

ARTICLES

J P Hambrook*

PRE-INCORPORATION CONTRACTS AND THE NATIONAL COMPANIES CODE: WHAT DOES SECTION 81 REALLY MEAN?

Introduction

From 1 July 1982, with the exception of the Northern Territory, Australia has uniform companies laws.¹ Most of the laws are reasonably familiar; s 81 of the National Companies Code is not. This section is designed to reform the law relating to pre-incorporation contracts. The existing common law position involves commercial difficulty, arbitrariness and injustice.² The common law is not in tune with commercial needs or expectations. But will s 81 provide the much needed panacea? Will it, above all, create conditions of commercial certainty and equity? Will the fine, somewhat irrelevant, distinctions which have characterised the common law disappear? The purpose of this article is to critically examine s 81 in the light of the perceived deficiencies in the common law. It will be shown that, although s 81 may be a step in the right direction, it is by no means an adequate response to the problem of pre-incorporation contracts. Indeed, the section may create more problems than it solves.

The Common Law Position

(1) *The contractual capacity of the unregistered company*

Until a company is registered as a corporation it lacks legal personality. Since contractual capacity runs, at least in part, with legal personality, it necessarily follows that a company cannot be directly or indirectly a party to a contract prior to incorporation.³ Just as this fundamental legal difficulty has not stopped members of unincorporated voluntary associations from purporting to enter into contracts in the name of their association, so it has not caused company promoters to refrain from purporting to bind a non-existent corporation.⁴ The

* Senior Lecturer in Law, University of Adelaide.

- 1 The provisions of the Commonwealth Government's Companies Act 1981-1982, apply as the laws of each State pursuant to each State's Companies Act (Application of Laws) Act. See, for example, Companies (Application of Laws) (South Australia) Act 1982, s 6. Pursuant to the State application laws the Commonwealth Companies Act, with certain amendments, is to be published as the Companies Code of each State. The Code is *prima facie* evidence of the Commonwealth laws applying in each State: see, for example, s 10 of the South Australian Act. Throughout the text the Commonwealth Companies Act will be referred to as "the Companies Code" or "the Code".
- 2 Ford, *Principles of Company Law* (3rd edn 1982) 127-8; Gower, *Principles of Modern Company Law* (4th edn 1979) 335-6; Law Reform Commissioner of Victoria Report No 8, *Pre-Incorporation Contracts* (1979) §1-16.
- 3 On the registration of a company's memorandum of association the National Companies and Securities Commission (or its State delegate) certifies under its common seal that the company is "on and from the date specified in the certificate incorporated": National Companies Code s 35(2). An incorporated company is capable forthwith of performing all the functions of a body corporate: *ibid* s 35(5)(a).
- 4 For an excellent comparative analysis of the approaches of the courts to pre-incorporation contracts and contracts with voluntary unincorporated associations see Pitt, *Contracting With Non-Existent Entities* (1981). This unpublished honours degree dissertation is held in the University of Adelaide Law School Library.

commercial need for promoters to act in this way is undoubted. A successful promotion may well depend upon the newly-formed corporation being in a position to manage or control certain property or rights. Arrangements to ensure that the company to be formed will be in such a position are often completed prior to incorporation. Given the legal incapacity of a company prior to incorporation there is the ever-present risk that these arrangements will be frustrated.

(2) *Ratification by the registered company*

Not only is it impossible for an unregistered company to be a party to a contract, but the company cannot ratify such a contract upon incorporation.⁵ The rules relating to ratification were, in the main, established before commercial corporations became prevalent. One of the fundamental rules is that a principal cannot ratify a contract unless, at the time the contract was entered into, the principal was in a position to enter into the contract on its own behalf.⁶ In the case of a corporation, this means that ratification is impossible unless the corporation was in existence at the date of the contract sought to be ratified. The only ways in which a corporation may be affected by a pre-incorporation contract are (i) by the contract being novated to it; and (ii) by the benefit of the contract being assigned to it, after registration. If the pre-incorporation contract failed for want of competent parties a novation or an assignment will not be possible. In these circumstances, should the person who dealt with the promoters still be willing, the corporation might enter into a fresh contract on terms similar to the failed pre-incorporation contract.⁷

(3) *Liability on a pre-incorporation contract*

There is no rule of law that a person who contracts for a non-existent principal is personally liable on the contract. The true intention of the parties must be ascertained.⁸ If the contract is in writing there is some doubt as to whether the intention of the parties can be gleaned from extrinsic circumstances or whether that intention must be found within the four corners of the written agreement. Some authorities suggest that parol evidence is not admissible in such cases.⁹ However, as Professor Lucke has indicated, there is a distinction between

5 *Kelner v Baxter* (1866) LR 2 CP 174. Until 1856, however, it was thought that a company upon incorporation was automatically bound by a pre-incorporation contract; the company came in *esse cum onere*: see, for example, *Edwards v The Grand Junction Railway Co* (1836) 1 My & Cr 650, 40 ER 525; *Stanley v Chester and Birkenhead Railway Co* (1838) 3 My & Cr 773, 40 ER 1124. This doctrine was doubted in 1856 by Lord Cranworth LC in *Preston v The Liverpool and Manchester Railway Co* (1856) 5 HLC 605, 617; 10 ER 1037, 1043 before being overruled in *Kelner v Baxter*. See further on this Pitt, *supra* n 4 at 66-7.

6 *Kelner v Baxter* (1866) LR 2 CP 174; *Dudley Buildings Pty Ltd v Rose* (1933) 49 CLR 84, 94; *Vickery v Woods* (1952) 85 CLR 336, 348; Fridman, *The Law of Agency* (4th edn 1976) 46-8; Powell, *The Law of Agency* (2nd edn 1961) 124-5; *Bowstead on Agency* (13th edn 1968, ed Reynolds and Davenport) 40-2.

7 If the third party or the registered company has supplied goods or services pursuant to the supposed "contract" the quasi-contractual actions of *quantum valebant* or *quantum meruit* may result in the recipient being liable to compensate the supplier: see, for example, *Re Dale and Plant Ltd* (1889) 43 Ch D 255.

8 *Kelner v Baxter* (1866) LR 2 CP 174; *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45; *Black v Smallwood* (1966) 117 CLR 52; *Summergreene v Parker* (1950) 80 CLR 304; *Marblestone Industries Ltd v Fairchild* [1975] 1 NZLR 529.

9 *Kelner v Baxter* (1866) LR 2 CP 174 where the Court refused to consider parol evidence which indicated that the promoters who signed the contract were not intended

"the conclusion of a contract and the determination of its contents. The latter must certainly largely proceed in exclusive reliance on the terms of the written document. But when the question is whether a party has bound himself at all to the written terms, extrinsic evidence must be freely admissible, even to contradict the document."¹⁰

Parol evidence has been admitted by some courts¹¹ in order to establish that the parties were aware of the non-existence of the company at the date of the contract.

The cases suggest that a promoter will not be personally liable on a pre-incorporation contract unless the parties were aware of the company's non-existence at the date of that contract.¹² The rationale for the promoter being presumed to be liable, if the company's non-existence was appreciated, is that the parties must be taken (in the absence of evidence to the contrary) to have intended to conclude a binding agreement. Given the non-existence of the company, the only way to effectuate this intention is to regard the promoter as being personally liable. Thus in *Kelner v Baxter*¹³ the promoters who contracted "for a proposed company" were held personally liable for wine delivered to and consumed in the company's business. The intention of the parties in that case could be found in the written contract. The reference to the "proposed" company indicated that the parties were aware of its non-existence.

9 Cont.

to be personally liable. Erle CJ, at 176, said: "The paper expresses in terms a contract to buy. And it is a cardinal rule that no oral evidence shall be admitted to show an intention different from that which appears on the face of the writing." See also *Stott Land Development Ltd v Dean* [1967] WAR 86, 93; *Summergreene v Parker* (1950) 80 CLR 304, 323-4 per Fullagar J and 318 per Williams J. Adherence to the parol evidence rule may also explain the tenuous attention paid to the form of the signature in *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45. It would have been more satisfactory if this case had been decided on the basis that the third party wrongly believed the company to be in existence. But parol evidence would have been necessary to establish that belief. The *obiter* comments of Oliver LJ in *Phonogram Ltd v Lane* [1981] 3 WLR 736, 741-2 also suggest a slavish adherence to the parol evidence rule. The opinion of Oliver LJ that *Newborne* turned on the fact that the contract was on the company's notepaper and thus "was clearly intended to be a company's contract" is difficult to square with the judgments delivered in that case.

10 "Contracts Made By Promoters On Behalf of Companies Yet To Be Incorporated" (1967) 3 Adel LR 102, 104.

11 See, for example, *Rita Joan Dairies Ltd v Thomson* [1974] 1 NZLR 285. See also the *obiter* remarks of Lord Denning MR in *Phonogram Ltd v Lane* [1981] 3 WLR 736, 737. In *Black v Smallwood* (1966) 117 CLR 52, the High Court certainly construed the written contract in the light of parol evidence that the parties believed that the company was in existence at the date of the contract.

12 See, generally, Pitt, *supra* n 4 69-79. In *Marblestone Industries Ltd v Fairchild* [1975] 1 NZLR 529, 542, Mahon J said: "[P]ersonal liability [is] dependent upon proof of subjective knowledge of non-registration". But the promoters will not be personally liable if it is impossible to sensibly construe the terms of the contract with the names of the promoters inserted wherever that of the company appears; see *Summergreene v Parker* (1950) 80 CLR 304, 314 per Latham CJ and 326 per Fullagar J. Somewhat surprisingly Legoe J, in *Poonindie Bricks Pty. Ltd and Ors v Bascombe* (1982) 6 ACLR 321 at 335, considered that the fact that this substitution was possible was irrelevant in ascertaining the intention of the parties. Because the contract referred to a proposed company "it would be pointless to substitute the promoters' names everywhere in the contract for the company to be formed because if one were to do that, then there would be no point in incorporating the company". The reason for incorporating the company is, of course, to accept a novation of the contract. It is curious that this point should have eluded Legoe J particularly when the facts of *Poonindie Bricks* made the strategy abundantly clear.

13 (1866) LR 2 CP 174.

Similarly, in the New Zealand cases *Rita Joan Davies Ltd v Thomson*¹⁴ and *Marblestone Industries Ltd v Fairchild*,¹⁵ promoters were held to be liable when it was clear from the facts that the parties to the respective contracts were aware that the named companies were not in existence.

If the parties wrongly believed that the company was in existence at the date of the contract it will usually be very difficult to show that the promoter was intended to be personally liable. The leading cases of *Newborne v Sensolid (Great Britain) Ltd*¹⁶ and *Black v Smallwood*¹⁷ illustrate this point. Both decisions are, however, frequently regarded as standing for the proposition that a promoter, who merely acts in a ministerial capacity in relation to a pre-incorporation contract (as, for example, by initialing a contract or by signing his name beside that of the company), cannot enforce or be personally liable on the contract. Certainly, the respective judgments of the Court of Appeal and the High Court do seem to support that proposition. However, there is much to be said for the view that nothing should turn on whether a promoter signs a contract "for and on behalf of" a company, or merely authenticates the signature of a company by placing his initials or name beside that of the company. In *Phonogram Ltd v Lane*, Oliver LJ, *obiter*, indicated that he was not "convinced that the common law position . . . depends upon the narrow distinction between a signature 'for and on behalf of' and a signature in the name of a company or an association. The question . . . in each case is what is the real intent as revealed by the contract?"¹⁸

If the "narrow distinction" referred to by Oliver LJ is crucial then presumably the decisions in *Newborne v Sensolid (Great Britain) Ltd* and *Black v Smallwood* would have been the same even if the parties concerned had known that the respective companies were not then in existence. It is most unlikely that the Court of Appeal or the High Court would have arrived at the same conclusion in such circumstances. The High Court in *Black v Smallwood* certainly construed the contract on the basis that the parties wrongly believed the company was in existence. In *Marblestone Industries Ltd v Fairchild*,¹⁹ Mahon J indicated that the promoter could be liable, irrespective of the precise form of the

14 [1974] 1 NZLR 285. The written contract for the sale of a business was signed by the promoters "as trustees for a company to be formed". But in *Poonindie Bricks Pty Ltd & Ors v Bascombe* (1982) 6 ACLR 321 Legoe J, in the South Australian Supreme Court, held that two promoters who purported to contract as "nominees" for a proposed company could not enforce the contract as principals. Legoe J strangely relied upon *Newborne* to justify this result although, as indicated above, in *Newborne* at least one of the parties was mistaken as to the company's existence. Legoe J does not appear to have recognised that there is a presumption that promoters who contract for a proposed company are personally liable. Significantly none of the leading New Zealand cases is referred to in the judgment. It is submitted that the judgment in *Poonindie Bricks* is out of step with the clear trend of the authorities. This point is emphasised by the fact that in another South Australian Supreme Court judgment, less than two weeks after *Poonindie Bricks*, Cox J recognised that there was a presumption of personal liability where a promoter acted for a company which the parties were aware did not exist: *Lomax v Dankel* (1982) 29 SASR 68, 72-3.

15 [1975] 1 NZLR 529. Parol evidence was admitted to show that the parties were aware that the company had not been formed.

16 [1954] 1 QB 45.

17 [1966] 117 CLR 52.

18 [1981] 3 WLR 736, 741-2. The distinction is described as "absurd" in Gower, *supra* n 2 at 336. See also Treitel, *The Law of Contract* (5th edn 1979) 559.

19 *Supra* n 15.

agreement, provided that the parties were aware that the company referred to in the contract did not exist.²⁰

It is, therefore, suggested that at common law a promoter is only likely to be liable on a pre-incorporation contract if the parties to it were aware of the non-existence of the company. In determining the state of mind of the parties, parol evidence should be admissible even if that evidence contradicts the terms of a written agreement. Although some courts have concentrated on the precise form of a pre-incorporation contract, the liability of a promoter will not in practice be determined solely, or even mainly, by reference to the form of the contract.

Perhaps surprisingly, some courts have considered events subsequent to the making of a pre-incorporation contract as being relevant to the parties' contractual intentions. Fullagar J, in *Summergreene v Parker*,²¹ suggested that the presumption that a promoter is personally liable²² could "only be rebutted in very exceptional circumstances" if the third party had fully executed his side of the agreement in reliance on the existence of a contract binding on somebody. *Kelner v Baxter* was given by Fullagar J as an example but, of course, in that case the additional vital factor of knowledge of the company's non-existence was also present. Similarly, in *Marblestone Industries Ltd v Fairchild*,²³ Mahon J thought that "the presumption of personal liability on the part of the agent seems irresistible" if the third party, knowing of the company's non-existence at the date of the contract, executed his side of that agreement.

The fact that the third party has executed his side of the agreement will not, in itself, mean that the promoter or agent is liable. It will not override the contrary inference to be drawn from the fact that the parties wrongly believed the company to exist. Thus in *Hawkes Bay Milk Corporation v Watson*,²⁴ promoters were not held liable for the cost of goods supplied by the third party in the mistaken belief, shared by all parties, that the company had been formed.

(4) Breach of warranty of authority

As Willes J stated in *Collen v Wright*,

"a person, who induces another to contract with him as the agent of a third party by an unqualified assertion of his being authorized to act as such agent, is answerable to the person who

20 Ibid 542. See also: *Miller Associates (Australia) Pty Ltd v Bennington Pty Ltd* [1975] 2 NSWLR 506, 513-9; and *Hawkes Bay Milk Corporation v Watson* [1974] 1 NZLR 236, where Wild CJ held that promoters who had contracted as directors of a company were not liable as principals because all parties mistakenly believed that the company had been incorporated. If the third party believes that the company exists, yet the promoter knows that it does not, it seems that there will be no imputation of personal liability to the promoter: cf *Wickberg v Shatsky* (1969) 4 DLR (3d) 540. See also *Lomax v Dankel* (1981) 29 SASR 68, 73.

21 (1950) 80 CLR 304, 323-4.

22 This presumption may arise from the circumstances surrounding the making of the contract and, in particular, because the parties were aware of the non-existence of the company at the date of the contract. See, for example, *Vickery v Woods* (1952) 85 CLR 336, 343 per Dixon J and *Marblestone Industries Ltd v Fairchild* [1975] 1 NZLR 529, 539-541 per Mahon J.

23 [1975] 1 NZLR 529, 542.

24 [1974] 1 NZLR 236. An action in quasi-contract may be available in such circumstances; see *Re Dale and Plant Ltd* (1889) 43 Ch D 255.

so contracts for any damages which he may sustain by reason of the assertion of authority being untrue.”²⁵

There is judicial authority that this action for breach of warranty does lie against a promoter who purports to act as agent for a non-existent company.²⁶ The action may also lie against a promoter who acted in a purely ministerial capacity on behalf of a non-existent company. Indeed, it is difficult to see why any distinction should be made according to the capacity in which the promoter purported to act. The action should be available whenever the third person is induced by the promoter to believe that an enforceable contract with a registered corporation has been entered into. In *Lomax v Dankel*,²⁷ Cox J observed:

“In principle, the reason for a lack of authority on the part of the ‘agent’ would seem to be unimportant. Where A implies that he has authority to contract on behalf of B, he is surely implying that B exists. The gist of the action . . . is an implied authority to contract on another’s behalf, and the essential nature of the representation is unaffected, it seems to me, by the circumstance that the named principal happens to be non-existent.”²⁸

Cox J concluded that:

“it does not matter, in an action for breach of want of authority, whether the claim is based upon a want of adequate instructions upon the part of an existing principal or upon the more radical footing of the principal’s non-existence.”²⁹

Though this cause of action would appear to provide a third party with an effective remedy this may not be so in practice. The difficulty with the remedy relates to the appropriate measure of damages. The traditional view is that the remedy is contractual in nature. Indeed, in *Collen v Wright*,³⁰ Willes J seems to make this clear:

“The obligation arising in such a case is well expressed by saying that a person, professing to contract as agent for another, impliedly, if not expressly, undertakes to or promises the person who enters into such contract, upon the faith of the professed agent being duly authorized, that the authority which he professes to have does in point of fact exist. The fact of entering into the transaction with the professed agent, as such, is *good consideration for the promise*.”³¹ [Emphasis added.]

With few exceptions the courts have proceeded on the basis that the measure of damages is governed by contractual principles. Consequently, the third party is entitled to recover from the agent such damages as

25 (1857) 8 E & B 647, 657; 120 ER 241, 245. See also *Richardson v Williamson* (1871) LR 6 QB 276; *Starkey v Bank of England* [1903] AC 114; *Leggo v Brown and Dureau Ltd* (1923) 32 CLR 95; *Dickson v Reuter’s Telegram Co* (1877) 3 CPD 1; *Brownnett v Newton* (1941) 64 CLR 439.

26 *Black v Smallwood* (1964) 65 SR (NSW) 431, 457 per Asprey J; (1966) 117 CLR 52, 64 per Windeyer J; *Crane v Lavoie* (1912) 4 DLR 175; *Delta Construction Co Ltd v Lidstone* (1979) 96 DLR (3d) 457; *Lomax v Dankel* (1981) 29 SASR 68. *Contra: Black v Smallwood* (1964) 65 SR (NSW) 431, 445-6 per Walsh J.

27 (1981) 29 SASR 68.

28 *Ibid* 75.

29 *Ibid* 77.

30 (1857) 8 E & B 647; 120 ER 241.

31 *Ibid* 657-8 and 245 respectively.

compensate the third party for not having a contract with the supposed principal.³² The courts try to put the third party in a position no worse than that he expected to be in as a result of dealing with the agent. Thus regard is had to what the third person would have *recovered* in an action against the principal for non-performance of the contract.³³ The measure of damages is not what would have been *awarded* against the principal. If the principal is insolvent the third party can only recover from the agent nominal damages together with the costs of the action.³⁴ Unless the courts accept that a person is entitled to recover damages incurred in relying on the existence of an enforceable contract (eg, the loss of the opportunity to contract with someone else), the only damage compensable will be that resulting directly from the frustration of the person's expectation that the named principal will perform the contract.³⁵

Since a corporation lacks funds as well as legal personality prior to registration it presumably must be treated in the same way as an insolvent principal. This means that the promoter would only be liable for nominal damages for breach of his warranty of authority. This seemingly inequitable result has both judicial and academic support.³⁶ The fact that the company may subsequently be registered with sufficient funds to meet any liability on the contract should be of no avail to the third person because the breach of warranty necessarily occurred prior to that time, and the damages must be measured according to the facts at the date of the breach.³⁷ Assuming that the cause of action is contractual in nature the only way it may provide an effective remedy to the third party is if the promoter is also taken to have warranted that the principal is solvent. The courts have never suggested that an agent so warrants.

In *Delta Construction Co Ltd v Lidstone*³⁸ the plaintiff was awarded nominal damages against a promoter in an action for breach of warranty of authority. The claim concerned work done for a company prior to its

32 *Richardson v Williamson* (1871) LR 6 QB 276, 277 per Blackburn J; *Simons v Patchett* (1857) 7 E & B 568; *In re National Coffee Palace Company* (1883) 24 Ch D 367, 372 per Brett MR and 375 per Bowen LJ.

33 *Simons v Patchett* (1857) 7 E & B 568, 572 per Lord Campbell CJ and 574 per Crompton J; *In re National Coffee Palace Company* (1883) 24 Ch D 367, 372 per Brett MR and 375 per Bowen LJ.

34 *Simons v Patchett* (1857) 7 E & B 568, 574 per Crompton J; *Richardson v Williamson* (1872) LR 6 QB 276, 279 per Cockburn CJ; *In re National Coffee Palace Company* (1883) 24 Ch D 367, 372 per Brett MR, 373-4 per Cotton LJ and 375 per Bowen LJ. Powell, supra n 6 at 257, states that if D is insolvent T can recover from A the full extent of his loss without regard to what he might have recovered from D if the contract had been authorised. This proposition is not supported by the judgment of Brett MR in *National Coffee Palace* which is the only authority cited for it: Brett MR asserts the contrary proposition. See also *Meek v Wendt and Co* (1888) 21 QBD 126.

35 For a discussion of the "reliance" and "expectation" heads of damages see Fuller and Perdue, "The Reliance Interest in Contract Damages" (1936) 46 Yale LJ 52 and 373, and Cauchi, "The Protection of the Reliance Interest and Anticipated Contracts which Fail to Materialise" (1981) 19 U West Ont LR 237. Although the courts have not indicated that reliance damages are available in a breach of warranty of authority action, equity would seem to demand that something more than expectation loss should be remedial.

36 *Wickberg v Shatsky* [1969] 4 DLR (3d) 540; *Bowstead on Agency*, supra n 6 at 392.

37 *Crane v Lavoie* [1912] 4 DLR 175, 185 per Richards JA; *Wickberg v Shatsky* [1969] 4 DLR (3d) 540, 543-4 per Dryer J. See also Pitt, supra n 4 at 85-7, and Getz "Pre-Incorporation Contracts: Some Proposals" [1967] UBCL Rev 381, 398.

38 (1979) 96 DLR (3d) 457.

incorporation. The company was registered but soon went into liquidation insolvent. Noel J, in the Newfoundland Supreme Court, said:

“Did the plaintiff suffer damages as a result of Lidstone’s breach of warranty?”

At most Lidstone represented that an existing company, Algo Enterprises Limited, required work to be done by the plaintiff. The plaintiff was, clearly, expected to extend credit to the company but Lidstone did not warrant that the company had any assets, that it was solvent, or that the plaintiff’s account would be paid. The decision to extend credit was made by the plaintiff. Since the project foundered, it is reasonable to suppose that if the plaintiff is successful in this suit . . ., assuming the defendants to be solvent, it would be in a better position than it would have been in had the company been in existence as the parties believed. In short, the non-existence of the company would be a windfall for the plaintiff. If the defendants are obliged to pay the plaintiff’s account, in effect, they would be guarantors of the account which neither they nor the plaintiff intended should be the case.”³⁹

Insofar as Noel J’s comments suggest that the result may have been different if the company had been formed and was solvent it is submitted that they are wrong. For the reason stated above events relating to the solvency of the principal, occurring subsequent to the breach of warranty, should not determine the damages awarded.

There is some support for the view that the action for breach of warranty of authority should not be regarded as necessarily contractual in nature. In *Lomax v Dankel*,⁴⁰ Cox J refused to disturb a lower court finding that a promoter was liable to pay a third party \$1313 as compensation for supplying a hot water service to a non-existent company. The claim was upheld on the basis of breach of warranty of authority notwithstanding that the plaintiff’s pleadings claimed damages “on the basis of quasi-contract”. Cox J observed that:

“A *Collen v Wright* action is frequently categorized as being based upon an implied contract between the self-styled agent and the third party — that is, a contract collateral to the intended contract between the third party and the proposed principal... — but there are theoretical difficulties about this (Cheshire & Fifoot, *Law of Contract* (4th Aust. ed. 1981), par. 2091), and at least one writer has put the remedy into the somewhat imprecise classification of quasi-contract (Woodward, *Law of Quasi-Contract* (1913), cited in Winfield, *The Province of the Law of Tort* (1931), 178). There is also, as it happens, respectable authority for classifying it as ‘quasi-tort’ or ‘quasi-assumpsit’ (Winfield, *ibid*). In this state of conceptual uncertainty it would seem inappropriate to be too critical about a pleading which, however obscure it might have been, does not appear to have caused the appellant any embarrassment.”⁴¹

³⁹ *Ibid* 462.

⁴⁰ (1981) 29 SASR 68.

⁴¹ *Ibid* 77. Cheshire & Fifoot is critical of the suggestion by Wedderburn, [1959] CLJ 58, 68, that *Collen v Wright* is an early example of “collateral contract”. Rather Cheshire & Fifoot properly, it is submitted, regard the *Collen v Wright* breach of warranty of

Apart from the quasi-contract and quasi-tort possibilities it is conceivable that, in some circumstances, the third party may have a remedy in deceit or negligence.⁴² Although the *Hedley Byrne v Heller*⁴³ negligent misrepresentation principle has not yet been tested in the pre-incorporation contract area there does not seem to be any insuperable barrier to its successful use.⁴⁴ This would be particularly true if the defendant was a professional promoter. It is unfortunate that Cox J in *Lomax* did not have to determine the real basis of the breach of warranty of authority action. As indicated above the basis of the action will determine the appropriate measure of damages and hence the effectiveness of the third party's remedy on a pre-incorporation contract. Cox J found it unnecessary to consider the proper measure of damages because no appeal had been taken on the quantum of the plaintiff's claim. The only question before the Court concerned the promoter's liability for that claim.⁴⁵

Section 81 Of The National Companies Code

(1) Introduction

The main impetus for s 81 was the 1979 report on "Pre-incorporation Contracts" by the former Victorian Law Reform Commissioner, Sir John Minogue.⁴⁶ His report reviewed the common law and the reforms enacted in other jurisdictions. His recommendations for reform have, with one exception,⁴⁷ been embodied in s 81.

Section 81 permits a company to ratify certain pre-incorporation contracts provided the company is formed within a reasonable time of the contract being made⁴⁸ and provided also that the ratification occurs

41 Cont.

authority action as being based on a contract between the agent and third party — a contract which exists independently of the purported contract between the third party and the agent's supposed principal.

- 42 For the remedy in deceit see *Bowstead on Agency*, supra n 6 at 392; Cheshire & Fifoot, *The Law of Contract* (4th Aust edn 1981, ed Starke, Higgins & Seddon) §2097; *Smallwood v Black* [1964-5] NSWLR 1973, 1996 per Asprey J; *Lomax v Dankel* (1981) 29 SASR 68, 75 per Cox J. The remedy in deceit is only available if the promoter wilfully misrepresented that he had the authority of a registered company. For the possible remedy in tort see *Bowstead on Agency*, supra n 6 at 392 and Palmer, "Pre-Incorporation Contracts and the Implied Warranty of Authority" (1975) 9 Univ Qld LR 123, 125-6. There is much to be said for Palmer's view that the breach of warranty of authority action should preferably be in tort. However, it is difficult to accept his proposition that Wild CJ, in *Hawkes Bay Milk Corp Ltd v Watson* [1974] 1 NZLR 236, considered the remedy to be tortious rather than contractual. The plaintiff's statement of claim in *Hawkes Bay* only alleged what the defendant promoters were liable as principals on the contract purportedly made with the non-existent company. Although the breach of warranty of authority argument was put before the Court, Wild CJ rejected it because "the action in this case is founded in contract and not in damages for breach of warranty" (239).
- 43 [1964] AC 465.
- 44 In *Esso Petroleum Co Ltd v Mardon* [1976] 2 WLR 583, for example, the Court of Appeal held that a misrepresentation in a pre-contractual situation could be actionable in tort as well as in contract if it induced the making of a contract. The fact that the resulting contract may be a nullity should not prevent the misrepresentation being actionable in tort although it would seem to be fatal to an action under misrepresentation legislation such as South Australia's Misrepresentation Act 1971.
- 45 (1981) 29 SASR 68, 77-78
- 46 Herein referred to as the *Minogue Report*.
- 47 The recommendation in §32 of the Report that a ratified pre-incorporation contract should be lodged with the registering authority within 21 days of the act of ratification has not been accepted; see infra n 69.
- 48 S 81(2)(b).

within a reasonable time of the company's formation.⁴⁹ If the company referred to in the pre-incorporation contract fails to ratify it the promoter will, in the absence of a written exemption from liability signed by the third party,⁵⁰ be liable in damages to the third party.⁵¹ Unlike the reform legislation in other jurisdictions,⁵² s 81 does not make the promoter liable on the contract as a principal. The sole liability is in damages. The damages are to be assessed as the amount that the third party would have been *awarded* against the company had the company been formed, ratified the agreement, and then failed to perform any of its obligations under it.⁵³

(2) *The contracts to which section 81 applies*

The impression has been given that s 81 applies to all pre-incorporation contracts. The *Explanatory Memorandum* relating to the Commonwealth Companies Bill 1981, does not suggest that any pre-incorporation contracts are beyond the reach of the provision.⁵⁴ Professor Ford, in his recently published text, also does not indicate that any contracts may be outside the section.⁵⁵ In fact, s 81 may not embrace some of the most common types of contract.

Section 81 applies to contracts purportedly entered into by a non-existent company.⁵⁶ Two situations are defined as involving a non-existent company purporting to enter into a contract. The first is where a person executes a contract in the name of a company, where no such company exists.⁵⁷ The second is where a person purports to enter into a contract as agent or trustee for a proposed company.⁵⁸ The reference to "a person executing a contract in the name of a company, where no such company exists" appears to cover the so-called company signature cases such as *Newborne v Sensolid (Great Britain) Ltd*⁵⁹ and *Black v Smallwood*.⁶⁰ Section 81 will now catch such contracts and nothing seems to turn on the knowledge or belief of the promoter and the third party as to the existence of the company at the time of the purported contract. It is enough that the company does not in fact then exist.

49 S 81(2).

50 S 81(8) and s 81(9).

51 S 81(4).

52 See, for example, UK European Communities Act 1972, s 9(2); Ghanaian Companies Code 1963, s 13; Canada Business Corporations Act 1975, s 14.

53 S 81(4). The problem of the insolvent principal discussed infra at 125 is overcome by gearing the damages to the amount that would have been *awarded* against the company, rather than the amount that could have been *recovered* from it.

54 See paras 219-227. Traditionally the Courts have refused to look at parliamentary debates or other parliamentary documents when construing the meaning of a statute: see generally Pearce, *Statutory Interpretation in Australia* (4th edn 1981) §76-80. The High Court, by a 4-1 majority, appeared to endorse the traditional view in *Commissioner for Prices and Consumer Affairs (SA) v Charles Moore (Aust) Ltd* (1977) 14 ALR 485. Interestingly, one of the majority judges in *Charles Moore*, Mason J, recently considered it proper to look at parliamentary debates and an explanatory memorandum of the responsible minister in order to ascertain the mischief that a particular statutory provision was introduced to remedy: see *FC of T v Whitfords Beach Pty Ltd* (1982) 82 ATC 4,031, particularly 4,040-2.

55 Ford, supra n 2 at 126-130.

56 S 81(2).

57 S 81(1)(a)(i).

58 S 81(1)(a)(ii).

59 [1954] 1 QB 45.

60 (1966) 117 CLR 52.

The reference to a person purporting to enter into a contract as agent or trustee for a proposed company may, at first glance, be thought apposite to cover cases like *Kelner v Baxter*.⁶¹ But this would only be so if by using the words "for and on behalf of" the promoter is held to have purported to act as agent of the proposed company. If the promoter was really contracting as principal s 81 would not apply. There is no rule of law that these words mean that their author is an agent. As Windeyer J said in *Black v Smallwood*:

"The words 'on behalf of' do not necessarily imply agency in the relevant legal sense, any more than does the word 'for' when a man says 'I am buying this for' someone whom he names. The words cannot be regarded as indicative of agency for a principal when it is known to the user of the words that there is no principal in existence. The defendant is *Kelner v Baxter* therefore contracted as principals. They were not substituted as principals. They were the principals."⁶²

In *Kelner v Baxter*, however, the Court was primarily concerned to give some effect to the agreement. As the law then stood the best way of doing so was to find that the promoters were the intended principals. Given s 81, a court may now take the view that the best way of effectuating the intention of the parties is to regard the contract as being subject to ratification by the company, with the promoter only being liable if there is no valid ratification. Nevertheless, the words 'agent' and 'trustee' are terms of art. There is a large body of law on their respective meanings. It is unfortunate that the operation of s 81 may depend upon whether in law a person has purported to act in one of these capacities. It may have been more appropriate for s 81 to refer to a person purporting to contract for or on behalf of a proposed company and whether as agent, trustee or otherwise.⁶³

Even if the facts are interpreted as involving the promoter purporting to act as an agent, rather than a principal, it seems that s 81 will not necessarily apply. A promoter can only have purported to contract as agent for a *proposed* company if the parties to the contract believed or knew, as in *Kelner v Baxter*, that the company was not then in existence. If they wrongly believed that it was in existence the promoter would presumably have purported to act as an agent of an *existing* company, and not a *proposed* one. Since s 81 clearly distinguishes between "contract execution" and "agency" cases it would not be possible to construe any contract made by a person purporting to act as an agent or

61 (1866) LR 2 CP 174. Erle C J indicated that the defendants would have been taken to have signed the contract as agents had the company been incorporated. However, "where a contract is signed by one who professes to be signing 'as agent', but who has no principal existing at the time, and the contract would be altogether inoperative unless binding upon the person who signed it, he is bound thereby." (183)

62 (1966) 117 CLR 52, 63.

63 This broader formulation is used in several overseas statutes such as the Ghanaian Companies Code 1963, s 13(1) and the Canada Business Corporation Act 1975, s 14(1). The UK European Communities Act 1972, s 9(2), however, speaks of a contract being "made by a company or by a person as agent for a company". Would a promoter who contracts as "nominee" for a proposed company be covered by s 81(1)(a)(ii)? It is probable that a court would interpret "nominee" to mean agent or trustee in the context of s 81. Cf *Lord v Trippe* (1977) ALR 129, 141, per Mason J and see also *Poonindie Bricks Pty Ltd & Ors v Bascombe* (1982) 6 ACLR 321, 334-5.

trustee as being within the "contract execution" provision. Whereas the knowledge or belief of the promoter and third party, as to the company's existence, is not relevant to a "contract execution" case, that knowledge or belief appears to be critical to the application of the "agency/trustee" limb of s 81. If the promoter acts as agent, in the mistaken belief that the company is then registered, s 81 may well be inapplicable. This would appear to be so even if the third party knew or believed that the company had not been formed. It is the way *the promoter* purported to act that seems to be decisive.

It may be argued that the operation of the agency limb of s 81 does not depend upon the subjective knowledge or belief of the parties to a pre-incorporation contract as to the company's existence. On this view, s 81 applies to an agency case if, viewed objectively, it was "proposed" that the named company should be incorporated. It is, however, necessary to strain the language of s 81(1)(a) to achieve this result. If the legislature had intended to establish an objective test why does not s 81(1)(a)(ii) use language similar to s 81(1)(a)(i)? It could, for example, have referred to "a person purporting to contract as agent or trustee for a company, where no such company exists." These words state an objective test; the words used in s 81(1)(a)(ii) do not.

There is no obvious policy reason why s 81 should not apply to all pre-incorporation contracts other than those where the promoter was clearly intended to be liable as principal. It is probable that the gap in its coverage can be explained as a drafting error. If this is so it is difficult to understand why it has not been remedied. The problem was, after all, pointed out during a debate on the companies legislation in the House of Representatives in September, 1981.⁶⁴ Contracts which are beyond the reach of s 81 will continue to be subject to the common law. If s 81(1)(a)(ii) does not apply because of the mistaken belief of the "promoter/agent", as to the existence of the company, it is most unlikely that he will be held liable as a principal on the contract.⁶⁵ The company will be unable to ratify it and the sole remedy of the third person may be to sue the promoter for breach of warranty of authority. As indicated above, this action might only yield nominal damages and, presumably, may not in practice be instituted.

(3) *Ratification by the company*

Those contracts which are within s 81 may be ratified by a company provided the company is formed within a reasonable time of the contract being made, and provided also that the ratification occurs within a reasonable time of the company's formation.⁶⁶ The ratifying company must be "reasonably identifiable" with the company referred to in the pre-incorporation contract.⁶⁷ The company may ratify the pre-incorporation contract in the same manner as such a contract could be made by the company.⁶⁸ No special procedure is stipulated, and there is no requirement that a copy of ratified pre-incorporation contracts be lodged with the National Companies and Securities Commission.⁶⁹

64 See the comments of the Hon. Ralph Jacobi MHR in Commonwealth *Parliamentary Debates* (H Repts, 23 Sept 1981) 1688.

65 See, *supra* at 121-3.

66 S 81(2).

67 S 81(1)(c).

68 S 81(13).

69 The *Minogue Report* recommended that an epitome of ratified contracts should be lodged with the Corporate Affairs Office within 21 days of ratification: § 32. The

(i) *Ratification within a reasonable time*

In determining whether a company is able to ratify it will first be necessary to establish whether it has been formed within a reasonable time of the contract.⁷⁰ Ratification must then be shown to have occurred within a reasonable time of the company's registration. No attempt to define "a reasonable time" has been made in the legislation. Presumably the courts will not establish inflexible periods. All of the circumstances surrounding the contract should be relevant in determining whether ratification is permissible. The common law rule is that ratification must occur within a reasonable time although there is not the complicating factor of also having to bring the principal into existence within a reasonable time.⁷¹ At common law ratification will not be allowed after (a) any time set for ratification by the parties;⁷² (b) any time fixed by the parties for the commencement of the performance of the contract;⁷³ or (c) after the expiration of a reasonable time.⁷⁴

It is unclear from s 81 whether the parties may themselves control the time within which ratification may occur as in (a) and (b) above. It is, however, unlikely that the legislature intended to interfere with this aspect of freedom of contract. The better view would be that "a reasonable time", for the purposes of s 81, includes any time expressly or impliedly stipulated by the parties having regard to the terms and nature of the contract. A contract for the sale of existing perishables would, for example, presumably have to be ratified almost immediately.

In the absence of any indications from the circumstances surrounding the contract as to what the parties considered to be a reasonable time, how would a Court decide on a reasonable time for the formation of a company and for the subsequent ratification by the registered company? ⁷⁵

69 *Cont.*

recommendation followed a suggestion by the Victorian Commissioner for Corporate Affairs. Disclosure of ratified contracts was thought to be "in the interests of potential traders with and creditors of a company in its initial stages". These persons might benefit from information "as to the receipt of assets and incurring of liabilities before the commencement of its business". Under the Companies Code, a company is able to commence business immediately upon its incorporation. Consequently, the rationale for the recommended disclosure has disappeared.

70 S 81(2).

71 See, generally, *Bowstead on Agency*, supra n 6 at 46, Art 18(2)(c); *Fridman*, supra n 6 at 55-9; *Powell*, supra n 6 at 131-4. See also *Metropolitan Asylums Board Managers v Kingham and Son* (1890) 6 TLR 217.72 The parties are clearly free to determine their own time limits. In effect such a term amounts to a promise to keep an "offer" open for the specified period. There is no concluded contract until ratification: cf *Watson v Davies* [1931] 1 Ch 455. See infra at 138-9.73 *Metropolitan Asylums Board Managers v Kingham and Son* (1890) 6 TLR 217; *Dibbins v Dibbins* [1896] 2 Ch 348.74 *Re Portuguese Consolidated Copper Mines Ltd* (1890) 45 Ch D 16, 34-5 per Bowen LJ: "[Ratification] must take place within a reasonable time, and the standard of reasonableness must depend upon the circumstances of each case . . . It must be a question of fact in each case what the reasonable limit is. Mere time is nothing except with reference to the circumstances."75 It is interesting that the *Explanatory Memorandum* to the Commonwealth Companies Bill 1981, in paraphrasing the *Minogue Report* § 4, says that "the difficulty that arises from the present law is that, during the time that it takes for a company to be incorporated (*a period that may take months*), the promoter of the company may undertake many actions intended to have legal effect and directed to the successful launching into the commercial world of the fledgling company. At least some of these

Because an effective ratification is dependent upon the acts of incorporation and ratification both occurring within a reasonable time, and since the respective time frames have different commencement and termination times, in theory some curious results may eventuate. Let us assume that Company X and Company Y are in all respects identical and that the promoters of both companies entered into identical contracts with A on the same date. Let us also assume that in respect of the particular contracts a three month period is a reasonable time for the two companies to be incorporated for the purposes of s 81(2)(b). Further assume that it would be reasonable for the two companies to ratify the contracts within a period of two months from the date of their incorporation. In theory if X Company was not formed for four months from the date of the contract [ie an unreasonably long time for the purposes of s 81(2)(b)] it could not ratify the contract even if it purported to do so immediately upon its incorporation. Y Company, on the other hand, could validly ratify the contract one month after X company's ineffectual ratification provided it was incorporated three months after the date of the contract. Consequently, a ratification five months after the date of the contract would be valid whereas the earlier ratification of X Company would be invalid. It may have been preferable to simply require ratification of the contract within a reasonable time.

(ii) *The identity of the ratifying company*

The ratifying company must in the circumstances be "reasonably identifiable" with the company for which the promoter purported to act.⁷⁶ The aim of this provision is to ensure that ratification is not prevented by technical factors such as registration of a company with a name different from that the promoter used.

At common law, ratification is not possible unless the principal was identified to, or was identifiable by, the third party at the date of the contract:

"The law obviously requires that the person for whom the agent professes to act must be a person capable of being ascertained at the time. It is not necessary that he should be named; but there must be such a description of him as shall amount to a reasonable designation of the person intended to be bound by the contract."⁷⁷

Factors which will presumably be relevant in determining whether a company is "reasonably identifiable" with the company referred to in the

⁷⁵ *Cont.*

actions may require legally binding agreements": s 221. Is this indicative of a legislative belief that a company may be formed within a reasonable time for the purposes of s 81(2)(b) even if several months elapse from the making of the contract? On whether a Court may have regard to the *Explanatory Memorandum* see supra n 54. There is no doubt that a Court may have regard to the *Minogue Report*: see Pearce, supra n 54 at p 81.

⁷⁶ S 81(1)(c).

⁷⁷ *Watson v Swann* (1862) 11 CB(NS) 756, 771; 142 ER 993, 999 per Willes J. If a promoter purported to act on behalf of a proposed, yet totally unidentified company, would s 81 have any application? If it did apply it would mean that although ratification would appear to be impossible, the promoter could still be liable under s 81(4). Perhaps it would be better to read s 81 as a whole down so that it only applies to a contract which was capable of ratification. This would leave undisturbed the common law rule that a person who contracts as agent for an undisclosed principal is personally liable on the contract.

pre-incorporation contract include (a) whether the company has the same or a substantially similar name or address, and (b) if the contract names the company's directors, or provides other information relating to its structure and operations, whether the ratifying company conforms substantially with that detail.

Problems may arise if the ratifying company has a completely different name or address or if its status is different to that referred to in the contract. Could a no-liability company ratify a contract purportedly made by a limited liability company? Could a proprietary company ratify a contract purportedly made by a public company? Such cases may be very difficult to resolve because it could be argued that the third party relied upon the particular status of the company in choosing to deal with it.

The fact that the proposed name of a company has been voluntarily or necessarily changed prior to registration would probably not prevent the company from ratifying provided there was sufficient other evidence to link the company with the contract. This would be true even if the company's name, but not the type or status, was completely different.

(4) *Position of the parties pending ratification*

It seems clear from s 81 that until ratification occurs there is no contract binding on anybody unless, of course, the promoter has contracted as principal in which case s 81 would have no application at all. This follows from the liability of the promoter in damages if no ratification occurs. This liability under s 81 is said to be in substitution for any liability that the promoter would otherwise be subject to in relation to the contract.⁷⁸

Does the fact that the promoter is liable if either the company is not formed within a reasonable time, or is formed and fails to ratify the contract within a reasonable time, mean that there is nothing that the promoter or third party can do to put an end to the arrangement? It is, of course, true that the third party may expressly exempt the promoter from liability on the agreement.⁷⁹ But if there is no such express exemption will the promoter be automatically liable in the circumstances outlined above? What if the third party purports to withdraw from the agreement prior to ratification? Or what if, at common law, the agreement is for some reason incapable of ratification? Section 81 is silent on the extent to which the common law ratification rules are relevant. The *Minogue Report* says:

"It is not thought necessary that statutory formulation should be given to these rules except that probably it should be made clear that a pre-incorporation contract should be ratified within a reasonable time after incorporation."⁸⁰

This failure to expressly integrate s 81 with the common law ratification rules has resulted in considerable uncertainty as to how, if at all, those rules are to apply to s 81 contracts. The term "ratification rules" is itself misleading as many of these "rules" are ill-defined and controversial.

78 S 81(11).

79 S 81(8).

80 § 30.

Consider how s 81 might apply to the following hypothetical fact situations.

(i) T contracts to sell goods to a non-existent company. The contract is executed on the company's behalf by D. Before (a) the company is registered, or (b) the company ratifies the agreement, T notifies D that he is withdrawing from the contract. T then sells the goods to X. Can the company ratify the agreement? Is there anything to ratify? If the company cannot ratify is D liable to T under s 81(4)?

At common law, *Bolton Partners Ltd v Lambert*⁸¹ is authority for the highly controversial proposition that ratification is effective notwithstanding that the third party had purported to withdraw from the agreement prior to the ratification occurring. This strict application of the "relation back" concept has been criticized or doubted by both courts and critics.

In *Davison v Vickery's Motors Ltd*⁸² Isaacs J expressed the opinion that *Bolton Partners* was wrongly decided:

"The basic assumption on which the novel and special doctrine of *Bolton Partners* . . . rests is that a person may by the act of another become party to a bilateral contract without his authority or knowledge and possibly contrary to his express decision. The assumption connotes that there is no instant binding effect on the supposed principal and yet that the other party is instantly bound . . . You cannot have a contract which at the same time is no contract . . . Even in the case of a direct communication between A and B, an arrangement however specific between them personally which merely leaves one of them open to buy or sell does not constitute a contract. Only when the election is made and the gap closed can there be said to be a contract. *And then, only if thereby the conjoint wills concur* [emphasis added] . . . The basic assumption of the case cannot, therefore, in my opinion, be supported."⁸³

The view taken by Isaacs J has its supporters⁸⁴ and detractors.⁸⁵ The fact remains, however, that although *Bolton Partners* is frequently

81 (1889) LR 41 Ch D 295. See also *Re Portuguese Consolidated Copper Mines Ltd* (1890) 45 Ch D 16. It should be noted that in neither of these cases did the third party seek to withdraw *because of* the agent's lack of authority. It is submitted that the decisions would probably have been different if the lack of authority had been appreciated by the respective third parties. See further on this *infra* at 139.

82 (1926) 37 CLR 1.

83 *Ibid* 18-19.

84 Lord Lindley, who delivered the opinion of the Privy Council in *Fleming v Bank of New Zealand* [1900] AC 577, 587, said that *Bolton Partners* "presents difficulties; and their Lordships reserve their liberty to reconsider it if on some future occasion it should be necessary to do so". These remarks are of greater than usual significance because Lord Lindley was one of the three judges who decided *Bolton Partners*. See also the comments of North J in *Re Portuguese Consolidated Copper Mines* (1890), 45 Ch D 16, 21. For some academic support see, for example, Wambaugh, "A Problem As To Ratification" (1895) 9 Harv LR 60, particularly 68-71; Tamaki, "The Rule in *Bolton v Lambert*" (1941) 19 Can BR 733; Seavey "The Rationale of Agency" (1920) 29 Yale LJ 859, 891.

85 Most agency academics support *Bolton Partners*. See, for example, Stoljar, *The Law of Agency* (1961) 189-193; *Bowstead on Agency*, *supra* n 6 at 45-7; Fridman, *supra* n 4 at 56-7.

distinguished no court has yet expressly declined to follow it. An analysis of its application to pre-incorporation contracts is thus highly relevant.

Does the ratio of *Bolton Partners* mean that the third party can do nothing to escape from his agreement notwithstanding that he wrongly believed that a concluded agreement with a competent principal had been negotiated? A strict application of *Bolton Partners* may mean that the third party could not withdraw unilaterally so as to prevent ratification. But the rule in *Bolton Partners* is subject to several important exceptions.

For example, there is some authority for the view that ratification is not possible if the unauthorised agent and the third party have previously agreed to cancel the contract. In *Bolton Partners*, Cotton LJ referred to *Walter v James*⁸⁶ as involving an agreement between the assumed agent of the defendant and the plaintiff to cancel what had been done before any ratification by the defendant.⁸⁷ Cotton LJ was able to distinguish this case because in *Bolton Partners* the unauthorised agent had not agreed to cancel the contract. In *Walter v James*, X had, without P's authority, discharged a debt owing from P to T. T returned the money to X before P ratified X's action. It was held that P's ratification was ineffective as there was nothing to ratify, the act having been undone by the mutual consent of X and T. This decision was necessary in order to avoid a manifestly unjust result; an effective ratification would have meant that P's debt had been validly discharged. But can *Walter v James* be applied so as to enable the unmaking of a contract prior to ratification? The inference from Cotton LJ's remarks in *Bolton Partners* is that it can. If this is so, it may mean that a company has no power under s 81 to ratify a pre-incorporation contract if the promoter and the third party have mutually agreed to cancel that contract.

Short of agreeing to cancel a contract the promoter and the third party may reach agreement as to the time within which ratification must occur. As previously suggested what is a "reasonable time" for ratification should be determined by reference to any express or implied agreement between the parties. If the parties had not considered ratification at the date of their agreement because, for example, of their mistaken belief that the company was registered, they may subsequently wish to stipulate a ratification period. There is no legal or policy reason why they should not have this power. If a very short ratification period is agreed upon the company may effectively be denied the right to ratify the contract.

The position seems to be clear in those jurisdictions where the promoter is deemed to be the principal until and unless the company ratifies the contract. As a deemed principal the promoter could breach or repudiate the contract prior to the company ratifying it. The promoter would, in effect, have complete control over the agreement. A repudiation of the contract by the promoter would prevent the company from subsequently ratifying it. In *Landmark Inns of Canada Ltd v Horeak*,⁸⁸ a non-existent company purported to lease premises from T. The contract was executed by P in the name of the company. Prior to

86 (1871) LR 6 Ex 124.

87 (1889) LR 41 Ch D 295, 307.

88 [1982] 2 WWR 377.

the company being formed P told T that the lease was no longer required. T then sought to obtain a new tenant. Several months later the company was incorporated and it then purported to ratify the lease agreement. T sued P for breach of the agreement because, under s 14 of the Saskatchewan Business Corporations Act 1978, the promoter is liable as principal on a pre-incorporation contract unless the company has validly ratified it. Maurice J rejected T's defence that as the company had ratified the contract it was now the company's contract and not his. It was held that because the contract had been repudiated by P, and T had accepted that repudiation, the contract was at an end. It could not, therefore, be subsequently ratified by the company; there was simply nothing for the company to ratify. Consequently P was liable to T for breach of contract.

Is it possible to apply a case like *Landmark Inns* to s 81 of the National Companies Code? There is nothing in the *Minogue Report* which touches upon the problem. The position of the parties to a pre-incorporation contract prior to ratification was not addressed at all in that Report except to the extent that it recommended that the promoter was not to be taken as being a deemed principal during that period.

Assuming that *Landmark Inns* can be applied to a s 81 case it means that if a promoter cancels a contract prior to ratification, the company could not ratify the contract and the third party could recover damages from the promoter pursuant to s 81(4). If the roles were reversed, and the third party repudiated the contract, it is inconceivable that the third party could then sue the promoter under s 81(4). It would, after all, be the third party's own act that would have made it impossible for the company to ratify the agreement. If the promoter refused to accept the third party's repudiation, the *ratio* of *Bolton Partners* might apply so that the company could ratify and enforce the contract against the third party. If the company failed to ratify, the promoter would still appear to be liable under s 81(4) although he would have no cause of action against the third party because s 81 confers no contractual rights on the promoter. The situation would, of course, be different in those jurisdictions where the promoter is a deemed principal. As a deemed principal the promoter could sue the third party for breach of contract.

A second exception to the *Bolton Partners* rule is said to be that ratification does not entitle the principal to sue the third party for any breach of the agreement that occurred prior to ratification.⁸⁹ Cotton LJ in *Bolton Partners* said that "An estate once vested cannot be divested, nor can an act lawful at the time of its performance be rendered unlawful, by the application of the doctrine of ratification."⁹⁰ Fridman takes an expansive view of this exception and suggests that if the third party sells the goods in question to X, before the principal ratifies the contract, the third party could not be sued by the principal for the breach of contract necessarily involved in his act of selling to X:—

89 Fridman, *supra* n 6 at 58; Powell, *supra* n 6 at 129-135; *Bowstead on Agency*, *supra* n 6 at 45-50. This exception is said to be part of the more general principle that ratification will not be allowed if the third party would thereby be unfairly prejudiced. Nor will ratification be allowed to prejudice other parties. Thus ratification will not be allowed to interfere with, or divest, property rights which have already vested in others.

90 (1889) LR 41 Ch D 295, 307.

“For if the third party, between the time of the agent’s acceptance and the principal’s ratification does something which, in effect, makes the contract between the third party and the principal virtually non-existent (e.g. commencing to work for another employer, after having agreed to work for the principal) then the third party will be able to have all the advantages of the revocation or withdrawal of his offer, even though he cannot technically revoke or withdraw it.”⁹¹

The authority relied upon by Fridman is *Kidderminster Corporation v Hardwick*⁹² decided some 16 years before *Bolton Partners*, but not referred to in that case. In *Kidderminster Corporation* the plaintiff corporation sued the defendant for damages for breach of contract. The contract was one which required the affixing of the plaintiff corporation’s common seal but this was not done. After the defendant purported to withdraw from the agreement the corporation resolved to adopt the contract and this resolution was minuted under the corporation’s seal. The Court of Exchequer held that the corporation’s action must fail. All three judges held that there was a lack of mutuality because the corporation had not signified its assent by placing its seal on the agreement. Only two of the judges dealt with the argument that the agreement had been validly ratified. Kelly CB said:

“It was finally argued that there was a ratification of the contract by the resolution under seal . . . But that (even supposing it to amount to a ratification, which may be doubted) came too late; it came after the breach, which is the time we must look at; and therefore cannot enable the plaintiffs to maintain this action.”⁹³

Piggot B said:

“This was a contract which, if made by a corporation, ordinarily requires a seal, and to which the plaintiffs’ seal was never affixed, for the alleged confirmation by the resolutions of the 7th August was not until after the defendant had withdrawn from the contract . . . , and therefore came too late.”⁹⁴

Far from supporting an exception to *Bolton Partners* the *Kidderminster Corporation* case appears to be flatly opposed to it.⁹⁵

(ii) T contracts to sell property to D who is acting on behalf of a proposed company. Both T and D are aware that the company does not exist. T subsequently tells D that the arrangement is off. The company later purports to ratify the agreement.

The threshold question is does s 81 apply at all? D has not executed a contract on the company’s behalf. Thus, unless D has purported to act as an agent or trustee for the proposed company, s 81 will not apply. D has not called himself an agent and, given *Kelner v Baxter*, it is possible that he would be taken to have contracted as a principal and not agent. Therefore, s 81 may not apply.

91 *Supra* n 6 at 58.

92 (1873) LR 9 Ex 13.

93 *Ibid* 22.

94 *Ibid* 22-3.

95 This was the view of Isaacs J in *Davison v Vickery’s Motor Ltd* (1925) 37 CLR 1, 14, 20.

If s 81 does apply, what is the third party's position? At common law, if an agreement is expressly made subject to ratification, there is authority for the view that until ratification occurs the third party is able to withdraw. In *Watson v Davies*,⁹⁶ T offered to sell certain property to the plaintiff charity. Some members of the plaintiff's board of management were prepared to accept the offer but they indicated to T that their decision was subject to ratification by a full board meeting. On the day that meeting was to be held, T cancelled all negotiations. Maugham J held:

"An acceptance by an agent subject in express terms to ratification by his principal is legally a nullity until ratification, and is no more binding on the other party than an unaccepted offer which can, of course, be withdrawn before acceptance."⁹⁷

The *ratio* of *Watson v Davies* was applied by the Privy Council in *Warehousing and Forwarding Co of East Africa Ltd v Jafferli & Sons*.⁹⁸ The Privy Council also held that the third party could withdraw from the agreement until the fact that the principal had ratified it had been communicated to him.

Lord Guest delivered the judgment:

"In their lordships' opinion the evidence does not clearly establish whether Mr. Elliott was negotiating subject to the approval of Mr. Keir or had contracted with Jafferli subject to Mr. Keir's ratification. If Mr. Elliott contracted subject to ratification by his principal there would be no concluded contract until ratification had been obtained. The respondents contended on the authority of *Koenigsblatt v. Sweet*⁹⁹ that ratification by the principal can operate back to the date when the contract was made by the agent without the necessity of communication to the other party. But in that case the limitation of the agent's authority was not known to the other contracting party. In such a case the agent contracts as principal¹⁰⁰ and his principal is bound on ratification taking place. When, however, the other party to the contract has intimation of the limitation of the agent's authority neither party can be bound until ratification has been duly intimated to the other party to the contract. It would be contrary to good sense to hold that a concluded contract had been made in these circumstances."¹⁰¹

Fridman suggests that the Privy Council's reference to the other party having an "intimation of the limitation of the agent's authority" may mean that "*Bolton Partners* . . . will only apply where a third party is in ignorance of the agent's want of authority."¹⁰² A similar view is expressed in *Bowstead on Agency*.¹⁰³

96 [1931] 1 Ch 455.

97 *Ibid* 469. As Powell, *supra* n 6 at 142 pertinently asks, "[I]f an acceptance conditional on ratification by the principal is legally a nullity, what is there for the principal to ratify if the offer is not revoked?"

98 [1963] 3 All ER 571.

99 [1923] 2 Ch 314.

100 This proposition is irreconcilable with the pre-incorporation cases discussed *supra* at 120-3.

101 [1963] 3 All ER 571, 575.

102 Fridman, *supra* n 6 at 58.

103 *Bowstead on Agency*, *supra* n 6 at 45, n 3.

In the case of pre-incorporation contracts this means that whenever the third party knows, at the time of the agreement with the promoter, that the company is not in existence, the agreement will, by inference, be subject to ratification. Thus the agreement would be a nullity until ratification, and the third party could withdraw from it at any time before the company had ratified it, and had communicated the fact of the ratification to him. It would seem that the third party's notice of withdrawal need only be communicated to the promoter. This must be the case in the period before the registration of the company because until then the company does not exist. It is difficult to see why the mere fact that the company is registered should change the third party's obligations. However, given that in *Watson v Davies* and *Warehousing and Forwarding Co of East Africa Ltd v Jafferli & Sons*, the third party did notify the intended principal of his withdrawal, a third party may be wise to also adopt that course in connection with a pre-incorporation contract. There would certainly seem to be nothing to prevent the third party from claiming that his withdrawal notice is valid if communicated to the newly-formed company rather than the promoter.

If the third party wrongly believed, whether because of misrepresentations made by the promoter or otherwise, that the company was in existence when he entered into the contract can he withdraw upon finding out that the principal was not in existence at that time? The contract with the promoter would not have been expressly or impliedly subject to ratification, and thus the cases discussed above are not directly in point. Yet once the facts become known to the third party it must be clear that the agreement is subject to ratification. Why should the third party then be in a worse position than if he had that knowledge from the outset? This question is difficult to answer, particularly if the promoter has misled the third party into believing that the company did exist. The common law does not provide a ready solution for the obvious reason that, at common law, a principal *must* have been in existence at the date of the contract in order to be able to ratify it. However, it is noteworthy that in *Bolton Partners* there was no evidence that the third party was aware of any defect in the authority of the company's agent at the time of his purported but ineffectual withdrawal. It may thus be possible to distinguish the case on that basis. Support for the view that the *ratio* of *Bolton Partners* only applies if the reason for the third party's withdrawal is unrelated to the agent's lack of authority can be found in *Re Portuguese Consolidated Copper Mines Ltd*.¹⁰⁴ This case was decided by the Court of Appeal soon after *Bolton Partners*. The Court held that a company had validly ratified defective share allotment contracts within a reasonable time. The company was therefore able to enforce the contracts notwithstanding that the allottees had intimated to the company their desire to opt out of the contracts prior to ratification. The Court of Appeal noted that despite their protests the allottees had not purported to repudiate the contracts on the basis of any defect or irregularity in them. The inference is that the company's ratification may have been ineffective if there had been such an informed repudiation.

Given the shaky foundations of the rule in *Bolton Partners* and the apparent width of the exceptions to that rule, it would seem that in the

case of most, if not all, pre-incorporation contracts the third party would have the power to withdraw prior to ratification by the company. This would be so unless s 81 is inconsistent with the existence or exercise of that power.

It would be surprising if s 81 were to significantly worsen the third party's position at common law. The section seems to be aimed at providing the third party with effective remedies where none existed previously. The third party is completely protected by s 81. If the company is formed and ratifies the contract he can sue on the contract. If the company fails to ratify he can sue the promoter. The promoter on the other hand, has no contractual rights under s 81. If the company does not ratify he cannot sue the third party on the contract. Given that s 81 was intended to implement the *Minogue Report*, it might also be said that the section is intended to permit promoters to secure rights for an unformed company. The *Minogue Report* indicates that in the absence of "binding" pre-incorporation contracts a promotion may fail: "There are occasions when the acquisition of property determines the formation of a company and it can be said 'no acquisition in some way secured by a binding contract, no company'."¹⁰⁵ This objective would be defeated if the third party was able to unilaterally withdraw from a pre-incorporation contract without thereby being liable to either the promoter or the company. On the other hand, it would be unfair to the third party if notwithstanding, for example, a mistaken belief that a binding contract was immediately on foot, he was required to wait for an indefinite period before being sure of his contractual position. Given the relatively clear common law rule that a third party can unilaterally withdraw from a contract which is known to be subject to ratification, it is, perhaps, difficult to argue that under s 81 that power should not exist. Yet if the third party has entered into a pre-incorporation contract with his eyes open, knowing of the non-existence of the company, commercial certainty would best be achieved by him having no power to unilaterally withdraw prior to ratification. But should the commercial certainty argument prevail over the third party's plea that he should not be in a worse position *vis a vis* a contract with a non-existent principal than he is in relation to an existing principal?

Unfortunately, neither the *Minogue Report* nor the parliamentary draftsman has paid much attention to the important question of how the s 81 rights and liabilities relate to existing common law powers. It is true that ss(11) states that:

"Any rights or liabilities of a person under this section (including rights or liabilities under an order made by a court . . .) in relation to a contract are in substitution for any rights that the person would have, or any liabilities to which the person would be subject, as the case may be, apart from the section, in relation to the contract."

This provision is presumably designed to do little more than protect the promoter from the prospect of double liability under s 81(4) and at common law for breach of warranty of authority or, perhaps, as principal on the contract. It is unlikely that the legislature intended the right of the third party to sue the promoter under s 81, should

ratification not occur, to also be in substitution for the third party's power to withdraw prior to ratification or to reach agreement with the promoter to cancel the contract. A court would probably require clearer words than those used in s 81(11) to displace these "rights". They are not, after all, in the nature of rights to sue which are presumably the type of rights referred to in the sub-section. This would seem to follow from the juxtaposition of "rights" and "liabilities".

It might also be argued that s 81(3) is inconsistent with the third party having any power to withdraw from or cancel a pre-incorporation contract.¹⁰⁶ The provision states that when a company ratifies a contract under s 81(2) "the company is bound by, and entitled to the benefit of that contract as if the company had been formed before the contract was entered into and had been a party to that contract." The argument is that under s 81(2) a company has an absolute right to ratify a pre-incorporation contract, provided the time constraints are met, and any valid ratification will necessarily have the consequences set out in s 81(3). Yet s 81(3) can be seen as doing no more than stating the necessary effects of the doctrine of ratification; it is merely reciting what the doctrine means. It is to strain the language of s 81(3) to say that it is necessarily inconsistent with the third party having any of the common law powers to cancel or withdraw *prior to* ratification. At common law a valid cancellation or withdrawal prior to ratification by the principal means that there is nothing for the principal to ratify. If there is nothing to ratify the doctrine of relation back has no work to do. Thus both s 81(2) and s 81(3) can be interpreted as applying only if there is at the relevant time something to ratify. This was the interpretation adopted by Maurice J in *Landmark Inns Ltd v Horeak*.¹⁰⁷ His decision, that a repudiated contract could not be ratified under s 14 of the Saskatchewan Business Corporations Act 1978 was arrived at notwithstanding that s 14(2)(a) of that Act¹⁰⁸ expressly states, in terms substantially the same as s 81(3) of the Companies Code, that on ratification "the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto."

(5) *The act of ratification*

Section 81(13) provides that a contract may be ratified by a company in the same manner as a contract may be made by a company under s 80. There is no special ratification procedure. In practice this means that a board of directors will usually have the power to ratify a pre-incorporation contract.¹⁰⁹ Ratification could result from an express decision of an authorised company organ or agent or it could be inferred from part-performance of the contract by the company.¹¹⁰

106 Professor HAJ Ford expressed this view in a letter to the author dated 6 April 1982. 107 [1982] 2 WWR 377. See the discussion of this case *supra* at 135-6.

108 Section 14 of the Saskatchewan Act 1978 is in the same terms as s 14 of the Canada Business Corporations Act 1975.

109 The board of directors will usually have the relevant power pursuant to an article like Reg 66 of Table A, Schedule 3 of the National Companies Code. The board is usually in a position to delegate any of its powers. If the promoters are directors they will have to be careful to comply with their statutory and fiduciary duties in connection with any pre-incorporation contract in which they have an interest. Any potential personal liability under s 81(4) of the Code would make them interested in a pre-incorporation contract.

110 See, for example, *Wilson v West Hartlepool Railway and Harbour Co* (1865) 2 De GJ & S 475. In *Re Portuguese Consolidated Copper Mines Ltd* (1890) 45 Ch D 16, the

A contract that is *ultra vires* a company may not, at common law, be ratified.¹¹¹ If a company purported to ratify an *ultra vires* contract might s 68 of the National Companies Code come into play? Section 68 applies to an act of a company which is invalid by reason only of the fact that the company was without the capacity or power to do the act. Except in the circumstances set out in s 68(2) no such act is to be regarded as invalid. Thus, unless the *act of ratification* is restrained pursuant to s 68(2)(a), that act will be valid and effective. Even if this is so, any *performance* of a ratified *ultra vires* contract may be the subject of a restraining order under s 68(2)(a) and of consequential damages relief, at the Court's discretion, under s 68(3).

If the act of ratification was successfully restrained under s 68(2)(a) the promoter would be liable under s 81(4). The promoter could not rely upon the doctrine of constructive notice as a defence any more than a company's director can; only a company may assert and rely upon that doctrine.¹¹² Section 68(3) would appear to be irrelevant in such a situation because it could hardly be said that the act being restrained relates "to any contract to which the company *is a party*". [Emphasis added].

(6) *The consequences of a valid ratification*

Where a company ratifies a contract the company is bound by, and entitled to the benefits of, that contract as if the company had been formed before the contract was entered into and had been a party to that contract.¹¹³ If the company then fails to perform the contract it may be sued in the normal ways. If the third party brings an action for damages against the company the Court may, under s 81(7), if it thinks it just and equitable to do so, order the promoter to pay the whole or some of the damages awarded against the company. No such order may be made against the promoter if the third party has expressly exempted him in writing from any liability on the contract.¹¹⁴ Section 81(7) is designed to catch cases where the third party would be prejudiced if ratification completely extinguished the promoter's liability. The promoter might have set up a company with insufficient assets to meet its pre-incorporation contract commitments.¹¹⁵ If the promoter was the major shareholder he could get the company to ratify the contracts knowing that it would be unable to perform them. There may, of course, also be some scope for the operation of s 556 of the Companies Code in such circumstances.¹¹⁶

If a promoter is ordered to pay damages under s 81(7), merely because he has set up an undercapitalised company, it would be as if the

110 *Cont.*

institution of legal proceedings, by the competent company organ, to enforce the contract was taken as the ratifying act.

111 *Ashbury Railway Carriage Co v Riche* (1875) LR 7 HL 653.

112 See, for example, *Brownnett v Newton* (1941) 54 CLR 439. In any event, the doctrine of constructive notice could not apply as at the date of the agreement between T and P because no memorandum or articles of association relating to the company would have been registered then.

113 S 81(3).

114 S 81(8) and s 81(9).

115 See the *Minogue Report* § 45, and the *Explanatory Memorandum* § 227(3).

116 S 556 provides a civil remedy to a creditor in respect of a debt incurred by a company when there are reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due. The remedy may be enforced jointly or severally against, *inter alia*, the company's directors.

promoter had breached a warranty that the company, referred to in the pre-incorporation contract, was or would be sufficiently solvent to meet its liability on the contract. As we have seen, at common law an agent does not impliedly warrant the solvency of his principal. It could be argued that no order should be made under s 81(7) unless there is evidence that a warranty of solvency was in fact given by the promoter. If a Court took account of the *Minogue Report*, or the Commonwealth Government's *Explanatory Memorandum*, however, it could discern that s 81(7) was not intended to be confined to such circumstances.¹¹⁷

(7) *The consequences of a failure to ratify*

If the company referred to in a pre-incorporation contract either (i) is not incorporated within a reasonable time, or (ii) is incorporated within reasonable time, but then fails to ratify the contract within a reasonable time, the promoter is liable to the third party for damages.¹¹⁸ The amount of damages is equivalent to the amount that the third party would have obtained judgment for against the company had the company validly ratified the contract and then failed to perform any obligations under it. The common law problem of the insolvent principal referred to earlier is overcome by gearing damages to the amount of a judgment rather than the amount that could have been recovered from the company on execution of the judgment.

Unlike the effect of reform legislation elsewhere,¹¹⁹ the promoter is not considered to be a party to the contract if the company fails to ratify it. The sole liability is for damages. The justification for not following the legislative examples set elsewhere stems from the opinion expressed in the *Minogue Report*, that

"it would *in most cases* [emphasis added] be difficult to justify the imposition of contractual obligations on a person wishing to contract with a company in favour of a promoter or 'agent' with whom he had no intention of contracting. This would be particularly so when personal considerations are important as for example, where the agreement is one for employment or for the allowing of credit."¹²⁰

The difficulties perceived in the *Minogue Report* could, of course, only arise if the company failed to validly ratify the agreement. It is probable that most pre-incorporation contracts would be so ratified. No doubt in

117 As to whether a Court may look at these documents see supra nn 54 and 75.

118 S 81(4).

119 See, for example, the legislation noted supra n 52. One consequence of the promoter not being a party is that a case like *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45 would be decided the same way under s 81 unless the company ratified the contract. Such a result would seem to be unfair to the promoter if the evidence suggests that the third party would have been just as happy to contract with him personally as with the company.

120 § 35. If the agreement involves the granting of credit it is difficult to see how the third party could be prejudiced if the promoter, rather than a non-existent and necessarily insolvent company, was a party to the contract. The position would, of course, be different if the promoter had made representations that the company existed and had particular net assets. Further, if the contract is one of employment it will not usually be specifically enforceable. "[T]he courts have never dreamt of enforcing agreements strictly personal in their nature . . . [such as] agreements of hiring and service, being the common relation of master and servant": *Rigby v Connoll* (1880) Ch D 482,487.

connection with *some* of the unratified contracts it could be unfair to the third party for the promoter to be liable as principal. If the promoter is a party then, of course, the contract may be enforced by, as well as against, that person. However, it is fallacious to argue that because the third party may be prejudiced in *some cases* if the promoter was to have the benefit of the contract, then in *no case* should the third party be allowed to specifically enforce that agreement against the promoter. It may have been better to allow the third party to elect whether or not to hold the promoter liable on the contract.¹²¹ Specific performance of a contract may be more advantageous to the third party than the remedy provided by s 81(4). Further, a promoter may find it preferable to perform the contract rather than incur the s 81(4) liability. No doubt, in practice, if the third party and promoter agree that the contract should be performed, despite a failure of the relevant company to ratify, no action would be instituted by the third party under s 81(4). If the promoter performed the contract could he still be liable under s 81(4)? Literally interpreted, he would still be liable unless: (i) the relevant company had been formed and had received some benefits or property pursuant to the contract in which case the Court may refuse to award any damages under s 81(4),¹²² or (ii) the third party had expressly exempted the promoter in writing from liability in relation to the contract.¹²³ If neither of these circumstances existed the promoter could argue that the pre-incorporation contract had impliedly been cancelled by mutual consent and replaced by another contract which had been performed. The success of this argument depends upon the existence of the right to cancel a pre-incorporation contract prior to ratification discussed above.

If the promoter could not establish that he had performed his side of a new agreement what rights, if any, would he have to be reimbursed by the third party for the goods or services he has supplied to him? Normally, quasi-contractual remedies would be available in these circumstances, but the effect of s 81(11) may be to exclude them in connection with pre-incorporation contracts. Can it be said that a quasi-contractual right or liability arises "in relation to a contract" as those words are used in s 81(11)? If it can, then a quasi-contractual remedy would be unavailable and the promoter would seem to be left without any remedy. Such a result would be indefensible and surely cannot have been intended by the legislature. However, the legislature does not appear to have considered the repercussions which necessarily flow from failing to deem the promoter to be a party to a pre-incorporation contract with all of the normal contractual remedies and rights. On balance, s 81(11) probably is intended to exclude quasi-contractual remedies. These remedies would seem to "relate" to the pre-incorporation contracts referred to in s 81. The remedy for breach of warranty of authority may

121 Cf Ford, *supra* n 2 at § 544. There are difficulties with the third party having the right of election. For example, when and how would an election be made? Would the promoter be deemed to be a principal unless the third party elected otherwise? It also seems unfair that a promoter should, in all circumstances, be deprived of the benefit of the contract at the whim of the third party (cf *Newborne v Sensolid (Great Britain) Ltd* *supra* n 119). A better solution would be to allow the third party to convince a court that it would be unfairly prejudicial to him if the promoter was to have the benefit of the contract. See *infra* at 148.

122 See s 81(5) and s 81(6).

123 See s 81(8) and s 81(9).

also be excluded. But this would only be so if the remedy on the separate warranty of authority contract could be said to "relate to" the contract referred to in s 81(11) which contract is presumably the pre-incorporation contract. At common law of course, the pre-incorporation contract itself may well have been void *ab initio* for want of competent parties, and thus there could be no "contract" until a valid ratification under s 81. Yet the legislature presumably intended s 81(11) to apply to "purported contracts" as well as "ratified contracts". If s 81 had contained a definition of "contract", which included void or voidable contracts, the issue could have been put beyond doubt.

One further point needs to be made about s 81(11). Literally interpreted, it would seem to prevent a third party, or a promoter, from enforcing a pre-incorporation contract against each other even if the promoter was clearly intended to be jointly liable with the non-existent company on the contract. It will be necessary for a court to construe the word "contract", as it appears in s 81(11), as being referable only to the purported or actual contract between the third party and the company. Even if this interpretation is adopted a nice question might arise as to whether the promoter, in such circumstances, is to be liable under the contract, to the extent that he is personally a party to it, as well as being personally liable under s 81(4), to the extent that the company has failed to validly ratify it.

If a person has purported to contract as a trustee for a proposed company, s 81(12) states that the person has no right to be indemnified by the company should it be formed and fail to ratify the contract. The aim of this section, according to the *Explanatory Memorandum*, is to prevent "the operation of equitable principles by which the trustee may be able to avoid liability for statutory damages under s 81(4)." ¹²⁴ Assuming that, just as there may be a valid trust for an unborn infant, there may be a trust for an unregistered company,¹²⁵ the trustee (ie the promoter) would be entitled to be indemnified out of the trust property, or if that is insufficient, by the beneficiary (ie the registered *sui juris* company) were it not for s 81(12).¹²⁶

However, given that the beneficiary could not have authorised the trustee to incur the liability (it was, after all, not in existence) the right to be indemnified only arises if the beneficiary has ratified the transaction (in which case s 81(12) does not apply) or if the beneficiary has received the benefit of it. The paramount principle, as stated by the Privy Council in *Hardoon v Belilios*, is that "the cestui que trust who gets all the benefit of the property should bear its burden."¹²⁷ If the receiving of the benefit does not itself constitute ratification, it would nevertheless be a relevant factor in how the Court exercises its discretion under s 81(5) and s 81(6). If an action is brought against a promoter under s 81(4), and the non-ratifying company is shown to have received the benefit of the contract, the Court may, if it thinks it just and equitable to do so, direct the company to transfer the benefit or its value

124 § 227(j).

125 See generally, Pitt, *supra* n 4 at 102; Gower, *supra* n 2 at 328; McKenzie "The Legal Status of the Unborn Company" (1973) 5 NZULR 211, particularly 215 ff. See also *Queensland Mines Ltd v Hudson* [1976] ACLC 28,658 where, at 28,684, Wootten J held that such a trust existed.

126 *Stott v Milne* (1884) 25 Ch D 710; *Hardoon v Belilios* [1901] AC 118 [PC].

127 [1901] AC 118, 123.

to another person (presumably, in most cases, to the third party). If such an order is made the Court, under s 81(6), may refuse to award any damages against the promoter or it may reduce the damages that would otherwise have been awarded against him. The Court may also, under s 81(5), order the company to pay the whole or part of the damages that the promoter is liable to pay under s 81(4).

The effect of any Court orders made under s 81(5) and s 81(6) may be to reduce or extinguish the liability of the promoter, and consequently the amount for which he could seek an indemnity, were it not for s 81(12). Section 81(12) will, in practice, have very little work to do. However, because the section only applies to unratified contracts it would not prevent a promoter from seeking an indemnity for any damages which a court orders him to pay under s 81(7). Section 81(7) only applies to ratified contracts. Since a court would normally only make an order against a promoter under s 81(7) if the company was insolvent the theoretical right to an indemnity from the company is probably of little practical significance. The promoter would, of course, be entitled to an indemnity for any s 81(7) liability whether he acted as agent or trustee.

(8) *The release or discharge of the promoter from liability*

(i) *Release*

Pursuant to s 81(8), the third party to a pre-incorporation contract may grant an express, written, signed exemption from liability in relation to the contract to the promoter. This exemption may apparently be granted at any time; it does not have to be given at the date of the contract. The effect of such an exemption is that the promoter will not be liable to pay damages under s 81(4) or s 81(7).¹²⁸

A third party may agree to exempt a promoter from liability in accordance with s 81(8) in the mistaken belief that the company either is liable or will necessarily become liable upon incorporation. In order to protect persons dealing with promoters it may have been desirable for s 81(8) to have required the written exemption to clearly indicate that the third party appreciated his legal position. An exemption form similar to that suggested by Getz could have been prescribed.¹²⁹

If the third party transfers some benefit to the company, after having exempted the promoter from liability, he will be reliant on the company ratifying the contract.¹³⁰ If no valid ratification occurs his only remedies would appear to be quasi-contractual. These remedies would only be available if they are not excluded by s 81(11).¹³¹ Even if they are excluded it may be possible to obtain relief under s 81(5). The Court has the power, under s 81(5)(c), to order the company to transfer property or to pay for any benefit received by it as a result of an unratified contract. These orders may, however, only be made where proceedings are brought to recover damages from the promoter under s 81(4). Given that no damages could be recovered under s 81(4) because of the s 81(8) exemption from liability, could the third party nevertheless institute a

128 S 81(9).

129 Getz, *supra* n 37 at 408-9.

130 The receipt of the benefit by the company could, in some circumstances, amount to an implied ratification by the company.

131 See discussion *supra* at 144.

futile s 81(4) action so as to give the Court the power to make orders against the company under s 81(5)(c)? The Court's power to make these orders is not expressed to be conditional on a promoter being liable under s 81(4).

(ii) *Discharge*

Subject to the power of the Court to award damages against a promoter under s 81(7), a promoter will be discharged from liability on the contract upon the company validly ratifying it.¹³² A promoter will also be discharged from liability under s 81(10) if the company, after its formation, enters into a contract in substitution for the pre-incorporation contract. It will, of course, be a question of fact whether a new contract has been substituted for the old. It is conceivable that in some circumstances it will be difficult to determine whether particular conduct of a company is to be construed as involving ratification of a pre-incorporation contract, or as signifying an intention to be bound by a new contract. In order to overcome such problems, s 81(10) perhaps should have stipulated that the new contract contain a clause indicating that it was intended to be in substitution for the old. Presumably, a wise promoter would insist upon the inclusion of such a clause. This in turn means that a third party may be duped into entering into a new contract without realising that one consequence of so doing is to release the promoter from all personal liability in connection with the pre-incorporation contract. If the company failed to perform the substituted contract the third party would have no remedy against anyone but the company. If the company is insolvent the third party's only chance of recovering damages would be under s 556 of the Code¹³³ and this remedy, of course, may be unavailable or unproductive.

Conclusion

The attempt to reform pre-incorporation law embodied in s 81 of the Companies Code is long overdue. The common law is not attuned to commercial realities and expectations. But as has happened on countless previous occasions the legislature has regarded the process of reform as being deceptively simple. It is easy to identify the substantial defects in the common law. It is easy to state that a company should be able to ratify a pre-incorporation contract. It is easy to legislate to this end. What is not easy is to fully appreciate that the common law rule denying a non-existent principal the power of ratification is just one part of a whole body of inter-related agency laws. To earmark one of these rules for change without fully considering how the remaining rules will relate to it, in its new form, is a recipe for confusion. So it is with s 81. Neither the *Minogue Report* nor s 81 adequately indicate how the new rules are to be integrated with the old. It seems that the problems alluded to above have not been seen let alone resolved.

It is evident that the major cause of difficulty stems from the adoption of the *Minogue Report* recommendation not to treat the promoter as being, under any circumstances, liable as principal on a contract caught by s 81. If the promoter was deemed to be a principal, until and unless ratification occurred, there would at all times be an enforceable contract

132 This is because the liability under s 81(4) can only arise if there is no ratification within a reasonable time.

133 *Supra* n 116.

on foot; commercial certainty would be achieved in the sense that mutual rights and obligations would always exist. The approach taken in s 81 leaves an apparent vacuum between the date of the "contract" and any subsequent valid ratification of the "contract". The common law must, it seems, apply to this contractual no-mans land. The fact that this key *Minogue Report* recommendation will create commercial uncertainty in virtually all cases, while it will avoid unfairness in only a minority of cases, seems to have gone unnoticed.

The primary purpose of this article has been to critically examine s 81 as it stands. It is not possible here to fully articulate and defend a better solution to the pre-incorporation contract problem than that found in s 81. Nevertheless it is suggested that subject to an express agreement to the contrary, it would be preferable to deem the promoter to be a party to the contract unless and until the company ratified it. To protect the position of the third party the Court, on the application of that party, should be given the power to declare that the promoter is not a party to the contract. Such a declaration should be made whenever the third party could establish that he would be unfairly prejudiced if the promoter was a party to the agreement.¹³⁴ The Court could take into account such factors as (i) whether the third party reasonably believed the company to be in existence at the date of the contract, and (ii) whether the obligations ostensibly imposed on the company in the contract could be fully performed by the promoter without prejudice to the third party.

If the promoter is not a party to the contract (whether because of an express agreement to that effect or a court order) the third party should be entitled to look to the promoter for compensation if the company failed to ratify the agreement. The Court should be able to award such compensation to the third party as it deems just and equitable in the circumstances. The Court should also be given broad remedial powers to protect the position of all parties, including a promoter who may have provided goods or services pursuant to the contract.

The third party should have no power to unilaterally withdraw from a pre-incorporation contract, so as to preclude ratification by the company, if he was aware of the non-existence of the company when the contract was entered into. In other cases the third party should have the right to unilaterally repudiate the contract, without penalty, by giving written notice to the promoter within a prescribed period of becoming aware that the company was not in existence at the date of the contract.

134 At common law, a person may sometimes enforce a contract as principal notwithstanding that he had purported to act solely as an agent in respect to it. This will not, however, be allowed if the other party would be prejudiced: *Fellowes v Gwydyr* (1829) 1 Russ & My 83; 39 ER 32. In *Rayner v Grote* (1846) 15 M & W 359, 365; 153 ER 888, 891, Alderson B said: "In many such cases, such as . . . contracts in which the skill or solvency of the person who is named as the principal may reasonably be considered as a material ingredient in the contract, it is clear that the agent cannot then shew himself to be the real principal, and sue in his own name." See also *Schmaltz v Avery* (1851) 16 QB 654; 117 ER 1031 and *Harper and Co v Vigers Bros* [1909] 2 KB 549. In all of these cases the agent had, for various reasons, disguised the fact that he was contracting as principal. In *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45, 51 Lord Goddard CJ indicated that *Schmaltz* and *Harper* were of no use to Mr Newborne because, given the form of the contract, he had not purported to act as agent or as principal. It would have been more equitable, it is submitted, to allow Mr Newborne to sue on the contract as principal subject to the defendant successfully invoking the unfair prejudice concept. See also Treitel, *supra* n 18 at 558.

Should the contract have been partially performed at the date of the third party's repudiation, the promoter or the third party should have the right to apply to the Court for appropriate orders for compensation or the transfer of property.