PROPOSALS FOR CODIFICATION

OF

THE INDOOR MANAGEMENT RULE

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I. Introduction

This paper is the final phase of a discussion of the inter-related areas of ultra vires, the doctrine of constructive notice, and the indoor management rule, in the field of company law. This paper will examine the indoor management rule as developed through the common law, and its importance with regards to possible reform or codification. Recommendations which will complement earlier recommendations on the doctrine of ultra vires and the doctrine of constructive notice will conclude this discussion.

The approach of this paper will not be to dwell on the very complicated and intricate situations which bring the indoor management rule into play, or the technalities of agency doctrines. Instead, this paper will examine the area with the view to assessing where the ultimate loss should lie as between two innocent and conflicting interests, and with a view to promoting an effective commercial setting for corporate business transactions.

II. What is the Indoor Management Rule?

A. The Rule Itself

The indoor management rule developed from the famous case of Royal British Bank v. Turquand (1856) .6 EB, 327, 119 E.R. 886 and has blossomed into an area of company law which has been "an exceptionally fertile source of litigation."[1] The present state of the law is still not wholly clear or satisfactory. An accepted statement of the rule can be gleaned from the judgement of Ferguson J. Sheppard v. Bonanza Nickel Mining Company of Sudbury at page 310.[2]

> "Then where a party dealing with the company ascertains the existence [of power] on the part of the company to do the act, that is to make and give him the obligation, he may go on with the dealing without inquiring as to any formalities that may have been prescribed as preliminaries. He may presume without inquiring that these have been properly attended to."

From another perspective, it may be argued that the indoor management rule is not really a positive rule of law but may be considered as an expression of the apparent authority doctrine in the field of company law:[3]

> It is merely an acknowledgement that, in reference to apparent authority, constructive notice is not to be carried beyond the memorandum and articles to include matters of mere procedure, such as quorums, voting and internal resolutions and regulations.

In the case of Freeman and Lockyar v. Buckhurst Park Properties (Mangal) Limited, Diplock L. J. outlined four requirements which must be fulfilled in order to allow a third party to invoke the indoor management rule against a company entered into on behalf of the company by an agent who had no actual authority to do so:[4]

> If the foregoing analysis of the relevant law is correct, it can be summarised by stating four conditions which must be fulfilled to entitle a contractor to enforce against a company a contract entered into on behalf of the company by an agent who had no actual authority to do so. It must be shown: (a) that a representation that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced was made to the contractor; (b) that such representation was made by a person or persons who had "actual" authority to manage the business of the company either generally or in respect of those matters to which the contract relates; (c) that he (the contractor) was induced by such representation to enter into the contract, i.e., that he in fact relied on it; and (d) that under its memorandum or articles of association the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent.

The indoor management rule also applies in some cases to statutory provisions establishing condition precedends to the valid conferral of power on corporate agents or the company itself. Whether or not an outsider can invoke the rule depends upon the classification placed on the provision as being either 'mandatory' or 'permissive'. If the provision is interpreted as being mandatory, the outsider will be unable to invoke the protection of the rule as compliance with the provision will be considered a condition precedent to a valid conferral of authority on the company or the agent.

It is difficult however, to determine what factors are used to categorize provisions as being mandatory. A. R. Thompson, in analyzing the Alberta Companies Act as to this classification made these conclusions:[5]

> The statutory restrictions in the Alberta Companies Act[126] are typical of those found in registration acts. Again, the restriction may generally be classed as prohibitive or permissive and the consequences of violation depend upon the particular interpretation applicable. Included in the prohibiting class are section 13, which prohibits the exercise by an Alberta company of powers pertaining to certain classes of business, section 14 which prohibits loans to shareholders, and section 29 which prevents a company which is not entitled to commence business from exercising its borrowing powers or being bound by a contract. No amount of apparent authority would entitle an outsider to succeed in enforcing a contract against a company that is not entitled to commence business for, by virtue of this section, a contract in such circumstances is not binding even when actually authorized.
>
> The permissive sections are those which authorize the company to act in certain matters by special resolution only. In some cases the Act requires the further sanction of the court. For example, under section 38 the company may alter the provisions of its memorandum with respect to its objects by a special resolution confirmed by court order. Sections of this type usually involve the constitution of the company and reflect the policy of the registration acts of leaving such matters in the hands of the shareholders. These sections would probably be construed so that the power to act would not exist unless exercised in accordance with the statute. However, as basic constitutional matters only are affected, the outsider is seldom involved and apparent authority is not significant. Where the outsider is involved, and the Act requires that the sanction of the court must be obtained, the court will see to his protection.

B. Rationale of the Indoor Management Rule

The indoor management rule was designed to protect outsiders from irregulatities in corporate proceedings. It is based on a matter of commercial convenience because efficient business transactions could not be carried on if a person dealing with the agents of a company were compelled to call for proof that all internal regulations of the company have been duly observed. Thus it is designed as a protection for third parties in their dealings with the company, and has paralleled the development of the constructive notice doctrine which protects shareholders against liabilities that they have little opportunity to control. As will be seen, these two doctrines are intricately interwoven and are the cause of a considerable amount of confusion and a conflict in the law.

Gower suggests that there is a second rationale to the rule:[5]

> Not only is it convenient, it is also just. The lot of creditors of a limited liability company is not a particularly happy one; it would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf.

C. To Whom Does the Rule Apply?

The expression 'outsider' is used in describing the type of person to whom the indoor management rule applies. It is not entirely clear what persons come within this class for the purposes of the rule and it seems to be a question of fact depending on the circumstances in each case. In some

cases, it has even been held that a director of a company is an outsider and not affected by internal procedures in a company.[6]

The test to determine who an outsider is as formulated by Gower is:[7]

> The test appears to be whether the acts done by him were so closely interwoven with his position as director as to make it impossible for him not to be treated as knowing of the limitations on the powers of the officers of the company with whom he dealt.[75] He will, however, necessarily be treated as an insider unless he can satisfy the court that he was not the "responsible officer" in connection with the transactions.[76]

Note also that an outsider will be precluded from relying on the indoor management rule where he has actual notice of the internal irregularity or whether the circumstances surrounding the agent's assertion of authority are so suspicious as to raise doubts as to the validity of his actions. Where he has put on notice, the authority suggests that the outsider is obligated to make some genuine attempt to determine the actual authority and this obligation will not be satisfied by a mere perusal of the public documents of the corporation (see A. L. Underwood Ltd. v. Bank of Liverpool and Martin's Bank [1924] 1 K.B. 775).

D. Where does the Indoor Management Rule Fit into the Scope of Company Law?

(1) Agency Principles

The nature of the corporation as a legal fiction leads to the consequence that in all things it must act

through human agents. As a result, the question of the agent's authority will be an issue in all cases of corporate contracts and thus the principles of agency law as applied to corporations are important. The major difficulty is that there may be some irregularity in the appointment of the agent or his authority and it is at this point that the indoor management rule becomes important. According to the rule, the third party is allowed to rely on the internal procedures of the company as having been properly complied with. However, there are an infinite number of irregularities which could make the appointment or the delegation of authority defective such as an improperly convened general or board meeting, an improper number of people present to form a quorum, or a resolution not properly put or carried. It is therefore necessary that we examine briefly the types of internal procedures by which the rule will come into effect.

a) Actions by the Board Itself

Actions by the board of directors will usually come under the scope of actual authority. However, the indoor management rule applies so as to protect outsiders from the risk of internal irregularities on the board, such as a defect in the election of a director as occurred in the Alberta case of Oliver v. Elliot (1960) 30 WWR 649.

b) Actions by Delegated Representations

It is in this area that the principles of agency law come into play i.e. through representations made by the board of directors to agents or outsiders regarding the authority of its agents.

(i) The agent has actual authority.

Actual authority can derive directly from the board itself or can be delegated. The only requirement is that it be actual authority, although the courts have allowed this authority to be implied as well as expressed. Provided that everything appears to be normal, an outsider dealing with an agent with actual authority is entitled to assume that all internal regulations of the company have been complied with. However, if he has knowledge to the contrary or there are suspicious circumstances putting him on enquiry, the outsider cannot rely on that actual authority or make use of the indoor management rule.

(ii) The agent has usual authority

If the agent does not have actual authority he might have "usual" authority. Gower defines as the authority of "a particular type of officer who proports to exercise a power which that officer would usually have."[8]

Usual authority is in most cases necessarily implied rather than expressed. As defined by Prentice:[9]

> This "usual" authority arises because its implication is necessary to enable the agent to execute the mandate of his actual authority, or because commercial customs attribute certain powers to an agent which automatically flow from the fact that he carries on certain functions.

In determining what the usual authority is the court must examine not only the conduct of the principle but also it must attempt to determine what authority is attributed to

the agent by prevailing commercial practices.

The concept of usual authority is a flexible one because it enables the courts to exercise considerable control over the outcome of a case without appearing to do any great violence to the classification of the facts. This is due to the great number of factors which must be taken into consideration in determining what it is that constitutes usual authority in each case.

The indoor management rule operates in this way as regards usual authority:

An outsider is entitled to hold the company liable (i.e.assuming the internal procedures are correct) unless:

a) the outsider knows the agent has not been so appointed or has no actual authority

b) the circumstances are such as to put him on enquiry

c) the public documents make it clear that the officer has no actual authority (doctrine of constructive notice).

Refer back to section II A for a list of the four conditions which the outsider must fulfill to enable him to enforce the contract against an agent who has no actual authority but is relying on usual authority.

(iii) The agent has apparent authority

If the agent does not have actual or usual authority, he might still bind the company by way of "apparent or ostensible" authority. This kind of authority is necessarily implied. A corporation, by its conduct towards a third party, can create an apparent authority in an agent in terms of creating a relationship which exists between the principal and a third party where there has been an appearance of authority made apparent by the principal to the outsider, who, having relied upon it in making a contract, seeks to bind the principal to the contract.

Apparent authority was succinctly defined by Diplock J. in the case of Freeman and Lockyar:[10]

> An " apparent " or " ostensible " authority, on the other hand, is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted on by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the " apparent " authority, so as to render the principal liable to perform any obligations imposed on him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation. The representation, when acted on by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.

The major difference in determining the scope of the agent's apparent authority as compared to the usual authority is that the court has to interpret only the words

or conduct of the principal and not the commercial practice as is the case with usual authority.

In order to apply to the indoor management rule to apparent authority the same four requirements as noted in the last section are required.

(2) The Interplay of Constructive Notice and Ultra Vires and the Indoor Management Rule

a) Constructive Notice

The constructive notice doctrine paralleled the development of the indoor management rule and was designed to protect shareholders against liabilities that they had little opportunity to control. It is along with ultra vires, in effect, the balancing factor which protects the company in its dealings with third parties by narrowing the application of the apparent authority doctrine. The basic issue for our purposes is in determining the importance of knowledge of the "public documents" of a company.

For example, The Alberta Companies Act in Table A, Section 56 allows directors to delegate authority to one or more of their body to perform certain functions:

> The directors may from time to time appoint one or more of their body to the office of managing director or manager or any other office...as they may think fit; but his appointment shall be subject to determination at the pleasure of the directors.

We must now determine, whether an outsider may use the doctrine of constructive notice to rely on a delegation such as is found in section 56 or conversely whether the company is bound by section 56 in its dealings with outsiders. For the purposes of this section it will be assumed that both the doctrine of constructive notice and the doctrine of ultra vires are in full effect. In a later section the implications of earlier recommendations regarding constructive notice and ultra vires will be examined.

(i) Actual Authority

Knowledge is irrelevant in the area of actual authority so that an outsider who is unaware of the provisions in the public documents conferring power on the agent will still have an enforceable contract.

(ii) Usual Authority

Constructive notice is also irrelevant in cases where an agent has usual authority on account of his being held out by the company, that he has authority vested in the holder of such a position, and the public documents impose no specific restrictions on the agent's authority.

However, constructive notice does come into play in the usual authority situation when the public documents do contain a provision specifically limiting the usual

authority of the agent. In this situation, a company could get out of a transaction with a third party because the doctrine of constructive notice would operate negatively to limit the usual authority of the agent which the outsider could otherwise have relied upon.

(iii) Apparent Authority

If the public documents contain no limiting provisions and empower the company to confer authority onto the agent beyond the scope of his usual authority, the doctrine of constructive notice will not operate to curtail the agent's apparent authority. In the Freeman and Lockyar case, the court used the above argument and based it largely on an estoppel by the company in denying the truth of the representation:[11]

> "In this case the company has known of and acquiesced in the agent professing to act on its behalf, and thereby impliedly representing that he has the company's authority to do so. The company is considered to have made the representation, or caused it to be made, or at any rate to be responsible for it. Accordingly, as against the other contracting party, who has altered his position in reliance on the representation, the company is estopped from denying the truth of the representation.

If the public documents provide limitations of the agent's authority so that the agent will not have the required authority, but the company itself represents the agent as having the apparent authority beyond the scope of his usual authority and the outsider does not or ought not to have actual knowledge of the limitation--does the doctrine apply?

The authorities which exist indicate that the constructive notice doctrine would apply. It could perhaps be argued that the doctrine should be superseded by the representation made by the company and some type of estoppel should operate to prevent the company from binding the outsider. However, in the case of Rama Corporation Limited v. Proved Tin and General Investments Limited [1952] 1 E.R. 554 it was held that it was not possible to create an apparent authority "inconsistent with or beyond the articles of association." [12]

The doctrine of constructive notice does not work in the opposite direction, however, so as to benefit an outsider. Thus if an agent is operating beyond the scope of his usual and actual authority, but has apparent authority because the public documents actually empower the potential capacity to enter into the type of contract in question, the outsider would be unable to use the doctrine of constructive notice to argue that he is deemed to have knowledge of the public documents and thereby rely on them so as to constitute a representation by the company:[13]

> In my judgment I am bound by the decision of the Court of Appeal in 1927 in *Houghton & Co.* v. *Nothard, Lowe & Wills* (1) to hold that a person who, at the time of purporting to make a contract with a company registered under the Companies Acts, has no knowledge of the company's articles of association, cannot rely on those articles as conferring ostensible or apparent authority on the agent with whom he dealt, and by the same authority I am constrained to hold that the doctrine of constructive notice of a company's registered documents, such as its memorandum of association, its articles of association, its special resolutions, etc., does not operate against a company, but only in its favour. Put in the converse way, the doctrine of constructive notice operates against the person who has failed to inquire, but does not operate in his favour. There is no positive doctrine of constructive notice, it is a purely negative one. I am also bound by the same authority to hold that a person cannot set up an ostensible or apparent authority unless he relied on it in making the contract or supposed contract.

b) Ultra Vires and the Indoor Management Rule

The major influence of the doctrine of Ultra Vires in this area is in the area of capacity of the agent and capacity of the company. The power of the agent to bind the company will be subject to the ultra vires doctrine. The company will be unable to create an authority in its agent which is ultra vires the company, thus limiting the scope of corporate capacity in this area.

The doctrine does not, however, effect any modification of the doctrine of apparent authority generally applicable to the principal and agent relationship. It is a fundamental principle of estoppel that one cannot be estopped from denying an act that is beyond his legal capacity and since the doctrine of apparent authority is basically an expression of the rule of estoppel, it follows that the corporate principle will not be bound even though its agent has been given apparent authority to enter into a contract on its behalf. As well, the outsider cannot plead a misrepresentation as the foundation for apparent authority when the misrepresentation is contradicted by a statutory provision which he has deemed to know due to the operation of the doctrine of constructive notice.

III. Should the Indoor Management Rule Apply to Forgeries

A. Introduction

The debate as to whether the indoor management rule applies to cases of forgery has been a perplexing question for both the courts and the academics. It is far from resolved and there have been some very able propositions put forward on both sides. The basic problem facing the courts in this type of situation is whether the company as

principal is bound by a transaction entered into between the company and an outsider by way of a corporate agent who has either by forgery or counterfeiting completed a contract with a third party who is now relying on some aspect of the agent's authority, either apparent or usual, to bind the company to the contract. The issue boils down to determining which of two innocent parties--the company, or the outsider is to bear the loss. Once this basic decision is made, it seems that both the courts and the writers have been able to formulate sound legal arguments to support either point of view.

As the next section of this paper will recommend a codification of the indoor management rule, this section will set out briefly the various legal arguments on both sides of the forgery issue and then it will conclude with some recommendations as to whether the indoor management rule, in statutory form, should deal with forgeries.

B. The Current Case Law and Legal Approaches

The basic issue had its roots in a statement by Lord Lorburn in his judgement in Ruben v. The Great Fingall Consolidated when he said that the indoor management rule:[14]

> Applies only to irregularities that otherwise might affect a genuine transaction. It cannot apply to forgery.

In Kreditbank Cassel G.m.b. H. v. Schenkers Limited it was held that "the doctrine that you need not investigate whether or not the conditions regulating the internal management of the company have been strictly carried out in accordance with the articles has no application in the case of the document which is an obvious forgery."[15] On the other hand, the rule was in fact applied to forged instruments

in Turquands case itself and numerous others.[16]

Professor Gower is of the opinion that basically, forgeries do come under the indoor management rule and this view is reflected in the Ghana code. Section 142 (3) of the code, which deals with forgeries, is:[17]

> Intended to make it clear that a company cannot escape a liability for false documents if it has authorized the officer concerned to issue true ones and the officer has done so in circumstances showing that the he impliedly warrants that they are genuine.

He explains in his text that:[18]

> The truth seems to be that there are no reasons why the fact that there is a forgery should exclude the *Turquand* rule. All the decisions can be explained on the ground either that the forged document was not put forward as genuine by an official acting within his usual or apparent authority, or that the outsider was put on inquiry.

Gower's argument is based on a principle of 'estoppel', rather than the indoor management rule itself. It is settled law that if a company represents a document as genuine, it is later estopped from afterwards denying, as against the person who relied on its representation, that the instrument is genuine. Gower's "rule 6" seems to be based on this estoppel principle. As well, Gower expressly states that a mere forgery i.e. a secretary forging the name of the director, will not bind the company.

> *Rule 6. If a document purporting to be sealed by or signed on behalf of the company is proved to be a forgery, it does not bind the company.*[42] *But the company may be estopped from disclaiming the document as a forgery if it has been put forward as genuine by an officer acting within his actual, usual, or apparent authority, and if a transaction is binding on the company under the foregoing rules the company will be liable notwithstanding that the officer has acted fraudulently or commited forgery.*[43]

Thus in Gower's view, the indoor management rule can apply to a forgery, but to do so, requires the "forger" to be acting in his usual or apparent authority, and for the company to be representing this authority to the outsider.

It should be noted that there are at least two different types of "forgery" used in this context and the two different types will later become relevant within the scope of our discussion. The essence of forgery, for civil purposes, is the making of a false document with the intent that it shall be acted upon as genuine. Forgery is popularly thought of as the counterfeiting of seals and signatures. As well, forgery can also occur when a person signs his own name but as agent for a principal for whom he has no authority to act.

Another approach to the forgery issue is to argue that the indoor management rule cannot apply to a forgery, no matter what kind. The reasoning of one advocate of this theory is as follows:

> ...the question of forgery is not one of mere irregularity which might affect a genuine transaction without the operation of the indoor management rule...An instrument which is genuine, not only appears to be genuine, but also appears to be genuine because of representation made by the company. But the genuine appearance of a forged instrument is not due to representation by the company. An appearance of regularity made apparent by the company and consistent with constitutional limitations either actually or constructively known by the outsider must have been relied upon before the indoor management rule can be invoked. Accordingly, the rule can never be invoked in respect of a forged instrument.[20]

However, the author of the above statement argues that when a company represents a forged instrument as genuine, it will then be estopped from denying the forged instrument as anything but genuine. As well, if a company represents that the forger had authority to execute the forged instrument, the company will be bound. However, this approach is a very narrow one and one that would tend to operate only in limited circumstances. This approach has been greatly criticized by other writers in this area. Prentice writing in Ziegel's Studies in Canadian Company Law argued.[21]

> Although such an interpretation is feasible it would not accurately reflect the principles on which the judgments in these cases were grounded. To explain the forgery cases in terms of agency doctrines, as Thompson does, would entail that the company would seldom be liable for forgery where the forgery involved the counterfeiting of a signature. Only with respect to routine matters could the outsider safely infer the creation of an apparent authority in an agent to sign on behalf of another and the cautious would only be satisfied when there has been a direct representation that the document is genuine. The delegation of authority to sign on behalf of a senior officer, in a matter which is of commercial importance to the company, would be such as to put the outsider on notice.[113]

Campbell in his article argues that this approach mistakenly assumes that an instrument which is genuine apart from some irregularity is not a forgery. "But instruments signed by persons who had no actual authority from the company come within this description, and for reasons already given they are forgeries"[22] (note the earlier discussion on the types of forgery to which this discussion relates).

Another one of his criticisms of the above approach was:[23]

> (2) Forgery is not a question of the appearance of a document but of the presence or absence of authority for its being made. The appearance of the document is, no doubt, highly relevant, because if inspection would lead a reasonable person to doubt its authenticity the other party can no longer rely on the ostensible authority of the agent by whom it purports to have been made. But that is not a reason for denying the applicability of the indoor management rule, which is in all cases qualified by the condition that the outsider must not have been put upon inquiry. Moreover, it is misleading to say that an instrument which is genuine appears to be so because of representations by the company. If it is genuine its appearance is immaterial. If it is genuine and appears so, it is of no consequence whether that appearance was produced by the company or not. Its validity is not in the slightest degree related to any representation by the company that it is genuine, or to any action of the company giving it the appearance of being genuine.

The analysis that Campbell himself uses is based on the different types of forgery noted earlier in this section and he considers that there is a major distinction between those cases of forgery in which the person who executed the instrument purported to do so as an agent and those in which he did not. He argues that the indoor management rule cannot apply to a forgery if the forger was not purporting to act as an agent or to be exercising an authority vested in himself to bind the company. The forger in this instance lacks even the potential authority required. Thus, where a person executes an instrument on behalf of a company as its agent, though without actual authority, the rule is applicable notwithstanding the fact that the instrument is a forgery. As will be seen, this analysis is the one that has been accepted in the statutory codifications of the indoor management rule with regard to forgery.

Yet another approach to this problem has been to say that the indoor management rule applies to mere irregularities and informalities of procedure only. However, as noted above, the whole basis of the indoor management rule is to

invoke the rule where there is no actual authority to bind the company. If the forgery occurs within the scope of actual or apparent authority one might ask how one can overlook this kind of irregularity. As Campbell argues "forgeries cannot be excluded from the scope of the rule simply on the ground that the rule merely cures irregularities."[24]

Prentice envisions a slightly broader approach than Campbell in this area and argues that the indoor management rule should apply to protect the outsider from forgeries where the document is formerly correct and emanates from the appropriate corporate organ. As he explains:[25]

> This would differ from Campbell's thesis in that it would cover the category of forgeries involving counterfeiting, for example, where a director forges the signature of the secretary on a share certificate. It would also provide more extensive protection to the outsider than the apparent agency doctrine, as this doctrine, as was stated above, would have only limited application where the forgery was of a counterfeiting nature.

Thus, as can be seen, there are numerous approaches in dealing with this problem. There is, however, an irreconcilable conflict in the authorities no matter what approach one takes. This discussion does however raise two points for discussion with regards to possible reform of the law in this area:

(1) Should the indoor management rule apply to forgeries?
(2) How far should a statute go in protecting one of the two innocent parties involved?

(1) The current rationale for not applying the indoor management rule to forgeries as expressed in the Rubens case:[25]

> "This is one of the cases in which it is said that one of two innocent persons must suffer. . . . A company cannot protect itself against the frauds of its secretary, and if the company has to bear the burden of this loss, of course the loss placed upon companies will be very great, and they must guard against it, but certainly theoretically — I do not know whether it is quite the case practically — the transferee has a safeguard, he can always apply to the two directors whose names appear on the certificate and inquire from them whether those signatures are valid and genuine signatures or not."[114]

However the gist of modern authorities indicate a favorable response in altering the current law position by applying the indoor management rule to forgeries. Prentice's comments exemplify the current trends towards this problem:[26]

> The fact of the matter is that someone has to bear the loss, and it is not an adequate answer to state that the contractual liability of a principal for the acts of his agent within the latter's apparent authority is narrower than the principal's tortious liability for the agent's negligent acts perpetrated in the course of the agent's employment.[115] The question is whether or not different principles for determining the liability of the principal for tortious acts, as opposed to his contractual liability for unauthorized acts, should be maintained.[116]

In practical terms, it seems the loss can best be prevented by the company and the risk best borne by it. A corporation should be able to insure its agents to cover losses resulting from forgeries. As well, a corporation is in a better position to distribute the loss over society. It should be noted that if apprehended, the agent will be subject to disciplinary action within the company. When a person without authority signs a contract as agent for another, it is still open for the principal (the company) to ratify and adopt the contract. Even if the forgery amounted to a crime, subsequent ratification will not affect the criminal liability of the forger nor will it implicate the principal. It is established that there may be ratification of such a contract

(Bank of Ireland v. Evans' Charities) 1855 (5 H.L.Cas. 389, at page 414). It is therefore recommended that the indoor management rule be codified so as to apply to forgeries.

The current rationale is admittedly one designed to protect the interest of the company and its shareholders in preference to the interests of outsiders dealing with the company. The position of the company law committee in the related area of ultra vires has been to opt for protection of the third party in preference to that of the shareholder and to allow the shareholder to protect his investment through some kind of legal remedy. In order for there to be consistency in this area, an outsider should also be able to rely on the protection afforded him by the indoor management rule.

Thus, as Gower concludes, "the truth seems to be that there are no reasons why the fact that there is a forgery should exclude the Turquand rule." [27] Having therefore recommended its adoption, we must now examine how best to codify this and how other jurisdictions have dealt with the problem.

(2) We must now determine how far we want to take this position. Should the company be bound by all types of forgeries or should there be some restrictions on its applicability. This section will indicate some of the restrictions which might be implemented.

Nothwithstanding some schools of thought, it seems that the corporation should not be held liable for forgeries which are apparent or ought to be apparent to the prudent outsider. If the outsider should have realized that the agent was acting in an improper manner he should have been put on his suspicion and should not be able to rely on the indoor management rule.

Another possible restriction of the application of this rule relates to the area of authority. Should the company be held liable for mere counterfeiting, even when the forger has no usual or apparent authority? Admittedly, the reasons noted earlier--basically--that the corporation is in a better position to suffer the loss, would indicate that of the two innocent parties, the corporation should bear the brunt of the damage. However, both the Dickerson report (and the new Federal bill) and the Ghana code have adopted a more restrictive approach. They are willing to apply the indoor management rule in cases of forgery only if the person who executed the document purported to do so as an agent.

> **3.05**
> A corporation may not assert against a person dealing with the corporation or with someone who has acquired rights from the corporation that
>
> (e) an officer or agent of the corporation having authority to issue or to certify copies of a document on behalf of the corporation did not have authority to warrant the genuineness of the document and the accuracy of copies so issued,
>
> except where the person has or ought to have by virtue of his position with or relationship to the corporation knowledge to the contrary.

And his commentary:

> **85.** Section 3.05 is new, and is based upon s. 142 of the Draft Ghana Companies Code. The purpose of the section is to attempt a statutory statement of the effect of the so-called rule in *Royal British Bank* v. *Turquand.* In terms of that decision, a person dealing with a corporation is entitled to assume that its internal procedures have been properly complied with. If a person dealing with a corporation was bound to satisfy himself that all formalities required by the corporate constitution had been properly satisfied, the efficient conduct of business would be difficult, if not impossible. The policy of the decision in *Turquand's* case is to relieve the outsider of any obligation to enquire whether there has been due compliance with internal procedures, and that policy is embodied in this section.

The Federal Act

18. A corporation or a guarantor of an obligation of the corporation may not assert against a person dealing with the corporation or with any person who has acquired rights from the corporation that

(*e*) a document issued by any director, officer or agent of a corporation with actual or usual authority to issue the document is not valid or not genuine,

except where the person has or ought to have by virtue of his position with or relationship to the corporation knowledge to the contrary.

The Draft Ghana Code

142. Any person having dealings with a company or with someone deriving title under the ...any shall be entitled to make the following assumptions and the company and those deriving ...der it shall be estopped from denying their truth:—

(3) That the secretary of the company, and every other officer or agent of the company having authority to issue documents or certified copies of documents on behalf of the company has authority to warrant the genuineness of the documents or the accuracy of the copies so issued.

and the commentary:

12. Subsection (3) of section 142 is designed to modify the existing case law. The Courts ...ve displayed an unaccountable reluctance to hold a company liable when documents are ...ued by fraudulent officers.

Subsection (3) is intended to ...ake it clear that a company cannot escape liability for false documents if it has authorised ...r officer concerned to issue true ones and the officer has done so in circumstances showing ...at he impliedly warrants that they are genuine.

It is submitted that the distinction made in the above statutes is a reasonable one. It basically emulates the distinction formulated by Campbell noted earlier in this section. The rule should not apply to a forgery if the person who executed the document did not purport to act as an agent. If the company has represented that the forger has authority to execute the instrument, the company will then be estopped from setting up that it is a forgery so that the outsider will be protected in that way. If the person who actually signed the document or placed the corporate seal, appears himself in the role of an agent of the company, only then is there an act which might have been authorized and which under the indoor management rule may be presumed to have been authorized. But the rule should not apply to a forgery when the person who executed the contract imitated the signature of another and did not purport to be exercising an authority vested in himself to bind the company. He has no potential authority to counterfeit the signature of other persons.

Prentice's approach, noted earlier, would make the company liable as long as the forged document emanated from the "appropriate corporate organ".[29] He himself admits that this would cover areas where the forger was not acting as an agent but as a mere counterfeiter, which would in effect cover almost every case of forgery within a company. In this instance, Prentice argues that it is the company who, of the two parties, is in a better position to suffer the loss. However, his is purely a policy decision because Prentice's thesis cannot be supportable using the logic and the principles of agency law which underlie all the other facets of the indoor management rule. Thus, in attempting to protect the rights of the outsider, Prentice has adopted a broad approach, basically unsupported by the principles of law on which the indoor management rule is based, but effective in achieving his

desired purpose.

To summarize the issues:

(a) Should the indoor management rule apply to forgeries or should an outsider merely rely on the doctrine of estoppel?

(b) If the indoor management rule should apply to forgeries, should the application of the rule be restricted in the manner of the Canada Act and others noted earlier, or should the application of the rules be much wider, as Prentice argues, so as to apply in almost every situation?

IV. Conclusions and Recommendations

A. Effect of the Company Law Committee Recommendations on Ultra Vires and Proposed Recommendations on Constructive Notice.

The Company Law Committee recommended the total abolition of the doctrine of Ultra Vires so that a company has full capacity and powers of a natural person. A contract made between the company and a third party would be binding in all cases. Thus, the company will be able to create any authority in its agents and will no longer be hindered by problems of capacity which were noted as a restriction to corporate capacity in Section II D Part (ii).

As well, in their discussions on Ultra Vires and other related areas, the committee seemed to adopt an approach which to a large extent placed the rights of the innocent third party contractor ahead of the shareholder in terms of upholding the transaction rather than allowing the shareholder to bring an action to avoid them and preferred to allow the shareholder to garner his protection by way of some kind of statutory remedy. The recommendations in this report regarding

the indoor management rule will be consistent with the approach enumerated above.

In a second paper on these inter-related areas it was recommended that the doctrine of constructive notice be abolished. As we have noted earlier, the constructive notice doctrine is intricately tied in with the indoor management rule, and elimination of it will lead to some changes in the current law. Presently, the authority indicate that if the public documents provide limitations on the authority of the agent and the company itself represents the agent as having the apparent authority, the constructive notice doctrine applies to prevent the third party from relying on the company's representation (see Rama Corporation case). With the proposed changes, a third party would in these circumstances be able to bind the company.

Constructive notice also comes into effect in the area of usual authority where the public documents contain a provision specifically limiting the usual authority of the agent. The doctrine operates negatively to limit the usual authority of the agent which the outsider could otherwise have relied on. Again, the abolition of the doctrine would remove that hurdle from the third party.

By abolishing the doctrine of constructive notice, an inequity in the law will be overcome whereby the third party will no longer be estopped from using the constructive notice doctrine to his advantage. Currently, as exemplified by the Rama case, the third party cannot use the doctrine of constructive notice positively so as to be able to deem itself with knowledge of the public documents in order to bind the corporation. However, the corporation can use the doctrine of constructive notice in its favor in cases where the knowledge of the public documents could allow the corporation to

escape from a transaction with an outsider.

The net effect of the constructive notice recommendations will be to provide more protection for third parties who have dealt with the company, allow for smoother business transactions and remove an impractical, expensive procedure which is unrealistic in today's commercial society.

B. Recommendations

As noted earlier, the purpose of the indoor management rule is basically to facilitate smoother and more efficient corporate transactions. The corporation, operating through its agents, are in a position to both regulate the apparent or usual authorities delegated to their directors, and to better bear the loss in a case where the agent has exceeded his authority. Consistency as well is an important consideration and earlier decisionsby the company law commitee have indicated an approach which favors the protection of the third party dealing with the company by attempting in most cases to preserve the contract and allowing the shareholders to protect themselves against the company through the use of a statutory remedy. The recommendations of this paper will attempt to remain consistent with the above rationale and approaches. It is recommended that the indoor management rule be codified for inclusion in the new Alberta Companies Act.

At this point it will be useful to examine the approaches to codification of the indoor management rule as found in other jurisdictions--notably the Federal Act and the Draft Ghana Code, both of which are very similar. It should be noted that although it was recommended by the legal profession in British Columbia,[29] the new British Columbia Companies Act does contain a codification of the indoor management rule, nor does the Ontario Business Corporation Act.

Draft Ghana Code

142. Any person having dealings with a company or with someone deriving title under the company shall be entitled to make the following assumptions and the company and those deriving title under it shall be estopped from denying their truth:—

(1) That the company's Regulations have been duly complied with.

(2) That every person described in the particulars filed with the Registrar pursuant to sections 27 and 197 of this Code as a director, managing director or secretary of the company, or represented by the company, acting through its members in general meeting, board of directors, or managing director, as an officer or agent of the company, has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by a director, managing director, or secretary of a company carrying on business of the type carried on by the company or customarily exercised or performed by an officer or agent of the type concerned.

(3) That the secretary of the company, and every other officer or agent of the company having authority to issue documents or certified copies of documents on behalf of the company has authority to warrant the genuineness of the documents or the accuracy of the copies so issued.

(4) That a document has been duly sealed by the company if it bears what purports to be the seal of the company attested by what purport to be the signatures of two persons who, in accordance with paragraph (2) of this section, can be assumed to be a director and the secretary of the company:

Provided that:

(a) a person shall not be entitled to make such assumptions as aforesaid if he had actual knowledge to the contrary or if, having regard to his position with or relationship to the company, he ought to have known the contrary;

(b) a person shall not be entitled to assume that any one or more of the directors of the company have been appointed to act as a committee of the board of directors or that an officer or agent of the company has the company's authority merely because the company's Regulations provide that authority to act in the matter may be delegated to a committee or to an officer or agent.

In section 142, Gower has tried to restate the indoor management rule in a clear form and to "strip it of some of the refinements which have tended to whittle away the protection which it affords to bona fide third parties."[30]

Section 142 (1) merely restates the current law, while section 142 (2) emphasises another particular aspect of the rule in that even if improperly appointed (either defective or non-existent appointment), if the proper authority exists (usual or ostensible) then the outsider is protected (Mahoney v. East Holyford Mining Company) 1875 (L.R. 7 H.L.

869 H.L.). This sub-section also lays down that officers of the company can be assumed to have the usual powers and duties of that sort of officer.

Section 142 (3) appears to be designed to cover the area of "apparent" authority which as we have seen occurs when the company holds out an individual as having certain authority. However, the wording of this section is narrow and can be confusing. As noted earlier, section 142 (3) is also the section used to apply the indoor management rule to forgery. It is submitted that two different sections to cover the two separate covers would be a better way of handling this. As well, apparent authority can encompass more than the mere issuing of documents and any attempt to codify apparent authority should be broader in scope than section 142 (3).

Section 142 (4) deals with the particular situation and is based on section 74 of the English Law of Property Act (1925). It entitles any person to assume that any corporate documents have been duly sealed if it purports to bear the company's seal or signature.

Section 14 (a) contains one of two provisos utilized by Gower and removes the protection from those who knew or ought to have known of the absence of authority.

Section 14 (b) is intended to deal with portions of the "public documents" such as section 56 of Table A regarding the power of the Board of Directors to delegate authority. Section 14 (b) makes it clear that no one is allowed to assume under the indoor management rule that there has been an appointment or delegation to a committee merely because the articles or regulations contain such a power. Thus, even if the outsider knew of the provision for delegation he cannot assume that it has been exercised. He will have to satisfy himself that a

delegation of authority has in fact been made. This position seems to follow from the above recommendations in that the indoor management rule is based on either the usual authority exercised by the agent, an apparent authority as represented by the company or an actual authority as is known to the third party. Thus there is in effect, no legal reason for the outsider to rely on this section in order to bind the company unless it is based on one of the above-mentioned forms of authority.

The Dickerson Report

3.05

A corporation may not assert against a person dealing with the corporation or with someone who has acquired rights from the corporation that

(a) the articles, by-laws and any unanimous shareholder agreement have not been complied with,

(b) the persons named in the most recent notice sent to the Registrar under section 9.05 or 9.12 are not the directors of the corporation,

(c) the place named in the most recent notice sent to the Registrar under section 4.01 is not the registered office of the corporation,

(d) a person held out by a corporation as an officer or agent of the corporation has not been duly appointed or has no authority to exercise the powers and perform the duties that are customary in the business of the corporation or usual for such officer or agent, and

(e) an officer or agent of the corporation having authority to issue or to certify copies of a document on behalf of the corporation did not have authority to warrant the genuineness of the document and the accuracy of copies so issued,

except where the person has or ought to have by virtue of his position with or relationship to the corporation knowledge to the contrary.

The Canada Business Corporations Act

18. A corporation or a guarantor of an obligation of the corporation may not assert against a person dealing with the corporation or with any person who has acquired rights from the corporation that

(*a*) the articles, by-laws and any unanimous shareholder agreement have not been complied with,

(*b*) the persons named in the most recent notice sent to the Director under section 101 or 108 are not the directors of the corporation,

(*c*) the place named in the most recent notice sent to the Director under section 19 is not the registered office of the corporation,

(*d*) a person held out by a corporation as a director, an officer or an agent of the corporation has not been duly appointed or has no authority to exercise the powers and perform the duties that are customary in the business of the corporation or usual for such director, officer or agent,

(*e*) a document issued by any director, officer or agent of a corporation with actual or usual authority to issue the document is not valid or not genuine, or

(*f*) financial assistance referred to in section 42 or a sale, lease or exchange of property referred to in subsection 183(2) was not authorized,

except where the person has or ought to have by virtue of his position with or relationship to the corporation knowledge to the contrary.

Dickerson credits his approach towards the indoor management rule to Gower and the Draft Ghana Code. Section 3.05 (a) (now section 18 (a) of the Act) restates the basic indoor management rule. Sub-sections (b) (c) and (f) deal with very specialized situations and need not be analyzed in-depth as they are self-explanatory. Sub-section (d) covers both the areas of usual authority and apparent authority but as in the Ghana Code, the language of the sub-section is confusing. Usual authority is based on more than a mere "holding out" by the company yet section 18 (d) makes it appear

that usual authority and apparent authority are both based on the same criteria which as we have seen earlier, they are most definitely not. Thus, for purposes of clarification, it would be better to codify the notion of apparent and usual authority into two separate sections.

Section 18 (e) deals with forgery and has been discussed in the last section. Note that there are differences in the wording between section 3.05 (e) of the Dickerson Report and section 18 (e) of the Federal Act, but the basic approach of both sections is the same.

The Dickerson Report and the new Federal Act both contain the proviso similar to section 143 (a) of the Ghana Code regarding the knowledge requirement--"has or ought to have by virtue of his position...knowledge to the contrary." As well, Dickerson's commentary emphasises that the section was drafted to make it clear that "anyone" is entitled to the protection of the indoor management rule. The Dickerson Report does not, however, contain a proviso similar to 143 (b) of the Ghana Report regarding delegation. The existing case law, in Kreditbank Cassel v. Schenkers [1927] 1 K.B. at 844 favors Gower's codification although it has been argued that if the third party actually knows of the provision, he is entitled to assume that it has been exercised. It is recommended that a codification of the indoor management rule contain a proviso similar to that found in section 143 (b) of the Ghana Act. However, it should also be noted that if the recommendations regarding changes to the doctrine of constructive notice are adopted, then the proviso will become much less important than is currently the case. This will be so because the doctrine of constructive notice will not operate to deem either the company or the third party with knowledge of the public documents.

Thus the approaches of both the Draft Ghana Code and the new Federal Act favor a codification of the indoor management rule which will have the effect of increasing the protection of outsiders dealing with the company. It should be noted that neither of the two statutes do anything but attempt to codify and clarify the existing law, except in the area of forgery. On the whole, the current common law position, although admittedly very confused, does provide the required protection for the outsider and it is therefore recommended that, like the Federal Act, the indoor management rule be codified in the new Alberta Companies Act. However, the actual drafting of the Federal Act and the Ghana Code, as noted earlier, tends to be confusing and when the rule is codified in Alberta it should be drafted in such a way as to reflect the differences of usual and apparent authority. As well, whatever decision is made regarding the application of the rule to forgery, it should be detailed in a separate subsection. Finally, it is recommended that the two provisos noted in the Ghana code 14 (a) and 14 (b) be incorporated into the Alberta Act, so as to ensure that the application of the indoor management rule continues to be based on the principles of agency law and does not become a catch-all device by which third party protection is given at the cost of severe limitations on the protection of the corporation itself.

It should be noted that both the Canada Act and the Draft Ghana Code contain sub-sections dealing with specific topics under the indoor management rule. (For examples, see section 18 (b) and section 18 (c) of the Canada Act). Dickerson's commentary does not explain the reasoning behind this and it does seem strange that the specified items, both of which seem to fall under the general ambit of the rule at any rate, should be given this attention. Thus, unless good reason can be found for individually specifying certain phases of indoor management

rule in statutory form, it is perhaps best in the interests of simplification of this area of the law, to consider codification of the indoor management rule by means of more general statements such as in section 18 (a) of the Canada Act or section 142 (2) of the Ghana Code. However, as noted earlier, any codification of the indoor management rule should be detailed to specify the various forms of authority to which the rule applies.

To summarize the issues:

(1) Should the indoor management rule be codified?

(2) If yes, should the approach be similar to that as found in the Canada Act and the Draft Ghana Code, i.e. based on the principles of Agency Law?

(3) What provisos should there be to provide limitations on the application of the indoor management rule?

FOOTNOTES

1. Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana. See commentary to section 143--paragraph 1 page 109.

2. (1895) 25 O.R. 305.

3. A. R. Thompson, Company Law Doctrines and Authority to Contract (1955-56) 11 U of T LJ 248 at page 257.

4. [1964] 2 Q.B. 480 at page 505.

5. Supra, note 3 at page 282.

5a. L. C. B. Gower, The Principles of Modern Company Law (3rd ed.) at page 153.

6. See Hely-Hutchinson V. Brayhead Ltd. [1967] 1 Q.B. 549 (C.A.) per Roskill J. at page 567.

7. Supra note 6 at page 156.

8. Ibid. at page 175.

9. Daniel D. Prentice. The Indoor Management Rule, Canadian Company Law, Ziegel (ed.) 1967, page 314.

10. See page 630.

11. Ibid. page 498 per Pearson L. J.

12. Rama Corporation Limited v. Proved Tin and General Investment Limited [1952] 1 All E.R. 554 at page 566.

13. Ibid. page 556 per Slade J.

14. [1906] A.C. 439 at 443.

15. [1917] 1 K.B. 826 at page 844.

16. See the list in I. D. Campbell's, Contracts with Companies [1960] 76 L.Q.R. at page 131.

17. Commentary to section 142 (3) of the Draft Ghana Code at page 111 paragraph 12.

18. Supra, note 6 at page 168.

19. Ibid., at page 167.

20. Supra, note 3 at page 274.

21. Supra, note 10 at page 338.

22. Supra, note 17 at page 135.

23. Ibid., at page 134.

24. Ibid., at page 134.

25. Supra, note 15 at page 447.

26. Supra, note 10 at page 339.

27. Supra, note 19 at page 168.

28. Supra, note 10 at page 340.

29. Comments on Proposed B. C. Companies Act, The Corporate Legislation Committee of the Canadian Bar Association, October 1972 at page 16.

30. Supra, note 1, at page 112.

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1. Campbell I. D. Contracts with Companies II - The Indoor Management Rule [1960] 76 L.Q.R. page 115.

2. Corporate Legislative Committee of the Canadian Bar Association, B. C. Branch, Comments on Proposed B. C. Companies Act, October 1972.

3. Dickerson R. W. et al, Proposals for a New Business Corporation Law for Canada, Vols. I and II, Ottawa 1971

4. Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana, (L. C. B. Gower Commissioner, 1961).

5. Gower, L. C. B. The Principles of Modern Company Law (3rd edition).

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7. Thompson, Andrew R., Company Law Doctrines and Authority to Contract (1955-56) 11 U of T L.J. page 248.