

Bonus Question 4

'In the great mass of contracts it is a matter of indifference to either party whether there is an undisclosed principal or not. If he exists it is, to say the least, extremely convenient that he should be able to sue and be sued as a principal, and he is only allowed to do so on terms which exclude injustice.'

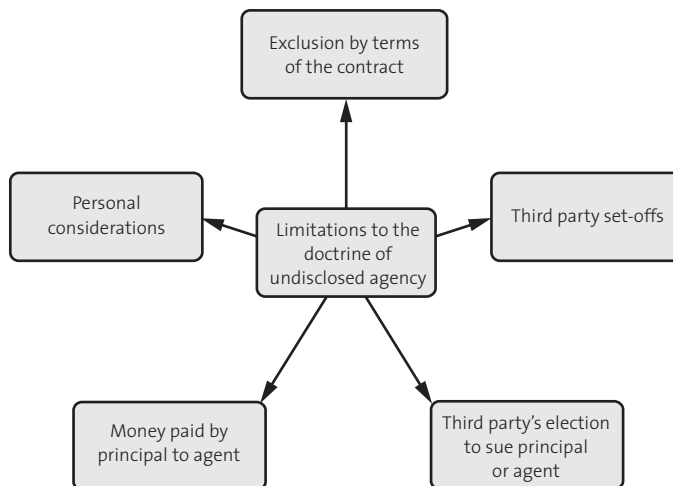
(Lord Lindley in *Keighley Maxted & Co v Durant* (1901))

► Discuss.

How to Answer this Question

In most commercial contracts, it does not matter who the other contracting party is. So it does not matter to the third party at the time he contracts with an agent whether there is an undisclosed principal or not. This is the essence of Lord Lindley's statement, hence the general rule that the principal can intervene and enforce the contract. This is an exception to the doctrine of privity under the common law. The **Contracts (Rights of Third Parties) Act 1999** does not apply because an undisclosed principal is neither identified nor identifiable within the meaning of s1 of that Act.

Applying the Law



This mind map illustrates the main points that will be covered in the answer.

ANSWER

The justification for the doctrine of the undisclosed principal has been the subject of much discussion. It is generally accepted that although it runs against the fundamental principles of privity of contract (that is, there must be agreement between the parties), the undisclosed principal rules are justified on grounds of commercial convenience. Generally, in commercial law, the assumption is that buyers and sellers are willing to buy/sell to anyone. Contracts are not personal and business people are not concerned about the identity of the other contracting party. As Lord Lloyd said in *Siu Yin Kwan v Eastern Insurance* (1994), an undisclosed principal can sue and be sued on a contract made by an agent on his behalf, if it was within the scope of the agent's actual authority, unless there are special circumstances.¹

It is important to bear in mind that the initial contract is between the agent and the third party. The undisclosed principal intervenes in an existing contract. This contradicts the fundamental principle of contract law that there needs to be agreement between the parties. There are, therefore, limitations to the doctrine of the undisclosed principal. There needs to be, because it might be unfair to a third party who thought he was dealing only with the other party to then find out that that other party was in fact the agent of a principal.

PERSONAL CONSIDERATIONS

The general rule is that an undisclosed principal cannot intervene if the agent's contract is of a personal nature, that is, where the third party relied on the skill, solvency or other personal characteristics of the agent and which cannot be vicariously performed.²

Difficulty has been caused by cases where the third party is not relying on the agent's positive attribute but is objecting to the undisclosed principal's negative attribute. *Said v Butt* (1920) involved a theatre critic who wanted tickets to attend the first night of a play. He knew the theatre owners would not sell him a ticket because he had written an unfavourable review on a previous occasion. He asked a friend to obtain tickets for him. When the critic arrived at the theatre, the manager would not permit him entry. The critic sued the manager for breach of contract. The court held that there was no contract between the theatre and the critic, because the theatre had reserved the right to sell

¹ *Greer v Downs Supply* (1927) is an example of such a special circumstance. The third party bought timber from an agent who was acting for an undisclosed principal. One reason for the purchase was because the agent owed the third party a debt on a previous transaction. The agent agreed to set off his previous debt against the purchase price. The Court of Appeal did not permit the undisclosed principal to intervene in this transaction because the third party intended to contract only with the agent. The agent specifically agreed that the third party could set off his previous debt against the purchase price. No other party can intervene.

² For example, if the third party and the agent enter into a contract whereby the agent is to paint the third party's portrait, the principal cannot intervene. This is because the third party is relying on the agent's positive attributes. These attributes need not be personal skills. It can be because of the agent's solvency or where the agent owes the third party money. We have already seen the case of *Greer v Downs Supply* (1927).

first-night tickets to selected persons and the critic was not a selected person. McCardie, J said that the critic could not assert the right as an undisclosed principal because he knew the theatre was not willing to contract with him.

Said v Butt has been severely criticised. Whether an undisclosed principal should be allowed to intervene ought to depend on whether the third party felt the agent was the only person he wanted to deal with, that is, the agent has some positive attribute important to the third party. The *Said v Butt* decision is allowing a third party to argue that although the agent's identity does not matter, the undisclosed principal's personality is detrimental. The court in *Said v Butt* clearly felt that the first-night performance at the theatre was a special case. Whatever happened on the first night would more or less determine the success or failure of the play, so the theatre had special reasons to restrict the audience to people who could influence the outcome of the first night in their favour. So the theatre would not wish to permit entry to antagonistic theatre critics.

The result in *Dyster v Randall* (1926) is preferred. A developer wanted to buy land from the owner, but he knew the owner mistrusted him. He therefore employed X to buy in X's name. The developer then said he intervened as an undisclosed principal. Specific performance was granted. The court held that there was a contract between the third party and the principal. Lawrence, J agreed with some of what McCardie, J said in *Said v Butt*. Perhaps the first night of a theatre performance was special. But in *Dyster*, the undisclosed principal could intervene because the third party did not rely on the personal attributes of the agent. It was a simple agreement for the sale of land. The benefit of such agreements is assignable and the assignee can enforce specific performance.³

Courts favour this approach, particularly where commercial parties are involved.⁴ The principle seems clear: an undisclosed principal can intervene even if the third party would not have dealt with the agent if he had known the agent was an agent of the principal. The decision in *Said v Butt* is out on a limb, that is, the limitation on the undisclosed principal's right to intervene should only relate to the agent's personal attributes and not to the principal's negative attributes.

EXCLUSION BY TERMS OF THE CONTRACT

The doctrine of the undisclosed principal can be excluded by the terms of the contract. In *Humble v Hunter* (1848), an agent chartered out a ship. He signed the charterparty as 'owner'. His mother was in fact the owner. His mother then revealed herself as the undisclosed principal and wanted to enforce the contract. The court held that the undisclosed principal cannot intervene. The description of the agent as 'owner' in the charterparty contract was inconsistent with the terms of that contract. It was a term of the contract that the agent was contracting as the owner of property. He cannot then show that

3 There was no direct misrepresentation in *Dyster*. If misrepresentation was involved, the undisclosed principal cannot intervene (*Archer v Stone* (1898)).

4 See also the case of *Nash v Dix* (1898), referred to by Lawrence, J in *Dyster*.

someone else is in fact the owner. The agent impliedly contracted that there is no principal behind him.

Humble v Hunter has been criticised and is unlikely to be followed. For example, in *Fred Drughorn v Rederiaktiebolaget Trans-Atlantic* (1919), the agent signed a charterparty as 'charterer'. The House of Lords held that the undisclosed principal can intervene in the contract. A charterparty is essentially a contract for the hire or use of a ship. It was a custom of the trade that charterers often contract as agents for undisclosed principals. *Humble v Hunter* was distinguished.

Only in exceptional cases will an undisclosed principal not be permitted to intervene on grounds that it is inconsistent with the terms of the contract. Possibly the only situation is if the agent signed as 'owner' or 'proprietor'.⁵

As Lord Lloyd said in *Siu Yin Kwan*, 'If courts are too ready to construe written contracts as contradicting the right of the undisclosed principal to intervene, it would go far to destroy the beneficial assumption in commercial cases.'

SET-OFFS

The general rule where the principal is undisclosed is that a third party can set off against the principal any defences accrued against the agent up to the point the principal intervenes. On the other hand, if the third party did not consider the other contracting party's identity as relevant or did not believe he was dealing with an agent (that is, the third party thought there might be an undisclosed principal involved), the third party cannot set off the agent's debts against the principal.⁶

5 In *Siu Yin Kwan v Eastern Insurance* (1994), an employer's liability insurance policy was taken out covering the crew on a ship. The agent's name was stated as the employer. In fact, the employers were the owners of the ship. The owners were negligent and the ship sank in a typhoon. Two crew members died. Because the owners were insolvent, the relatives of the dead crew members sued the insurers. The question was whether or not they could do so. The answer depended on whether the owners could themselves have enforced the policy. The insurers argued that the insurance policy included a term that benefits under the policy could not be assigned, so the undisclosed principal cannot intervene. The Privy Council held that the undisclosed principal (who was the true employer) can intervene. It was of no consequence to the insurance company who the employers were because all the information required was the same and thus nothing material to risk. The relatives were entitled to recover against the insurers.

6 In *Cooke v Shelby* (1887), the agents were cotton brokers. It was the practice of the Liverpool cotton market that brokers sometimes dealt on their own account and sometimes as agents. The agents sold cotton to a third party on behalf of an undisclosed principal. The third party did not enquire whether this transaction was on their own account or for an undisclosed principal. The third party had not paid when the undisclosed principal went into liquidation. The trustee in bankruptcy claimed the price from the third party. The third party argued that they should be allowed to set off what the agent owed them on a previous occasion. The House of Lords held that the third party had no right of set off. If it had really mattered to the third party that they dealt with the brokers on their own account (so they could set off previous debts), they should have enquired. The third party knew that the agents were either dealing on their own account or for an undisclosed principal. This was sufficient to put the third party on notice of the possible existence of a principal.

MONEY PAID

Armstrong v Stokes suggests that if an undisclosed principal gives money to his agent to pay a third party but the agent fails to do so, the principal is absolved from liability to the third party.⁷

Armstrong v Stokes (1872) has been severely criticised and the Court of Appeal in *Irvine v Watson* (1880) suggested that *Armstrong* will probably not be followed.⁸

In *Irvine v Watson*, the court said that the principal remained liable to the third party. Although the doctrine of the undisclosed principal exists for commercial convenience, it is important to protect the third party. In a situation where an agent fails to pass payment to the third party, either the principal or the third party will lose out. It is surely fairer to place the loss on the principal. It is submitted therefore that the better position is this: an undisclosed principal who pays his agent but whose agent does not pass the payment on to the third party, remains liable to the third party.⁹

ELECTION

In an undisclosed principal situation, the initial contract is between the agent and the third party, which is why Lord Lloyd in *Siu Yin Kwan* said that an agent can sue and be sued on the contract. Once the undisclosed principal intervenes, the agent loses his rights of action against the third party. The agent nevertheless remains liable to the third party until the third party elects whether to hold the principal or the agent liable.

The third party cannot sue both, because the third party only makes one contract with one person, that is, there is only one obligation. So, the right to sue the agent and the right to sue the principal are alternatives. The third party may lose his right to sue one of them if he has 'elected' to hold the other liable. The third party cannot change his mind who to sue once he has elected.¹⁰

7 This case involved agents who were brokers. They dealt sometimes on their account and sometimes they acted for principals. The third party dealt with these agents many times. They never asked if the agents were acting for themselves or for principals. The agents bought shirts from the third party on behalf of an undisclosed principal. The shirts were delivered to the agents on credit. The principal paid the price of the shirts to the agent but the agent did not pay the third party. When the third party discovered the existence of a principal, the third party sued the principal for the unpaid shirts. The court held that the third party was not entitled to be paid. The principal had already made payment via its agents.

8 In *Irvine v Watson* (1880), a principal employed an agent to buy oil. The agent bought from a third party on payment terms 'cash on delivery'. The third party knew the agent was buying for a principal but the principal was unnamed. The third party delivered the oil to the agent without asking for cash payment. The principal was not aware that the agent had not yet paid the third party in accordance with the contract terms, and the principal paid the agent. The agent did not pass on the monies to the third party who now sued the principal for the price. The Court of Appeal held that the principal must pay the third party.

9 The critical evaluation of a particular argument is what the examiner is looking for in an essay question.

10 Commencing proceedings constitutes evidence of election, but this is not conclusive (*Clarkson, Booker v Andjel* (1964)).

SUMMARY

As Lord Lindley's statement suggests, it is usually a matter of no importance to the contracting parties whether or not there is an undisclosed principal. The doctrine is justified on grounds of commercial convenience. Nevertheless, there needs to be some protection afforded to the third party so as to exclude injustice.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45