

## COMMENTS

## COMMENTAIRES

### The Undisclosed Principle of Undisclosed Principals

At common law, when A[gent] contracts with a T[hird Party] on behalf of a P[incipal] whose existence is not disclosed, both A and P can sue T and both can be sued by T. This doctrine is now well established: surprisingly so in view of its history of reluctant public acceptance,<sup>1</sup> characterization by the House of Lords as an anomaly,<sup>2</sup> and denunciation by Holmes and Ames as repugnant to common sense and legal principle.<sup>3</sup> But in this area commercial utility has triumphed. Since P controls A and receives the benefits of the transaction, there seems to be no harm in making P directly answerable to T for acts within the scope of A's delegated authority. And once an obligation flowing from P to T is established, there seems to be no injustice in allowing P a reciprocal right against T, at least in those situations where the personality of the obligor is not material.

The legal theory behind all this is harder to ascertain. The context of triangular consensual dealing seems to require a contract, and contract will indeed account for the mutual rights and duties of T and A. Sometimes the courts go farther and speak of the contractual relationship between P and T,<sup>4</sup> but this seems to involve the mysterious transubstantiation of the T-A contract into a T-P contract, with the T-A contract continuing to exist. In the absence of an objective manifestation of T's intention to be bound to P, it is better to eschew the label of contract as analytically misleading.<sup>5</sup> Perhaps the best that can be done is to recognize

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<sup>1</sup> *Scrimshire v. Alderton* (1743) 2 Str. 1182, 93 E.R. 1114.

<sup>2</sup> *Keighley, Maxsted & Co. v. Durant* [1901] A.C. 240 (H.L.).

<sup>3</sup> O. W. Holmes, "The History of Agency", *Select Essays in Anglo-American Legal History* (1909), 368, 404; James Barr Ames, *Undisclosed Principal — His Rights and Liabilities* (1909) 18 Yale L.J. 443.

<sup>4</sup> *Said v. Butt* [1920] 3 K.B. 497; *Cooke v. Eshelby* (1887) 12 App. Cas. 271 (H.L.).

<sup>5</sup> A. L. Goodhart and C. J. Hamson, *Undisclosed Principals in Contract* (1932) 4 Camb. L.J. 320, 326. Contrast Glanville L. Williams, *Mistake as to Party in the Law of Contract* (1945) 23 Can. Bar Rev. 380, 408, who protests that since P has rights and duties under the T-A contract, he must be a party to that contract in any meaningful sense of the word "party". But the dispute should not revolve around whether both A and P can be called parties but

that we are dealing with an autonomous doctrine in the law of agency, historically derivable from *assumpsit*,<sup>6</sup> which is similar to, but not identical with, the devices of assignment<sup>7</sup> and trust<sup>8</sup> and which operates so as to allow P to intervene upon a bargain struck by T and A.

This formulation may appear to be simple and obvious,<sup>9</sup> but the jurisprudence of this area is strewn with the torsos of cases mangled by judicial mistreatment. With regard to the problems of the parol evidence rule<sup>10</sup> and set-off,<sup>11</sup> the courts now seem to be aware that the first step is to elucidate the bargain upon which P is intervening, but no coherent theory, however simple, seems to underlie the treatment of situations where A has been paid by either T or P<sup>12</sup> or where T, having sued either A or P, now wants to sue the other.<sup>13</sup>

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rather whether they can be called parties in the same sense, and whether calling both A and P "parties to the contract" contributes to the understanding of the undisclosed principal doctrine and to its intelligent application to shifting patterns of facts.

<sup>6</sup> Wm. Draper Lewis, *The Liability of an Undisclosed Principal* (1909) 9 Colum. L. Rev. 116; Warren Seavey, *The Rationale of Agency* (1920) 29 Yale L.J. 65.

<sup>7</sup> Goodhart and Hamson, *supra*, f.n.5.

<sup>8</sup> P.F.P. Higgins, *The Equity of the Undisclosed Principal* (1965) 28 M. L.R. 167, 170.

<sup>9</sup> It is, however, significantly different from two of the currently popular theories. Goodhart and Hamson, *supra*, f.n.5, have P intervene upon the T-A contract (not the T-A bargain), and Diplock L.J. in *Freeman and Lockyer v. Buckhurst Park Properties (Mangal), Ltd.* [1964] 1 All E.R. 630, 644, regards the P's power to sue T and be sued by him as a procedural device that avoids circuity of actions. Neither of these theories can cope with the situation dealt with in this paper where the T-P relationship may be enforceable although the T-A one is not.

<sup>10</sup> *Murphy v. Rae* [1967] N.Z. L.R. 103 (S.C.).

<sup>11</sup> *Campbellville Gravel Supply v. Cook Paving* (1968) 70 D.L.R. (2d) 355 (Ont. C.A.). Contrast *Greer v. Downs Supply Co.* [1927] 2 K.B. 28 (C.A.) where T did not have to pay anything, even subject to his set-off against A, because there was no P-T contract (as if there ever is).

<sup>12</sup> *Butwick v. Grant* [1924] All E.R. Rep. 274 (K.B.); *Drakeford v. Piercy* (1866) 7 B. & S. 515 (Q.B.); *Armstrong v. Stokes* (1872) 26 L.T. 872 (Q.B.); *Irvine v. Watson* (1880) 42 L.T. 800 (C.A.), distinguished from the previous case although one member of the Court, Bramwell L.J., was baffled as to what was significant about the distinguishing feature.

<sup>13</sup> The doctrine of "election" is technically justified either on the supposed inability to assert inconsistent rights or on a theory of merger: e.g., *Brennan v. Thompson* (1915) 33 O.L.R. 465 (S.C. App. Div.). But there is nothing inconsistent in T's suing A on the contract and then P on the bargain embodied by the T-A contract, and merger wrongly presupposes that there is a single obligation in contract inherent in both the T-P and the T-A relationship. The arguments

The purpose of this discussion, however, is not to poke again through these well-known cans of worms but to vindicate the utility of the formulation that P intervenes on the T - A bargain through discussion of several seemingly unrelated English and Canadian cases. These cases are somewhat trivial, isolated, and atypical, and their treatment by the courts has been understandably piecemeal, if not cursory. They have never been treated as a group or with the recognition that they might be relevant to the elucidation of a coherent approach to the problem of the undisclosed principal. Yet, each of these cases illustrates that the incidents of the P - T relationship differ radically from those of the P - A relationship, and this characteristic makes this long-ignored group of cases conceptually very interesting.

To begin, let us consider the case of *Rhineland v. Mont*.<sup>14</sup> Here P, wishing to avoid publicity due to a pending divorce action, had his house insured with insurer T through A, who did not disclose the agency. When the house burned down, T duly paid the proceeds to A, but the latter refused to pay the money over to P. The Nova Scotia Supreme Court dismissed P's suit against A on the grounds that

... the defendant insured property which was not his and in which he had no interest. On this policy he could legally recover nothing, and cannot be said to hold what he did recover in trust for the plaintiff. The money really belongs to the insurer who paid it.<sup>15</sup>

This short passage raises several difficulties. First, the action at hand is between P and A, and as between these parties P has the superior right by virtue of the general rule of agency that A must pay over to P money received for P's use. P's suit is not based on a proprietary right to the specific proceeds, to which the defence of *jus tertii* might (or might not) be available, but is rather the claim of a creditor against a debtor.<sup>16</sup> Secondly, an insurance policy not founded on an insurable interest is considered to be illegal as well as unenforceable, with the result that the insured is not entitled to restitution of the premiums paid to the insurer.<sup>17</sup>

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of Maurice H. Merrill seem unanswerable whether expressed in prose as in *Election between Agent and Undisclosed Principal* (1933) 12 Neb. L. Bull. 100, or in poetry as in *Election (Undisclosed Principal) Revisited* (1955) 34 Neb. L. Rev. 613. For an interesting example of a court reaching the right result while groaning beneath the weight of precedent, see *Swanton Seed Service Ltd. v. Kulba* (1968) 64 W.W.R. 161 (Man. Q.B.).

<sup>14</sup> [1933] 2 D.L.R. 508 (N.S.S.C.).

<sup>15</sup> *Ibid.*, 511 per Mellish J.

<sup>16</sup> *Hydro-Electric Power Commission of Ontario v. Brown* (1959) 21 D.L.R. (2d) 551 (Ont. C.A.).

<sup>17</sup> *Harse v. Pearl Life Assurance Co.* [1904] 1 K.B. 558 (C.A.).

By parity of reasoning, the insurer should not be able to recover proceeds which have passed into the hands of the insured.

The real significance for present purposes, however, does not lie in these narrow and technical points, but in the court's unmistakable implication that because the insurer T could have withheld the proceeds from A, it could have withheld them from P. The reasoning is presumably that P's right of action is derived from A's and therefore can be no more efficacious than A's, and that P's intervention upon the unenforceable T-A contract must itself result in unenforceability. This is too mechanical however. The requirement of an insurable interest is a reflection of the indemnity nature of property insurance. It is intended to safeguard against the moral hazard of deliberate destruction and to discourage gambling.<sup>18</sup> However pertinent these considerations are when the claimant is suing on his own behalf for a loss suffered by someone else, they would not be forwarded by striking down an insurance policy made at P's ultimate initiative to cover P's own property. After all, there *is* an insurable interest underlying the T-P relationship. Once the T-A bargain has been struck, P should be able to intervene regardless of the enforceability of that bargain by A. Indeed, if one starts with the proposition that A must hold the proceeds for P, even A should be allowed to sue. Since there will be no personal profit by A, there is no reason to invoke the insurable interest requirement against him.<sup>19</sup>

A more sensitive treatment of a similar problem appears in *Danziger v. Thompson*.<sup>20</sup> Here the landlord T was claiming arrears of rent both from P and from A, who had signed the lease but who was in fact P's infant daughter. The case differs from *Rhineland* in that here the issue was enforceability *by* T rather than enforceability *as against* T. But if *Rhineland* had indicated a viable general approach to the undisclosed principal conundrum, that approach could have been applicable here: the T-P obligation being consequential upon the T-A one, the unenforceability of the latter because of A's incapacity as an infant would be fatal

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<sup>18</sup> Edwin W. Patterson, *Essentials of Insurance Law* 2d ed. (1957), 109.

<sup>19</sup> These remarks are directed only toward the court's handling of the lack of insurable interest. On the facts one suspects that an insurer might also have been able to argue concealment, which would raise problems similar to those adumbrated below regarding misrepresentation, or the personal nature of the insurance contract (*Rayner v. Preston* (1881) 18 Ch. D. 1 (C.A.); *Springfield Fire & Marine Inc. Co. v. Maxim* [1946] S.C.R. 604) which would require consideration of *Said v. Butt*, *supra*, f.n.4 and *Dyster v. Randall* [1926] 1 Ch. 932.

<sup>20</sup> [1944] K.B. 654, [1944] 2 All E.R. 151.

to a claim by T against P. The court's solution, however, was to grant the action against P but not against A.<sup>21</sup> The personal immunity of A from suit on the T-A contract did not unravel the T-P obligation, which was collateral to the T-A bargain. The policy of the law in protecting infants even at the expense of contractual expectations did not require, and would not have been forwarded by, its serving as a shield for the non-infant P. The result is equitable, as the infancy of A would not be a bar to the enforcement of the contract against T at the instance of A<sup>22</sup> and therefore (on the *Rhineland* premises) at the instance of P. Mutuality requires at least the subsistence of P's obligation to T.<sup>23</sup>

This brings us to the nice problem posed by the recent case of *Commonwealth Trust Co. v. Dewitt*,<sup>24</sup> which involved the relationship of the doctrines of undisclosed principal and *ultra vires*. A was a trust company which had contracted on behalf of an undisclosed P to purchase T's shares in real estate and travel agency enterprises. The objects of corporations such as A were set out in the *Trust Companies Act*,<sup>24a</sup> and while this statute allowed A to act as an agent, it did not include investments of the sort made by A in this case. When A purported to repudiate its contract with T, T sued A for damages. Berger J. had no doubt that the T - A contract standing alone was *ultra vires* and thus void. But when he came to consider the significance of the fact that A was an agent for an undisclosed principal, he quoted from *Bowstead on Agency* to the effect that under the undisclosed principal doctrine both P and A are liable to T, and concluded:

I think I should apply that here, I do not think it is circumventing the *Trust Companies Act* to do so. The Act says a trust company can act as an agent. It does not say that it can act as an agent, except for an undisclosed principal. So if it does act as an agent for an undisclosed principal, a trust company is liable on the contract itself, even if it

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<sup>21</sup> The facts and disposition of the case are actually very confused because it was reported only for its treatment of the parol evidence rule. It is not certain that P was actually undisclosed but, from the cases cited, the court seems to have treated him as if he was. Also the court seems to have given judgment in favour of A although A seems to have admitted her liability. In any event this article proposes to adumbrate a general approach to a particular problem rather than to recapitulate existing law, and the cases are accordingly offered as paradigms, not authorities.

<sup>22</sup> C.G. Cheshire, C.H.S. Fifoot, and M.P. Furmston, *The Law of Contract* 8th ed. (1972), 403.

<sup>23</sup> The case is in accord with the *Restatement of Agency* (2d), s.203.

<sup>24</sup> (1973) 40 D.L.R. (3d) 113 (B.C.S.C.).

<sup>24a</sup> R.S.B.C. 1960, c.389, Schedules A and B; as amended by S.B.C. 1962, c.65, ss.4 and 5.

is one which the trust company could not, as principal, enter into. Once the Act clothes a trust company with power to act as an agent, the law of agency applies to any transaction that a trust company enters into.<sup>25</sup>

Thus, A was held liable for breaching its contract with T.

This remarkable *denouement* deserves re-examination at several points. First, is Berger J. justified in discounting the possible circumvention to which he alludes? The Court had itself identified the purpose of the *ultra vires* rule as the protection of the expectations of the investing public: they are entitled to assume that the funds they deposit will not be used for the purchase of travel agencies and real estate businesses.<sup>26</sup> It would seem to be cold comfort to a depositing member of the public to be told that the transaction is void if the trust company is the sole obligor but is valid as against the trust company if a second entity is also an obligor.

Secondly, it does not follow that if the statute allows A to act for an undisclosed P, A must be liable itself. The thrust of the law of agency is to indicate that there is a mechanism whereby P can sue and be sued. To ascribe A's liability to the law of agency is insufficient since on this point the law of agency incorporates and reflects the concepts of contract. The T - A relationship is contractual, and this contract, like other *ultra vires* contracts, should be considered void.

Finally, if the otherwise void T - A contract is enforceable in the presence of an undisclosed principal, the structure of the reasoning must be: (i) the invalidity of the T - A contract does not *per se* invalidate the T - P obligation; and (ii) the valid T - P obligation *per se* validates the T - A obligation. The first branch of this argument is sound for the same underlying reason as in the *Danziger* case. The disqualifying factor is one that is personal to A and should not enure to the benefit of P. The policy of protecting A's investors would not be promoted by excusing P from the contract. P should thus be able to intervene on the T - A bargain even in the absence of an enforceable T - A contract. But the second branch seems less acceptable: the T - P obligation is always an offspring of the bargain between T and A, and accordingly it cannot infuse vitality into its creator. If the original T - A relationship does not stand on its own feet, it cannot be propped up by the collateral T - P one.

The court in *Commonwealth Trust* seems to have assumed that under the doctrine of undisclosed principal, T will have the lia-

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<sup>25</sup> *Supra*, f.n.24, 125.

<sup>26</sup> *Ibid.*, 122.

bility either of both A and P, or of neither. This is indeed usual, but it is not inevitable. There are two separate obligations involved: one founded on contract and the other on the sanctioning by the law of agency of P's intervention on A's bargain. Either obligation can have disqualifying features peculiar to it which leave the other obligation unaffected.<sup>27</sup> This does not mean that the two obligations must travel in water-tight compartments. Both are based on the bargain between P and A, and this bargain can be influenced by factors external to each individual relationship. It is, for instance, conceivable that the T-A contract was formed as a result of a misrepresentation by P operative on T's mind or a misrepresentation by T operative on P's mind.

Thus, in *Garnac Grain Co. Inc. v. H.M.F. Faure & Fairclough Ltd. and Bunge Corp.*<sup>28</sup> a supplier of vegetable oil was able to force merchants with whom it dealt to advance loans to it because of its position of near monopoly. Usually the supplier set up a chain of contracts ending with Faure, who sold to the ultimate consumer; but whenever the transaction with the ultimate consumer fell through the supplier would repurchase the oil from Faure, thus preserving goodwill and in effect allowing Faure interest on the loan. On the occasion in question the supplier, in order to extract advances of capital, set up the circular chain of supplier - first purchaser - Garnac - Faure - supplier, but secured Garnac's participation in the chain by fraudulently misinforming Garnac of the circular nature of the series of contracts. The supplier was not able to provide the oil, but Faure insisted upon Garnac's performance of their individual contract. Garnac's defense was that Faure was really contracting on behalf of the supplier, who was an undisclosed principal, and that the supplier's fraud entitled Garnac to rescission.

The case was eventually decided by the Court of Appeal and the House of Lords in favour of Faure on the grounds that the alleged agency relationship between Faure and the supplier did not exist. But Megaw J. at trial,<sup>29</sup> and more tentatively, Diplock L.J. on appeal,<sup>30</sup> were prepared to consider the novel legal question raised by Garnac's defence, namely whether T could rescind the T-A contract if he was induced to enter that contract by a fraudulent misrepresentation

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<sup>27</sup> In all three cases discussed the peculiarity attached to A, but it may equally attach to P so as to leave the T-A contract intact while striking down the T-P one. For instance, a transaction might yield a valid T-A contract but be *ultra vires* with regard to P. Compare *Job v. Lamb* (1856) 11 Exch. 539.

<sup>28</sup> [1967] 2 All E.R. 353 (H.L.), aff'g [1965] 3 All E.R. 273 (C.A.).

<sup>29</sup> [1965] 1 All E.R. 47 (Q.B.).

<sup>30</sup> [1965] 3 All E.R. 273, 286.

made by the undisclosed P. They inclined to the view that he could, because otherwise A would be answerable to P for the fruits of the T - A contract and P would thus benefit from his fraud. The result is sound, but at stake is a principle of wider application than to fraud alone. If the bargain which T has concluded with A and which lies at the heart of both the T - A and T - P relationships has been tainted, both those obligations should be unenforceable against T. In the context of enforceability as against T there is, in view of P's control over A and the benefit that P derives from A, no need to treat A and P as autonomous entities in matters that affect the bargain. Regardless of whether the misrepresentation was fraudulent or innocent,<sup>31</sup> and regardless of whether the misrepresentation was made by P or A, T should not be held to the unfair bargain thus achieved.

If misrepresentation by either P or A should allow T to rescind, one would expect that conversely T's misrepresentation would support rescission by both P and A. Such slender authority as exists, however, indicates that this is not so. In *Collins v. Associated Greyhound Racecourses Ltd.*<sup>32</sup> T issued a prospectus that contained an innocent misrepresentation. Relying upon this misrepresentation, P instructed A to purchase shares without disclosing the agency. In denying P's claim for rescission, Russell L.J. pointed to the existence of the contract between T and A and concluded that "rescission of that contract between [T] and [A] could only be obtained at the suit of [A] and upon proof of an allegation that [A] had been misled by the prospectus".<sup>33</sup> Here, both elements were absent. But what if it had been A who was misled and who obtained rescission? Presumably the effect of rescission of the T - A contract would be to unravel the T - P obligation as well, for here we are not concerned with a factor personal to A, such as infancy or the effects of an *ultra vires* contract, but with a factor that vitiates the entire bargain. T, prevented from enforcing a bargain induced by his misrepresentation against A, should not be allowed to do so against P.

Two consequences seem to follow from this. First of all, if T can secure the destruction of his obligation through A's suit, there is no reason, aside from a misplaced conceptual formalism, to prevent T from securing rescission directly. Secondly, the bargain on which

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<sup>31</sup> *Supra*, f.n.29; Megaw J. cautiously restricted his holding to a misrepresentation that is fraudulent.

<sup>32</sup> [1930] 1 Ch. 1. See the lucid treatment of this case in the classic article by Goodhart and Hamson, *supra*, f.n.5, 352. Those authors accept the decision as "undoubtedly correct" (at 355). Cf. also *Hyslop v. Morel* (1891) 7 T.L.R. 263 (Ch. D).

<sup>33</sup> *Ibid.*, 37.

both the T - A and T - P relationship is based seems equally tainted whether it is A or P who is misled. Russell L.J. perceived here the presence of a T - A contract and confined the remedy to one available against a contracting party. But the existence of an obligation collateral to the contract should have pointed to the possibility of an additional and collateral remedy. The device of rescission for innocent misrepresentation should be looked upon as illustrating, not exhausting, the law's attitude toward the proprieties of the bargaining process.

The purpose of this note has been to stress that the legal position of the undisclosed principal is derived from the T - A bargain even if that bargain is not clothed with the jural status of contract. Thus, the unenforceability of the obligations between T and A should have no effect on the T - P relationship unless the policy behind T - A unenforceability would be forwarded if applied as between P and T. Indeed, on occasion an alertness to the purpose served by an apparently invalidating condition, such as the insurable interest requirement, may indicate that both the T - A and the T - P obligation should nonetheless be sustained. Moreover, an excuse that is personal to A, such as infancy or corporate incapacity, should neither have any effect on the T - P relationship nor be itself stultified by the mere existence of P, as in the *Commonwealth Trust* case. Finally, since both the T - A contract and the T - P relationship are founded on the bargain struck by T and A, factors such as misrepresentation that taint the bargaining process should have the effect of invalidating both the T - A and the T - P obligations.

To a large extent we have been concerned here with the pathology of the undisclosed principal doctrine. The cases chosen for illustration have raised the possibility of T - P and T - A relationships that are not mirror images of each other. Such cases are rare, isolated, and to a certain extent freakish. But when one is dealing with a creature as enigmatic as the undisclosed principal, it may be precisely such cases that reveal the most about the anatomy of the underlying institutions.

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