. *East Holyford Mining Co.* (1875) L.R. 7 H.L. 869; *Biggerstaff* v. *Rowatt's Wharf Ltd.* [1896] 2 Ch. 93; *British Thomson-Houston Co. Ltd.* v. *Federated European Bank Ltd.* [1932] 2 K.B. 176; *Clay Hill Brick & Tile Co. Ltd.* v. *Rawlings* [1938] 4 All E.R. 100.

between the effect of individual "acquiescences" or "ratifications" by all directors and a joint acquiescence or ratification by them all. But because "indoor management rule" terminology suggests an internal shortcoming or irregularity which a company is not permitted to set up, this is hardly an appropriate term to embrace a rule which simply equates the knowledge and silence of all members of a constitutional organ individually with their joint acquiescence or joint ratification. The operative principle may be called simply the "corporate acquiescence and ratification principle".

A Joint but Irregular Contractual Act by Less than All Members of a Constitutional Organ

Although an irregular joint act by less than all members of a constitutional organ cannot be regarded as an "actual act" of the organ, yet perhaps some corporate indoor management rule will prevent the company from setting up the irregularity, provided the outsider can prove that he relied on certain minimal indicia of corporate assent, and provided, as ever of course, that he was not put on inquiry as to the irregularity. For example, an outsider might purport to contract by parol with "the directors" at a board meeting which is attended by a bare majority of the directors but which is later shown to have been convened without proper notice. He cannot rely on an actual act by the board; nor is there a holding out by the shareholders or the directors that a bare majority of the directors has authority as group-*agent* to bind the company. So, an outsider might be forced to rely at the hearing on a purported but similarly defective act of delegation, holding out or ratification.

Some assistance is gained by recalling certain facts: (1) an office-holder (e.g. a director) has implied actual authority from the company to represent that he holds the office in question; (2) the common law quorum of a constitutional organ is a bare majority of its members; (3) the identity and number of incumbents is "constructively known" to the outsider by virtue either of their having been named in the articles or of the publicly registered particulars of officers; (4) if the articles specify a quorum the outsider has constructive notice of this too. The result, it is submitted, is that if an outsider proves that he relied upon a joint parol act of contracting, delegation or representation (including holding out) participated in by a number of directors which would be at least a quorum consistently with the public documents (i.e., the quorum specified therein or if none, the common law quorum), then even though he did not read the public documents and thus had no reason for believing that the act on which he relied was that of a quorum, an indoor management rule of the *Turquand* type will operate to preclude the company from setting up an internal irregularity. This is a "third indoor management rule".

This rule calls for some elaboration. An outsider is affected favourably by what in fact appears to him (an act purporting to be that of a constitutional organ and participated in by a number of individuals who effectively represent that they are directors) and adversely by what he

would know if he read the public documents (the number and identity of the company's directors and by deduction the common law quorum, or of course, a quorum specified expressly in the articles). An actual act of a constitutional organ must, in the absence of unanimity, be defined in terms of a number of individuals and certain procedures. The individuals and their conduct are visible and external to the body corporate; the procedures are internal. The outsider relies on the actions of individuals purporting to constitute a contractual act of the organ. But since he has constructive notice of the number of members of the organ,[102] and therefore of the quorum (at common law or as specified) he cannot complain if he has relied upon an act of contracting, delegation or representation by a lesser number. Where the fixing of the quorum is itself a matter vested by the constitution in the organ itself, it is a matter of internal management, and if in these circumstances he relies upon an act by the common law quorum (i.e., a bare majority) he should succeed. An outsider can do no more in seeking to obtain an actual parol contractual act than to obtain an act participated in by what appears consistently with the public documents, to be a quorum of members of the constitutional organ in question.

It should be appreciated that the third indoor management rule, like the first and second, does not presuppose that the outsider has read the public documents. Assume for example, that articles of a company fix the minimum number of directors at seven, the directors, pursuant to an article have fixed their own quorum at three, and three out of seven incumbents perform a joint act of contracting, delegation or representation irregularly in right of the board. The outsider should succeed, even though, if he had read the articles, he could not have safely assumed that the quorum was less than four. If he had in fact read the articles he would have been put on inquiry in dealing with only three directors but in the event it is not their number but irregularity of functioning which affects their act, so it is thought again that the company could not succeed. Some part of the anomaly of this situation may be removed if it is recalled that there is an initial appearance of a corporate act in the form of a purported corporate act by a number of directors which later proves to have been a quorum. Although an internal fixing of the quorum may affect the outsider favourably it is otherwise to be disregarded. If in the illustration the directors had fixed their quorum at five and the outsider had contracted with three he should fail but if he had contracted with four he should succeed.

An irregular ratification is special since the outsider has not relied upon it at all at the time of contracting. It would seem on principle that an outsider should not succeed on anything less than an actual act of ratifi-

[102] Insofar as the publicly registered particulars do not state the true up-to-date position (e.g., by reason of intervening share transfers or non-notified directorial appointments) the outsider, it is submitted, is not affected.

cation.[103] This statement must be considered in the light of the one case in which *Turquand* was applied in respect of a corporate ratification; *viz, Re Land Credit Co. of Ireland.*[104] The directors of a trading company resolved that their chairman be authorized to accept bills drawn on the company by L upon L's depositing securities to a certain amount. The chairman accepted bills which the secretary countersigned but L did not deposit securities to the required amount. The directors affirmed the transaction but without knowledge of the inadequate deposit.

The case might well have been thought to turn upon a representation by the directors that the chairman was authorized, reliance thereon by the outsider, and the application of the "agency secret restriction or limitation rule". On this view any question of subsequent corporate ratification or of *Turquand's Case* would be irrelevant. But the judgment does not proceed so clearly and is confusing to say the least. Ratification seems to have been treated as crucial:

> . . . if, when an act within the scope of the powers of the board of directors is done by them, or (which is the same thing) is ratified and adopted by them, a person contracting with the directors is not bound to see that certain preliminaries which ought to have been gone through on the part of the company have been gone through, . . .[105]

Several points need to be made. The "preliminary" referred to is apparently not the chairman's taking of the securities but the board's checking that they had been taken; not the preliminary which the agent should have attended to before contracting, but the preliminary which the directors should have attended to before ratifying. Second, although the preliminary was not an element in the *functioning* of a constitutional organ but rather one external to it, since for the purpose of ratification no question of initial reliance is involved, there would be no difference in the principles to be applied. Third, the ousider did not "contract with the directors" and a ratification and adoption by them is not to be treated as "the same thing". Fourth, the case was decided three years after *Totterdell* v. *Fareham Blue Brick & Tile Co. Ltd.*[106] and bears the stamp of the old view of *Turquand* according to which the appearance of assent in reliance on which the outsider contracted, was treated as insignificant.

It is thought that the *Land Credit Co.*[107] decision can be supported only on the ground that the directors intended to give a "blanket" ratification or that the direction to the chairman as to the taking of securities did not reduce his authority at all but was merely an ancillary matter.[108]

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[103] It should be recalled however that individual acts of ratification by all directors will amount to an actual act of the directors by virtue of the corporate ratification principle.

[104] (1869) 4 Ch. App. 460.

[105] *Id.* at 469 *per* Selwyn, L.J.

[106] (1866) L.R. 1 C.P. 674.

[107] *Land Credit Co. of Ireland, In re; Ex p. Overend, Gurney & Co.* (1869) 4 Ch. App. 460.

[108] *Cf. id.* at 474 *per* Sir G. M. Giffard, L.J.

Otherwise and generally it seems that irregularity of any kind affecting a joint ratification participated in by less than all members of a constitutional organ may be set up by the company as vitiating the ratification.

Where the third indoor management rule applies to "cure" a defective delegation, is the result that the agent acquires actual authority which, for example, could be set up by an outsider suing the company as undisclosed principal? The answer will depend on whether the rule operates in favour of the agent himself. It is submitted that it does. Assume, for example, that an individual applies to be appointed general manager of a company's business at a certain remuneration and he is appointed by a majority of directors at a meeting of which the others were not notified, and that he then contracts with an outsider within the scope of the usual authority of such a manager. In the first place it seems that he has an enforceable contract of employment with the company. In the second place, even before the inevitable individual acquiescences by *all* the directors can be said to have occurred, the outsider should be able to succeed against the company in an action against it as undisclosed principal.

Individual Acts by Less than All Members of a Constitutional Organ

An outsider may be able to prove only individual acts by less than all members of a constitutional organ and no joint act at all. It seems clear that such acts will not constitute a corporate act of contracting, delegation or express representation. But do they constitute a corporate holding out by acquiescence or a corporate ratification? If, for example, there are individual acts of acquiescence or ratification by a number of directors exceeding the quorum, will these amount to an acquiescence or ratification by the company itself?

The cases do not help greatly. The many cases in which it is said that "the directors" acquiesced or ratified are consistent with their *all* having acted. *Mahony* v. *East Holyford Mining Co.*[109] might be thought to help because it is mentioned that six of the seven subscribers were in daily attendance at the company's premises, but when it is noted that the seventh was one of the individuals whose acting as a director was acquiesced in, it is clear that there were in effect acquiescences by all.

A case which has raised difficulty is *J. C. Houghton & Co.* v. *Nothard Lowe & Wills Ltd.*[110] In that case there were four directors of whom two were *participes criminis.* One would expect that at least both of the others must acquiesce to produce an acquiescence by "the directors" and that possibly even they would not suffice because they would not be a technical majority.[111] Yet it has been suggested that there are *dicta* of the House of Lords to the effect that the acquiescence of either *one* of those two

[109] *Mahony* v. *East Holyford Mining Co.* (1875) L.R. 7 H.L. 869.
[110] [1927] 1 K.B. 246 (C.A.); affirmed [1928] A.C. 1 (H.L.).
[111] *Cf.* the doubts of Fry, L.J. in *In re Portuguese Consolidated Copper Mines Ltd. (Steele's Case)* (1889) L.R. 42 Ch. D. 160.

would have sufficed.[112] It is submitted that the judgments do not warrant that interpretation.[113] Rather, *Houghton's Case* goes no further than to support the view that the "mind" of the company for the purpose of receiving knowledge (necessary to ground an acquiescence) is either the constitutional contracting organ or a functional organ.

In the absence of authority one can only presume that the exception allowed in favour of an acquiescence or a ratification arising from individual acts by all the members of an organ would not be extended to cases where the individual acts were those of only some, albeit a majority, of those members.

Conclusion

The expression "the rule in *Turquand's Case*" is used loosely to refer to several distinct rules or presumptions. The first and narrowest one derives from the common law affecting corporations where the common seal appears. This is the "first indoor management rule".

In the rare case where it is admitted or proved that a constitutional organ has performed a contractual act within its usual constitutional power, the company cannot set up against an outsider who dealt with that organ the fact that it had not become seised of the necessary power, except where that irregularity clearly appeared in the public documents. This is the "second indoor management rule" distinguished from the first by the absence of the common seal and its replacement by the concept of usual constitutional power.

Finally, where there is a purported corporate act of contracting, delegation or representation (including a holding out, express or by acquiescence) which an outsider relied upon at the time of contracting, and he can show that a quorum of the constitutional organ's members as fixed in the public documents, and if none was fixed in the public documents either a bare majority thereof (being the common law quorum of a corporate constitutional organ) or the actual quorum whichever is the less, participated in the act, then he is aided by a "third indoor management rule" to the effect that the company cannot repudiate the act as an act of the constitutional organ on the ground of non-compliance with manner and form requirements in the functioning of the organ.

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[112] *Cf.* Trebilcock, *supra* n. 12 at 322-23.

[113] Viscount Dunedin in *J.C. Houghton & Co.* v. *Nothard Lowe & Wills Ltd.*, *supra* n. 110 at 14, says: "But what if the knowledge of the director is the knowledge of a director who is himself *particeps criminis* . . . " and the consequence indicated by his Lordship is that such a director's knowledge is to be discounted. His Lordship does not imply that without the guilty mind, the knowledge of a single director must be attributed to his company.

Viscount Sumner, after saying that it is the knowledge of "the directors" which is the knowledge of a company, says at 19, "What a director knows or ought in the course of his duty to know may be the knowledge of the company, for it may be deemed to have been duly used so as to lead to the action, which a fully informed corporation would proceed to take on the strength of it". In other words, where it can be presumed from subsequent action by the board that it has received from its member communication of his knowledge, that knowledge its attributed to the company. This is unobjectionable.