FINANCIAL LAW
— PANEL —

- Legal uncertainties in fund management -

- A Private Paper -
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AGENCY/UNDISCLOSED PRINCIPAL

LEGAL UNCERTAINTIES IN FUND MANAGEMENT

The Financial Law Panel has been asked by subscriber firms to consider problems of agents and their principals and their dealings with third parties in the financial markets. The specific problem relates to banks and securities houses who are entering into large transactions with fund managers in securities, FX or derivatives. The fund managers see themselves, of course, as agents for their clients, who alone should bear the risks of transactions effected for them, and who alone should be liable to the market counterparties of their fund managers. However, the fund managers may not wish to reveal the identity of their clients for a variety of reasons which are considered later.

The result is that fund managers frequently contract on terms which try to make it clear that they incur no personal liability, but which do not identify a responsible client, in relation to whom the counterparty can take a prudent, informed credit decision.

It is not the concern of the FLP to address the question of how risk should be allocated. It is for market forces to decide. Nor is it our role to look at the consequences of the markets' allocation of commercial risk. That is the province of the regulators, who must decide on the appropriate level of capital required by businesses to support the risks they bear.

Rather, our purpose is to look at some of the more common relationships in this market, and to analyse where the legal risks lie, and to suggest ways in which uncertainties might be clarified and the risks, perhaps, be reduced.

This paper has been set out in the following parts:-
Part I  Commercial Issues;
Part II  SFA and IMRO Implications;
Part III Money Laundering;
Part IV Application of Agency Law to Particular Scenarios; and
Part V Conclusion.

Additionally, a separate paper has been drafted (the "Law of Agency Paper") which provides an analysis of agency law relating to this area. That paper is intended to provide the technical background for many of the analytical conclusions found here.
PART I: COMMERCIAL ISSUES

The commercial issues surrounding this problem are, in no particular order, as follows:-

1 From the viewpoint of the bank or securities house concerned, the following issues are relevant:-

1.1 the bank/securities house\(^1\) is not in a position to carry out a credit assessment of the counterparty (being the unnamed or undisclosed principal);

1.2 the bank cannot know whether the transaction is ultra vires the principal;

1.3 the bank will not be able to ascertain whether the principal has the correct authorisations under the rules of SFA;

1.4 the bank may have difficulties in complying with its obligations under the Money Laundering Regulations.

2 From the fund manager's viewpoint, however, the following issues may be relevant:-

2.1 for commercial purposes, the fund manager may be loathe to disclose the client's identity because it fears the bank concerned (which is part of an integrated house) might poach the client;

2.2 the fund manager may, particularly in OTC transactions, place a block order for securities or

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\(^1\) From now on, the term bank will be used to denote both banks and securities houses.
foreign exchange and will be able to allocate to particular funds only after the transaction has been effected;

2.3 in a similar way to 2.2 above, the transaction may have been an aggregated transaction although there may have been an allocation between individual funds, which pre-dates the placing of the order, but where the allocation is not notified to the bank.

3 The London Code of Conduct (issued by the Bank of England for the guidance of principals and broking firms in the wholesale markets) states, at paragraph 47, as follows:

Know Your Customer

"Principals (and brokers) need to 'know their customer' in order to help combat the use of the wholesale markets for money laundering. It is also an essential part of the process for proper assessment of creditworthiness.

There has been a growing trend towards discretionary management companies dealing in wholesale market products on behalf of their clients. For understandable reasons, the fund manager may not wish to divulge the name of the client(s) when concluding such deals. However, this practice does raise considerations - both in terms of assessing their credit risk and in meeting their money laundering prevention obligations - which principals need to address most carefully before being prepared to transact business on this basis. Senior management should decide, as a matter of policy, whether to undertake such business. In doing so, they should consider all the risks involved and fully document the decision which they reach".
Whilst this paragraph has been superseded by the Money Laundering Regulations, it still serves as a useful history of these issues.
PART II: SFA AND IMRO IMPLICATIONS

The bank will probably be a member of SFA, where the transactions concerned amount to "investment business". The applicable SFA rules in this regard are as follows:-

Rule 5-6 of the SFA Conduct of Business Rules provides:-

5-6(1) Where an agent identifies his principal to a firm, the identified principal will be an indirect customer of the firm unless there is an agreement in writing between the firm and the agent to the contrary.

5-6(2) Where the firm and the agent have agreed in writing that only the agent is to be the customer of the firm, then the identified principal will not be an indirect customer.

Accordingly, where the fund manager identifies his principal to the bank, then the principal will be treated as an indirect customer and the bank will have obligations to the indirect customer pursuant to the Conduct of Business Rules unless there is an agreement to the contrary.

The definition of an "indirect customer" is:-

"means, where a customer is known to be acting as agent, an identified principal who would be a customer if he were dealt with direct".

Therefore, the definition of indirect customer only includes those principals who have been identified.

Accordingly the SFA Rules avoid placing the bank in the invidious position where there was a strict parallel with the rules of agency.
The bank will clearly have to have sufficient capital in respect of each transaction, the amount of which will be determined with regard to the SFA Financial Rules.

The fund manager will, in all probability be an IMRO member.

IMRO capital requirements are based on a calculation which focuses on the expenditure side of the Member’s Profit and Loss Account. This assumes that the Member is not incurring or bearing liabilities as principal on transactions which need the support of capital.

While this is no doubt satisfactory at the moment, the position may change when the Capital Adequacy Directive is implemented (sometime before the end of 1995). Although it is not possible to make clear predictions of the exact operation of the Directive, until the form of implementation is settled, one principle is clear.

The Directive applies precise criteria to the calculation of risk on each item, and such criteria will not fit well where the legal position is uncertain. Therefore, it is all the more important that the legal ramifications of transactions entered into by counterparties, fund managers, and their clients, are clear and that the liabilities of each can be accurately determined.
PART III: MONEY LAUNDERING

A Statement of Principles was issued by the Basle Committee on Banking Regulations and Supervisory Practices in December 1988. This Statement is a general statement of the ethical principles which should encourage banks to put in place effective procedures to ensure that all persons conducting business with their institutions are properly identified; that transactions that do not appear legitimate are discouraged; and that co-operation with law enforcement agencies is achieved.

The Statement includes a principle that with a view to ensuring that the financial system is not used as a channel for criminal funds, banks should make reasonable efforts to determine the true identity of all customers requesting the institution's services. The Statement also says that it should be an explicit policy that significant business transactions will not be concluded with customers who fail to provide evidence of their identity.

The Bank of England circulated the Basle Statement of Principles to all authorised institutions and further reminded such institutions in November 1989.

Additionally, there are new Money Laundering Regulations, which came into force on 1 April 1994. The Regulations require financial institutions to put in place systems to deter money laundering and to assist relevant authorities to detect money laundering activities. Under the regulations, no person shall, in the course of relevant financial business, form any business relationship or carry out a one-off transaction with or for another unless that person:

(i) maintains procedures in accordance with the regulations established in relation to that party as to identification, record keeping, general reporting and internal control and communication.
(ii) takes appropriate measures for the employees to be aware of such procedures; and

(iii) provides training for the employees.

The Regulations also make provision for situations where one party acts as agent for another. In effect, and subject to certain exemptions (the most important of which is discussed below), the person concerned must require reasonable measures to be taken for the purpose of establishing the identity of any person on whose behalf the applicant for business is acting.

In determining what constitutes reasonable measures, the Regulations provide that regard shall be had to all the circumstances of the case, and, in particular, to best practice which, for the time being, is followed in the relevant field of business and which is applicable in those circumstances.

Furthermore, if certain conditions are satisfied, (being that in relation to the transaction there are reasonable grounds for believing that the applicant for business -

(a) acts in the course of a business in relation to which an overseas regulatory authority exercises regulatory functions; and

(b) is based or incorporated in, or formed under law of any country other than a member state in which there are in force provisions equivalent to the Money Laundering Directive)

then in relation to the applicant for business who is acting as agent, it is reasonable for the person to accept the written assurance from the applicant to the effect that evidence of the identity of any principal will have been obtained and recorded under the procedures followed by the applicant for business.
The most important exemption to the identification procedures laid down in the Money Laundering Regulations is if there are reasonable grounds for believing that the applicant for business is covered by the Money Laundering Regulations.
PART IV: APPLICATION OF AGENCY LAW TO PARTICULAR SCENARIOS

As has been noted previously in Part I "Commercial Issues", the contract, entered into by the fund manager (expressly as agent) with the third party bank, may in fact have been entered into before any allocation of securities or foreign exchange has been made by the fund manager between its managed funds, i.e., the allocation will only take place at the end of the day, after the contract has been entered into and after the bank has processed its confirmation note. In such a case, the purported allocation by the fund manager between the various funds, after the contract has been entered into and the confirmation note processed, will not be effective to alter the contractual liability of the parties (being the bank, the fund manager and its various funds), unless the bank knows of, and consents to the replacement of the original contract by a series of new ones, or agrees to the assignment of the original contract to the several funds.

Therefore, as market practice is such that allocation of a block order may well not take place until after the contract has been entered into between the fund manager and the bank, and the bank has not consented to any variation or assignment of the contract made between it and the fund manager, it is necessary to consider whether or not contractual relations have been formed between the bank and each of the funds for the proportion of stock or foreign exchange which has subsequently been allocated to them.

This is one of the factual situations which seems to arise often in practice (although among the more institutional fund managers, whose individual clients tend to be much larger, the situation seems much less common). There are others, where the legal rights and obligations of the parties are equally difficult to identify. The only way to address the problem is to consider the rights and liabilities of each of the parties in various factual scenarios. This
section of the paper consists of a legal analysis of each of the following situations:

(a) the fund manager executes the block transaction with the bank for securities and/or foreign exchange, informing that bank that is acting only as agent, but at the time the contract is made, no allocation has taken place between the several funds under the fund manager’s control.

(b) a foreign "universal" bank executes a large transaction with a third party bank for securities and/or foreign exchange, without the third party bank being aware that the purchasing bank is acting as fund manager for various principals.

(c) the fund manager writes to the bank informing them, correctly, that it is acting on behalf of a single known principal, but will not disclose the identity of the principal.

(d) the fund manager (acting for a single undisclosed principal) enters into a transaction with a bank and the bank is not aware of the identity of, or the existence of, the principal.

(e) the fund manager enters into a transaction with the bank without disclosing whether he is acting on his own behalf or on behalf of a principal (and the bank has dealt on both bases before) and the bank is therefore not aware of which basis the fund manager contracts, although the entirety of securities/foreign exchange are to be for the account of either the fund manager or a single principal.

(f) the fund manager enters into a transaction with the bank without disclosing whether he is acting on his own behalf or on behalf of one or more principals (and the bank has dealt on both bases before) and the bank is therefore not aware of which basis the fund manager contracts, although in fact, the fund
manager is acting for several principals (although at the time of the contract no allocation has been made).

The fund manager executes a block transaction with the bank for securities and/or foreign exchange, informing the bank that it is acting only as agent, but at the time the contract is made, no allocation has taken place between the several funds under the fund manager's control.

In this example, A Ltd (the fund manager) telephones B Plc (the bank/securities house) and states that it wishes to purchase 1,000,000 shares in Z Plc, stating as it does so that it is acting as agent. The transaction is effected and B Plc processes a confirmation notice for 1,000,000 Z Plc shares sold to A Ltd. Later that day, A Ltd proceeds to allocate the 1,000,000 Z Plc shares between 10 funds, which, for simplicity, are each allocated 100,000 shares.

In analysing this situation the position of both the funds and the fund manager must be considered.

1 The Funds

The contract, purportedly between B Plc and A Ltd as agent, is for 1,000,000 Z Plc shares as evidenced by the confirmation note issued by B Plc.

In order for the funds to be liable on the contract, the agent would have to ensure that contractual relations have been established between each of the ten funds and B Plc. However, at the time the transaction was effected, the ten funds had not been allocated their share of Z Plc shares. As this has not occurred, are the funds in a contractual relationship with B Plc?

(i) At the time the transaction was entered into, the allocation had not taken place, therefore, it appears
that the individual funds have not been brought into contractual relations with B Plc at that time.

(ii) Can the funds be brought into contractual privity by ratifying the transaction? The transaction is for 1,000,000 Z Plc shares. A principal can only adopt or reject the transaction in toto and therefore, the funds cannot each ratify the transaction for 100,000 shares each. (Had the agent however effected ten separate transactions for 100,000 shares it may have been possible, subject the following paragraph, for each fund to have ratified a separate contract.) However, as it is unlikely that separate contracts had been entered into, it is not possible for the funds to ratify the transaction.

Additionally, as discussed more fully in the Law of Agency Paper, there is some difficulty surrounding ratification of contracts by unnamed principals and whether the unnamed principal can in fact ratify the contract. However, in this scenario, this would be of importance only if the agent had effected ten separate contracts.

(iii) If the funds cannot ratify the transaction, can the funds be brought into contractual privity with B Plc by A Ltd novating the contract with B Plc? Again, it appears the answer must be no, as the consent of all parties to the transaction must be obtained for a novation. The result of a novation is that a new contract is formed which is not an assignment or transfer of liability. Therefore, a novation would take effect as extinguishing the original contract and replacing it with a new contract. Furthermore, for this to occur consideration must be provided for the
new contract. However, without the consent of the bank a novation of the contract cannot occur.

(iv) Will the allocation of the Z Plc shares by A Ltd constitute an assignment of the contract to the various funds? Although it might be said that the allocation constituted an equitable assignment of the benefit of the contract, as the shares have not yet been paid for, the burden of the contract, ie the payment obligation, cannot be transferred so as to discharge A Ltd without the consent of B Plc.

It appears from the above analysis that the effect of this scenario may be that the funds are not brought into contractual privity with B Plc and are not therefore bound to settle with B Plc and cannot be sued by B Plc. If for example, nine of the funds and A Ltd, the fund manager, all became insolvent simultaneously, B Plc could not enforce the contract for the sale and purchase of 1,000,000 Z Plc shares against the remaining fund nor, it appears, could it enforce it as to 100,000 Z Plc shares.

2 The Agent

Therefore, on the basis of the contract is not enforceable against the funds, it is necessary to consider what, if any, is the liability of the agent, A Ltd. In the event that settlement does not occur, B Plc would consider pursuing the following causes of action against A Ltd:

(i) B Plc would allege that A Ltd is liable to B Plc on the basis that the agent is personally liable on the contract. The situations whereby an agent may be liable are discussed under scenario (C) of this paper and also in the Law of Agency Paper. Whilst no general rules have been formulated, B Plc would seek
to show that A Ltd is liable to it on the basis that A Ltd has not made any contract binding on the funds, that A Ltd had made the contract in his own name thereby, incurring personal liability, or that A Ltd has incurred personal liability in other circumstances ie by virtue of a trade custom or on the ground that A Ltd was liable to perform the contract as well. A Ltd position vis-a-vis its funds would be unchanged. However, these arguments may be difficult to assert with any authority where A Ltd expressly stated that he enters into the contract as agent.

In the event that B Plc may not be able to find A Ltd personally liable on the contract, B Plc may allege that A Ltd was liable to it on a collateral contract to the main contract.

(ii) An action against A Ltd for breach of warranty of authority. B Plc may seek to bring an action for breach of warranty of authority against A Ltd. The warranty is that the agent has authority from its principal. The warranty is classified as contractual. Furthermore, the contract is usually unilateral, ie the agent offers to warrant his authority in exchange for the third party entering into a contract with the principal or otherwise acting as requested, and the offer being accepted by the third party acting accordingly. It is acknowledged that difficulties arise where the cause of the lack of authority is that there was no principal at the time of the contract. However, the situation is complicated further where A Ltd is a discretionary fund manager, because in such a case he may have the authority from the funds themselves to purchase 100,000 Z Plc shares, or perhaps more, perhaps even to the total amount of Z Plc shares purchased. However, at the time the
contract was effected, A Ltd had not identified which funds were going to be allocated with Z Plc shares, although A Ltd had represented to B Plc that he was acting as agent. Accordingly, B Plc may seek to endeavour to sue A Ltd on this ground, perhaps in tandem with other grounds.

(iii) B Plc may seek to hold A Ltd liable at common law on the rule, expounded by Bowstead, which provides that "where a person professes to contract on behalf of a principal, and the principal is a fictitious and non-existent person, the person so professing to contract may sometimes be regarded as having contracted personally". The cases in this area are usually based upon companies not yet formed or unincorporated associations. However, in our example where A Ltd expressly stated that it was acting as agent, it cannot be held to have contracted personally under this rule. It appears that the basis of A Ltd's liability should be for breach of warranty of authority. However, some of the difficulties of proving the liability of A Ltd on that ground have already been discussed.

(iv) B Plc may seek to assert that the agent was in fact principal and accordingly, that the agent should be liable on the contract. The Law of Agency Paper discusses the position where the agent is shown to be the real principal. However, B Plc may have little success in seeking to hold A Ltd personally liable on this ground as A Ltd has expressly stated that it is acting only as agent.

(v) B Plc may bring an action against A Ltd on the ground that an agent is personally liable for his own torts. The agent may incur liability:
in deceit, where he deliberately misrepresents his authority; or

for negligent misrepresentation. This could either arise under Section 2(1) of the Misrepresentation Act 1967 (this is however confined to representations made by a party to the contract, and does not cover misrepresentations by their agent unless the agent is a party to the contract. It will depend on the facts of each case as to whether the agent is a party to the contract).

The agent may however be liable at common law for negligent misrepresentation quite apart from liability under Section 2(1).

Accordingly, provided that B Plc can satisfy the components of a misrepresentation, A Ltd may be liable to B Plc by reason of such misrepresentation, the misrepresentation being that he was acting as agent when at the time the contract was made, he had not himself identified or allocated the Z Plc shares to the relevant principals. Accordingly, he could be found to be liable to B Plc under this head.

Summary

Therefore it appears that the funds themselves may not be liable on the contract although the fund manager, A Ltd, may be liable to B Plc on the grounds of either misrepresentation, or alternatively some form of breach of warranty of authority. Furthermore, A Ltd is stating that it is contracting only as agent, and the reason for so stating is to avoid incurring personal liability on the contract, but in fact there is no principal, in the event that settlement does not occur there
is a concern that this may give rise to an allegation of fraud on the part of the fund manager.

A foreign bank executes a large transaction with a third party bank for securities and/or foreign exchange, without the third party bank being aware that the purchasing bank is acting as fund manager for various principals.

In this scenario ABC Ag a foreign bank telephones B Plc and states that it wishes to purchase 5,000,000 shares in 123 Plc. ABC Ag does not inform B Plc that it is acting as agent; the contract is effected and B Plc issues a contract note to ABC Ag in respect of the 5,000,000 123 Plc shares. Unbeknown to B Plc, ABC Ag is, in fact, acting as a fund manager for funds under its discretionary management, but, as with A Ltd, ABC Ag only undertakes an allocation at the close of the day. As it happens ABC Ag allocates the shares as to 1,000,000 for each of five funds under its control.

The rights and liabilities of each of the parties in relation to this transaction appear to be as follows:

1 The Funds

As discussed in greater depth in the Law of Agency Paper, an undisclosed principal may, in some situations, sue or be sued on any contract made on his behalf, by his agent acting within the scope of his actual authority. However, in a similar way to (A) above, at the time of the transaction was effected, ABC Ag had not allocated the 123 Plc shares between its funds. Therefore, as the contract does not appear to have been made with the actual authority of each of the funds concerned, it appears that individual funds would be unable to sue B Plc. Conversely, once B Plc is aware of the existence of the funds, it would be unable to sue them. This is reinforced by the fact that (notwithstanding that ratification may be impossible due to the reasons set out in (A) above) in any event, ratification

Additionally as discussed in (A) above, novation is also not appropriate here.

Accordingly, it appears that the funds would not be liable to B Plc.

2 The Agent

This scenario envisages that B Plc is not aware that ABC Ag is in fact acting in the capacity of a fund manager. Accordingly, based on the doctrine of the undisclosed principal, the agent, ABC Ag, will be liable and entitled on the contract. Therefore, in the event that settlement does not occur, B Plc may sue ABC Ag. This is therefore much more straightforward than the position under (A) above.

(C) The fund manager writes to the bank informing them, correctly, that it is acting on behalf of a single known principal, but will not disclose the identity of the principal.

The analysis of this situation is more straightforward because although the bank is not aware of the identity of the principal, there is a single known principal for whom the agent is acting. That being said however, the position is not without its difficulties. The agent is acting on behalf of a disclosed but unnamed principal. Therefore, briefly, the consequences are:

(i) Provided that the fund manager is acting within the scope of his authority, direct contractual relations will be formed between the third party bank and the principal.
(ii) Settlement should be between the third party and the principal, although the parties may agree that the settlement should be through the agent.

However, strictly it appears that where the principal is unnamed, it cannot be a party to any agreement that the settlement should be through the agent. Therefore, unless there is a recognised trade custom that the third party should settle with the agent, or the agent is expressly authorised, or whilst the third party settles with the agent (without there being an agreement for him to do so) and the agent does indeed settle with the third party, there is a risk that the third party may, in the case of default by, or insolvency of, the agent, be liable to settle (again) with the principal.

Furthermore, and crucially, if the contract is between the principal and the third party, and settlement is made through the agent, if there are any debts owing from the agent to the third party these will not be able to be set off against the amounts owed to the principal. The bank has no security in respect of credit balances held for, or other debts owed to the agent.

(iii) If the agent, acting within the scope of his authority, concludes a contract, direct contractual relations between the principal and third party are established. If the principal is insolvent, the third party may incur a loss on the transaction without any redress to the agent. Furthermore, if the transaction is ultra vires the principal, as the law currently stands the agent gives no warranty to the third party that the principal has capacity, and therefore the
third party may again suffer loss, and he would have no redress against the agent.

(iv) If the agent is acting outside the scope of his authority, the unnamed principal will not be bound by the contract (unless he ratifies the transaction). Accordingly, assuming no ratification takes place, the liability will rest with the agent for breach of warranty of authority.

In the event that the principal is insolvent or the transaction was ultra vires the principal, the amount of damages would be likely to be nominal as the amount that could be recovered would either be nominal or nil, depending on the circumstances.

(v) As direct contractual relations exist between the principal and the third party, in strict agency law, the agent should "drop out of the picture" and should not be liable on the contract. However, as discussed in greater depth in the Law of Agency Paper, there are certain situations where the agent may be liable. This can be the case if:-

A the agent has sole liability; ie the agent (whilst he may not have intended this to be the case) may have contracted personally with the third party and therefore may be liable;

B the agent may find himself jointly or jointly and severally liable with the principal;

C the agent may be liable under a suretyship or contract of indemnity;
D the agent may be liable under a collateral contract; or

E the agent may have alternative liability.

Therefore whilst the agent may intend to contract purely as agent, he may find that he has incurred liability in certain situations.

If it is found that the agent does have liability, care must be taken in relation to the doctrines of merger and election, such that the third party may not recover, or even commence proceedings against the principal, if proceedings have been issued or recovery made against, the agent or vice versa.

(vi) However, it is important to note that much of the case law surrounding the disclosed but unnamed principal is based in the early nineteenth century cases. Notwithstanding the case of The Santa Carina [1977] 1 Lloyd's Rep 478 (which relates to oral contracts and is further discussed in the agency paper) leading academic writers, particularly F M B Reynolds, the current editor of Bowstead on Agency, submit that where a third party is dealing with an unnamed principal, though an agent, then the agent should be bound upon the contract. Support for this statement is found in the Second Restatement on Agency at paragraph 321. Accordingly, the application of agency law in the complex financial market structures which exist have yet to be subject to judicial interpretation of the law.

(vii) Additionally, where the desire has been to find the agent liable, situations where the appropriate doctrine would be the disclosed but unnamed principal
doctrine, the cases have been brought under the undisclosed principal doctrine, thereby giving the third party a remedy against the agent. Accordingly, if this situation were to arise, a third party may seek to bring an action against the agent, under the undisclosed principal doctrine in order to endeavour to hold the agent liable.

(D) The fund manager (acting for a single undisclosed principal) enters a transaction with a bank and the bank is not aware of the identity of, or the existence of, the principal

Again, notwithstanding that the principal is undisclosed, the position is more straightforward because there is a single undisclosed principal for whom the agent is acting. The position briefly, is as follows:

(i) The agent will be liable and entitled on the contract with the third party, as if he had been the principal. Therefore in the event of breach, the third party can sue the agent or be sued by the agent.

(ii) The undisclosed principal may be entitled to sue and be sued on the contract made by the agent acting on his behalf, if the agent acted within the scope of his actual authority. Therefore in the event of breach, the third party may find himself being sued by someone who he neither knows the identity of, nor the existence of. Conversely however, he may be able to sue the undisclosed principal (once aware of his existence or identity), rather than purely the agent alone.

(iii) If the agent has acted without authority, ratification cannot occur because the principal was undisclosed. Furthermore, where the agent has authority, although acts outside the scope of that authority, the leading
case of *Keighley Maxsted*, held that ratification still could not occur.

(iv) In the case where there is an express term of the contract that the agent is the only party to it, the undisclosed principal cannot intervene on it: *Siu & Another v Eastern Insurance Company Ltd*, The Times December 16 1993. However unless this is the case, it is probable that the existence of the undisclosed principal could be adduced notwithstanding the parol evidence rule.

(v) With regard to settlement between the principal and agent, if the undisclosed principal settles with his agent at a time when the third party still does not know of the existence of the principal, the principal is discharged.

(vi) Where the undisclosed principal sues the third party to the contract, the third party may use all the defences and rights of set-off that he had accrued against the agent (whether prior to the transaction or otherwise), before he had notice that the agent was not acting for himself.

(vii) As noted at A (vi) above, cases have been brought under the undisclosed principal doctrine where the true position is that they are cases where the principal is disclosed but unnamed. *The Law of Agency* Paper discusses the position in greater depth.

(E) The fund manager enters into a transaction with the bank without disclosing whether he is acting on his own behalf or on behalf of a principal (and the bank has dealt on both bases before) and the bank is therefore not aware of which basis the fund manager contracts although the entirety of the securities or foreign exchange are to be for the account of either the bank or the single principal.
Whilst there is only one principal, be that either the fund manager himself or his single client, the situation is difficult to analyse. This is because the law in this area is unclear. It cannot be identified with certainty that this will be dealt with on the basis of an undisclosed principal, so the rules in (D) apply or whether it will be considered on the basis of a disclosed but unnamed principal so that the rules laid out at (C) above apply. Additionally it may be further complicated by the agent being the real principal.

(i) In this type of case, the doctrine of the undisclosed principal may be applied in a situation where the third party is actually aware that the agent sometimes deals for himself and sometimes on behalf of others but does not know what is true on this occasion, Baring v Corrie [1818] 2 B & A 137.

It may be that such a case would be brought as an undisclosed principal situation in order to find the agent liable. However, this type of situation is probably best analysed as involving a disclosed but unnamed principal, if there was a rule that the agent of such a principal was prima facie liable had been adopted.

However, in this case, the fund managers may act, and indeed may be acting, as principal.

(ii) The issue of settlement is also of concern in such a situation. If the application of the unnamed, but disclosed, principal is found by the courts to be correct, as discussed in C above, the settlement should strictly be between the principal and third party. If however, it is analysed as undisclosed principal, or if the fund manager is the real
principal, then settlement between the principal and agent should be satisfactory.

Accordingly, what gives the most concern in such a situation, is the uncertainty of the legal relations between the two parties.

(iii) The issues of ratification of unauthorised acts is also important here. The same issues arise as discussed in C and D above.

(iv) Is the agent the real principal? If this is the correct analysis of this situation, and although the person professes to contract as agent and he is, in fact, the principal, he may be personally liable on the contract, and he may also be able to sue on the contract provided that certain criteria are met. However, the case law in this area is very old and rather than having personal liability, the agent may have liability under a collateral contract. These uncertainties surrounding this area of the law are discussed in the Law of Agency Paper.

Accordingly, the analysis of this situation is difficult. The attitude of the parties may have been that the third party may be assumed to take a risk and be willing to deal with the intermediary if he is dealing for himself or for the intermediary's unnamed principal, whoever he may be or the third party may view the situation that he knows only the intermediary and looks primarily to him. The way a court will react to such a situation is difficult to assess and may well depend on the facts in each case. However F.M.B Reynolds (the current editor of Bowstead on Agency) considers that an appropriate analysis would require liability of both agent and principal, the agent is a party to the contract, but the principal's intervention is not subject to all the equities
existing between the original parties, since the intervention is not to be regarded as totally unexpected.

The fund manager enters into a transaction with the bank without disclosing whether he is acting on his own behalf or on behalf of one or more principals (and the bank has dealt on both bases before) and the bank is therefore not aware of which basis the fund manager contracts, although in fact, the fund manager is acting for several principals (although at the time of the contract no allocation has been made)

This scenario is, in effect, an amalgamation of scenarios (A) and (B). The difficulties which have been highlighted under item A, ie whether the so called principals been brought into contractual relations with the third party bank are relevant because where no allocation has taken place, it is difficult to envisage a situation where contractual relations have been established between the funds and the bank concerned.

Furthermore, the potential liability of the foreign bank is also complicated by the fact that the principal's existence is not to be regarded as unexpected. The foreign bank may incur liability to the third party bank by virtue of the reasons set above.

If the contract is oral rather than in writing, will this make any difference?

Lord Justice Roskill in the Santa Carina said:-

"With an oral contract, the law is plain ... it is a question of fact in each case whether it was intended "[the word intended used subject to Lord Reid in McCutcheon v David MacBryde ... the judicial task is not to discover the actual intentions of each party; it is to decide what each was reasonably entitled to conclude from the attitude of the other] ... that the agent should or should not be personally liable".

However, as we have seen from the various examples, what the intentions of the parties are in any given case may be far from clear.
PART V: CONCLUSION

There are sound commercial reasons why a fund manager may not wish to, or may not be able to disclose the identity of its principal when dealing with banks and securities houses. It will not, however, wish to accept the position of principal on the transaction, since this does not reflect the commercial reality of its position, and will involve it in unacceptable capital costs. On the other hand, the fund manager's inability to disclose its principal gives rise to understandable concern for the bank which has to comply with the Money Laundering Regulations and its SFA obligations, and also has to undertake its own due diligence checks.

As has been seen, (particularly in the Law of Agency Paper), the law on this topic, which should establish where the legal responsibilities lie, is for the most part old. Extensive judicial interpretation of agency law in the context of modern financial markets has not yet taken place. Accordingly, in many situations where the position of the parties is not clarified in the contractual arrangements between them, there is uncertainty as to the legal position of the bank, the fund manager and the underlying principals.

The present situation is unsatisfactory:

(i) for banks, who often cannot know who is liable to them, and cannot report accurately their "large exposures" to counterparties whose identity is unknown;

(ii) for the fund managers, who may not know with certainty whether they have, contrary to their intentions and commercial needs, assumed liabilities on contracts made for the benefit of customers; and
(iii) regulators, who cannot make accurate assessments of capital requirements, since the liability of the supervisees is unclear.

There is a way out. There is no reason at all why the standard contracts between banks and fund managers cannot deal with all of the problems set out above, and define the liabilities of the parties in a way which is clear, consistent, and accepted as fair by all concerned. The solution will not be the same in each case. The parties to a transaction must decide among themselves where the liabilities and commercial risks should lie. This is a basic function of the market, with which it would be wrong and fruitless to interfere. It is not possible, or desirable, to provide a standard model for each factual situation.

However, we believe that it should be possible to agree a "menu" of standard clauses, providing a range of possible commercial solutions to different practical problems. As examples of what we have in mind, we set out below possible ways of addressing the problem which arises where a fund manager places an order for the benefit of a number of his discretionary clients, and makes the allocation between them afterwards:

1. The fund manager accepts that, because it cannot disclose the name of its principals in relation to the contract (as the securities have not yet been allocated), the fund manager will be treated as the principal and will be liable to the bank in respect of such contract. The fund manager is in a position to carry out a creditworthiness checks on its principals, the underlying funds.

2. The bank will agree that the fund manager has no direct liability provided that the fund manager warrants the creditworthiness of its principals, i.e. the funds for whom it is acting (and to whom it may finally allocate the securities) and that the funds will be able to complete the transactions.
Accordingly, the agent will incur no liability on the contract other than in respect of any breach of the warranty. It will, of course, have to make contractual arrangements to give the funds the benefit of the contracts after allocation.

As in 2 above, save that the agent agrees to indemnify the bank in the event of failure by the funds to complete.

The bank agrees that it will bear the creditworthiness risk, provided that, in order to ensure that direct contractual relations are established between the funds and the bank, that upon allocation, the fund manager will identify to the bank the allocation to each fund. Thereupon the bank (pursuant to a term in the contract) will automatically be deemed to consent to the allocation, and the contract would be replaced by contracts direct between the bank and the funds, as appropriate. This would provide legal certainty although the bank might not be aware of the identity of the fund concerned (if, for example, it were identified only by reference to an account number) and will maintain the credit risk.

In a similar manner to 4 above the bank consents in advance to a novation or assignment of the contract upon allocation, but the fund manager agrees to provide to the bank an indemnity or warranty as outlined in 2 or 3 above.

In our view steps should be taken immediately, with a view to agreeing and settling standard terms, as set out above, and producing certainty.

The successful conclusion of this task will not remove all of the problems which market participants now face. In particular, it will not relieve banks of the need, if the deal so dictates, to take a credit risk on a party whose creditworthiness cannot be verified in the usual way. The virtue of the proposal is that it will allow all parties to see clearly, where the risks lie: they need take only those
risks they have decided it is in their commercial interests to take. This will be an improvement on the current position.

Financial Law Panel
6 April 1994
THE LAW OF AGENCY

RELATING TO THIRD PARTIES AND AGENTS

ACTING ON BEHALF OF DISCLOSED BUT UNNAMED PRINCIPALS

AND UNDISCLOSED PRINCIPALS

In examining the law of agency relating to this area, there are particular areas which are of importance. These are:

1. definitions of disclosed/undisclosed principals;
2. authority of the agent;
3. relationship of the third party and the principal;
4. settlement between the principal and the agent;
5. settlement with or set-off against the agent affecting the rights of the principal;
6. rights and liabilities of the agent;
7. oral contracts;
8. pure undisclosed principals; and
9. where the agent is shown to be the real principal.

It is necessary to consider each of these in turn.

1. **Disclosed/Undisclosed Principals**

It is appropriate here to consider the correct terminology particularly with regard to disclosed and undisclosed principals.

A disclosed principal is a principal, whether named or unnamed, whose existence as principal is known to the third party at the time of the transaction in question. This should be compared with an undisclosed principal who is a principal whose existence as such is not known to the third party at the time of the transaction in question.
Therefore, in this paper where the principal is referred to as disclosed, this will indicate that the third party or bank concerned knows that there is a principal involved, regardless of whether or not the principal is named or identified as such to the third party bank.

As noted above, the term undisclosed principal will be used in cases where the third party bank does not know that there is a principal involved and intends to deal, and believes he is dealing only with the "agent".

The term unnamed principal will be used in cases where the third party bank is aware that the agent has a principal (therefore, the principal is disclosed), but does not know who that principal is.

The rules on agency differ depending on whether the principal is disclosed (whether named or unnamed) or undisclosed. One of the difficulties surrounding this area is that in certain marginal cases the undisclosed principal rules have been applied, where the proper interpretation should logically have been that the principal was disclosed, but unnamed. As Bowstead states "clarity is desirable in this area, ... it is in fact not clear in exactly what circumstances a person may rank as an undisclosed principal".

Section 8 of this paper deals with the position of undisclosed principals.

2 **Authority**

While it is not appropriate in this situation to discuss in any great depth the issues of authority, it is still worthwhile considering the following definitions from the leading text, Bowstead on Agency.¹

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(a) **The concept of authority**

"Agency is the fiduciary relationship which exists between two persons, one of whom expressly or impliedly consents that the other should act on his behalf, and the other of whom similarly consents so to act and so acts.

In respect of the acts which the principal expressly or impliedly consents that the agent shall do on the principal's behalf, the agent is said to have authority to act; and this authority constitutes a power to affect the principal's legal relations with third parties.

Where the agent's authority results from a manifestation of consent that he should represent or act for the principal expressly or impliedly made by the principal to the agent himself, the authority is called actual authority, express or implied. But the agent may also have authority resulting from such manifestation made by the principal to a third party; such authority is called apparent authority".

Apparent authority is conferred by the principal making some representation to a third party which gives the appearance that the "agent" has authority to act, as such. In the situations relevant to this paper, unnamed but disclosed principals and later undisclosed principals, apparent authority in most situations will not be relevant.

The authority element for undisclosed principals will be examined separately in Section 8.

Accordingly, the bank will be relying upon the "warranty" from the agent that he has actual authority, either express or implied, to act on behalf of the unnamed principal in each case.
Where the agent, acting within the scope of his actual authority, contracts with a third party on behalf of a disclosed albeit unnamed, principal, direct contractual relations are established between the principal and the third party and accordingly the principal can sue and be sued upon the contract. This will be considered further below. In certain situations, the agent may also have liabilities and, again, this will be examined later.

However, in the event that the agent does not have the requisite authority (express or implied) to bring the principal into contractual relations with the third party, then the principal will not be bound by the contract made by the agent unless the appropriate contract has been ratified.

(b) Ratification

It is worth noting that every act may be ratified, except an act which at its inception is void (unless it is void only because it is unauthorised). For example, if the transaction for the unnamed principal is not within the scope of its memorandum of association (if it is a company) or is otherwise beyond the powers of the principal concerned, it cannot be ratified because it is ultra vires, and therefore void.

The effect of ratification is that the principal and the third party will have entered into contractual relations and each may sue and be sued upon the contract.

In considering who can ratify any act, it is appropriate again to turn to Bowstead which states as follows:

"The only person who has the power to ratify an act is the person in whose name or on whose behalf the acts [sic] purported to be done, and it is necessary that he should have been in existence at the time when the
act was done, and competent at that time and at the
time of ratification to be the principal of the person
doing the act, but it is not necessary that at the
time the act was done he was known, either personally
or by name, to the third party".

Accordingly, as can be seen from the rule in Bowstead, provided
the other elements of ratification are present, ie the
principal is in existence and is competent, the fact that the
principal is unnamed should not prevent an act being ratified.

However, the law relating to ratification by unnamed principals
is somewhat unclear. This is due to the fact that the person
who must ratify must be the person in whose name and on whose
behalf the act was purported to be done. In considering the
degree of knowledge required by the third party, Bowstead
states that the rules for ratification follow those for initial
authority "the test is to inquire whether the principal could
have entered into such a transaction at the time when the agent
originally acted". Therefore, since the agent need not always
name his principal but may, and often does act, for a
completely unnamed principal, ratification should be possible
in such case on the basis that as the third party was willing
to deal on this basis, it should be bound by the ratification
document. However, case law suggests that the principal must
be known or ascertainable at the time of contracting. For
example:

Willes J said in Watson v Swann (1862) 11C.B. (N.S.) 756 as
follows:-

"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.

Bowstead takes the view that if this dictum was applied as a rule it would restrict the scope of ratification. Whilst Bowstead notes that it may be, as a matter of policy, that "the ability to ratify where the principal is unnamed will depend on the agent having a particular person in mind; and thus may permit him at a later stage to choose who is to ratify by declaring that this was the person he originally had in mind", Bowstead acknowledges that, in ordinary dealings on behalf of unnamed principals, this would not be true as actual authority would in the event of dispute need to be proved. It is also noted that there may be, to a certain degree, an element of choice where the agent may have identical instructions from several principals and in practice therefore, the agent may choose which principal should ratify any particular contract.

The dictum is nineteenth century and therefore Bowstead submits:

"that ratification by a principal who was at the time the act was done disclosed but completely unnamed should be regarded as valid".

Support is given to this argument by the Restatement¹ (paragraph 87) which allows an act to be ratified even by an unnamed principal who is not identified or described.

This can be compared with the position with regard to an undisclosed principal who cannot ratify the actions of the agent and, as discussed further in Section 8 below, cannot

¹ The Restatement is the Second Restatement on Agency (American Law Institute) 1958.
ratify an act which exceeds the agent's original authority


Accordingly, in a typical situation considered by this and the associated paper, where the third party bank is willing to deal on the basis of an unnamed principal, it is arguable that the principal could be bound by the doctrine of ratification just as under the normal principles of authority. However, this has not been considered recently before the courts, and accordingly is speculative.

(c) **If agent has no authority and the principal has not ratified the transaction**

In this situation, where the agent has exceeded his authority (actual or implied) and the principal has not ratified the agent's actions, the position is that the principal (named or unnamed) will incur no liability to the third party and the third party's remedy will be against the agent for breach by the agent of the agent's implied warranty of authority.

The rule is as follows:

"Where a person, by words or conduct, represents that he has authority to act on behalf of another, and a third party is induced by such representation to act in a manner in which he would not have acted if such representation had not been made, the first-mentioned person is deemed to warrant that the representation is true, and is liable for any loss caused to such third party by a breach of such implied warranty, even if he acted in good faith, under the mistaken belief that he had such authority."

Every person who purports to act as an agent is deemed by his conduct to represent that he is in fact duly authorised so to act, except where the nature and extent of his authority, or all material facts known to him from which its nature and extent may be inferred, are fully known to the other contracting party, or the purported agent expressly disclaims any present authority."

Bowstead
This includes a situation where the agent acted innocently. Colen v Wright (1857) 7E&B 301.

The warranty is to the effect that the agent has authority from the principal. It should be noted however that the warranty is not that the principal is solvent or that the principal has capacity to perform the contract.

The warranty will not be implied where the representation is one of law. Accordingly, it must be one of fact to be actionable. Distinguishing between representations of fact and representations of law is often difficult. For example, the case of Beattie v Ebury (1872) LR. 7. Ch. App 777, the distinction was made between a representation that the company has power to borrow which may be one of law, if on the true construction of its memorandum, the company had no such power, but if the power could have been conferred by resolution, the representation may be one of fact, ie that such resolution had been passed.

A representation that a company's borrowing limit has not been exceeded would be a representation of fact.

There may be a rebuttal of the warranty in certain situations, but these are beyond the scope of this paper.

It is worthwhile considering briefly the measure of damages that would available for a breach of warranty of authority. The measure of damages is as follows:

"The measure of damages for breach of warranty of authority is the loss which the parties should reasonably have contemplated as liable to result from the breach of warranty.

Where a contract is repudiated by the person on whose behalf it was made on the ground that it was made without his authority, such loss is prima facie the amount of damages that could have been recovered from
him in an action if he had duly authorised and subsequently refused to perform the contract, together with the costs and expenses (if any) incurred in respect of any legal proceedings reasonably taken against him on the contract".

Accordingly contractual damages are appropriate. It is worth considering two particular situations which are especially relevant:

(i) The Insolvent Principal

The general rule is that the amount of damages will be only nominal if the principal is insolvent. The reason for this is that had a successful action been brought against the principal, the third party would not have received any money (the principal being insolvent). However, account will be taken if, had the agent acted with authority, the third party would have, for example, preferred creditor status.

(ii) Transactions Unenforceable Against the Principal

Where no redress could be obtained from the principal, even if the agent had been authorised, again, there is no loss. **Haskell v Continental Express Limited** [1950] 1 ALL E.R. 1033.

If a third party enters into a transaction with an agent on behalf of an unnamed principal, and the third party is therefore unable to carry out any due diligence checks upon the principal, it may transpire that the principal has no power to enter into the transaction concerned. If this is the case, and the agent has no authority to enter into the transaction, not only will the principal have no liability (as the transaction
is not only unenforceable but also not binding as it was made without authority) but furthermore, if the agent was acting without authority, it appears that whilst he may be liable for breach of warranty of authority, the amount of damages available to the third party from the agent would be nominal, as the principal would not been liable under the contract as the transaction would have been ultra vires.

Accordingly, for third parties entering into transactions with agents acting on behalf of unnamed principals, if the agent is acting outside the scope of his authority, the third party is at risk and may suffer loss if the transaction would have been ultra vires the purported principal, without any effective redress to either the principal or the agent.

Furthermore, even if the agent has authority to enter into the transaction, on the same basis, if the transaction is ultra vires the principal, it must be that the agent will not be liable if he is acting within the scope of his authority because the action for breach of warranty of authority is on the basis of the warranty that the agent has authority to enter into the transaction, and not that the principal will or, even will be able to, perform the contract.

3 **Relationship between the Third Party and the Principal**

As we have noted earlier, a disclosed principal, whether named or unnamed, may sue or be sued on any contract made on his behalf, and in respect of any money paid or received on his behalf by his agent acting within the scope of his actual authority.

Where the principal is undisclosed, different rules apply with regard to the liability of the undisclosed principal and agent. These will be discussed at Section 8 below.
However, the undisclosed principal doctrine has been applied to certain situations where strictly the appropriate doctrine would be that of unnamed rather than undisclosed principal. These situations will be discussed further in part 8 below, but include cases where, for example, the third party is actually aware that the agent sometimes deals for himself and sometimes on behalf of others, but does not know which is true in this occasion; to situations where the third party is aware of the existence (possibly even the name) and involvement of the principal but it is not clear as to the exact relationship with the agent; and even to situations where the third party is aware that the principal is using the intermediary’s services on an agency basis, but does not wish to become a party to the agent’s contract. Clearly the agent is a party to the contract and these cases were all brought within the undisclosed principal doctrine with a view to the agent being personally liable and entitled as well as the principal. F M B Reynolds, the current editor of Bowstead is of the view that the agent of a disclosed but unnamed principal should be liable in certain situations. This is discussed further below.

It is also important to consider the effect on contract of particular customs and usages. In this regard Bowstead states:

(1) "Where an agent contracts in a particular market, the contract is deemed to be made subject to the rules, regulations, customs and usages of that market so far as they are not inconsistent with the express terms of the contract.

(2) But the principal is not bound by any unreasonable rule, regulation, custom or usage unless he had notice of it at the time when he authorised the agent to make the contract, nor by any rule, regulation, custom or usage which is unlawful."

However as Bowstead states: "The main point to note is that despite the incorporation of customary terms into contracts, the rights of the principal, disclosed or undisclosed, to sue, and his liability to be sued, need not be affected by the circumstances that the contract was
made in a market by the rules, regulations, customs or usages of which the agent is personally liable on the contract, and the contract is regarded as that of the agent alone. This is so whether or not such rules, regulations etc were known to the principal at the time when he authorised the agent to make the contract."

Many exchanges have rules that dealings will be treated between member firms as though each member firm is principal, notwithstanding that they may in fact be dealing in a different capacity.

4 Settlement between the Principal and Agent affecting recourse to the Principal

"The general rule is that a principal is not discharged by the circumstances that he has paid or settled or otherwise dealt with to his prejudice with the agent.

However, where a debt or obligation has been contracted through an agent, and the principal is induced by the conduct of the creditor reasonably to believe that the agent has paid the debt or discharged the obligation or that the creditor has elected to look to the agent alone for payment or discharge, and in consequence of such belief pays, or settles or otherwise deals to his prejudice with the agent, the creditor is not permitted to deny, as between himself and the principal, that the debt has been paid or the obligation discharged or that he has elected to give exclusive credit to the agent so as to discharge the principal." Rowstaaed

The second part of the rule appears somewhat difficult where the principal is unnamed.

Notwithstanding the general rule, a third party may be precluded from suing the principal who has settled with the agent, in certain situations:
(a) the third party may be prevented from so doing under the rules relating to merger and election; or

(b) the principal may be discharged where a third party has led him to suppose that he should settle with the agent (the "estoppel view"); or

(c) the principal may be discharged where hardship would be caused to him if it were forced to pay the third party ("prejudice of the principal view").

The more accepted view is the estoppel view. Where the position is that the principal is disclosed but unnamed, or named, Bowstead considers that the estoppel view is appropriate.

Accordingly, unless the contract provides to the contrary, the unnamed principal should settle with the third party bank unless the third party bank has indicated to the principal that settlement to the agent will be sufficient or indicates that he intends to rely on the agent alone for payment. As in most cases this will not be express, in the event of default by the agent after the principal has paid the agent, it may be that the principal could be liable to pay twice, ie the principal may be liable to pay the third party.

Accordingly, in an unnamed principal situation, this could give rise to concern.

5 Settlement with or Set-Off against the agent affecting the rights of the Principal

"The general rule is that the third party, in an action by the principal, has no right to set-off any claim he may have against the agent personally; and the principal is not bound by a payment to or settlement with the agent unless that payment or settlement was made in the ordinary course of business and in a manner actually or apparently authorised by him."

Bowstead
Therefore, as a general rule, the third party should take care before settling with the agent, (as this will not serve to discharge the third party) unless:

(a) The agent is authorised (such authority being actual or apparent) to receive payment, then the payment to him will discharge the third party's liability.

(b) If the agent is only expressly authorised to receive payment by a certain method and payment by some other means occurs, this will be insufficient unless agents in that position customarily receive payment by that means or the principal has held out the agent as being authorised to receive payment by that means.

(c) If the third party settled with the agent and the agent duly pays the principal, the third party will be discharged from liability.

Accordingly, if the three parties to the agency relationship have agreed that the third party should pay the agent, who in turn will account to the principal, there is no difficulty in the third party taking that course of action. However, in the event that this agreement has not been reached, then the position is far from clear.

6 Rights and Liabilities of the Agent

The general rule is that, in the absence of other indications, when an agent makes a contract, purporting to act solely on behalf of a disclosed principal, whether named or unnamed, he is not liable to the third party on it. Nor can he sue the third party on it in his own right. However, it is possible for the agent to be a contracting party instead of, or in addition to, his principal.

"It is not the law that, if a principal is liable, his agent cannot be. The true principal of law is that a person is
liable for his engagements (and for his torts) even though he is acting for another, unless he can show that by the law of agency he is to be held to have expressly or impliedly negated his personal liability.

Lord Scarman - Yeung Kai Yung v Hong Kong & Shanghai Banking Corporation [1981] AC 787

"An agent who makes a contract on his principal's behalf is liable to or entitled to sue the third party in accordance with the terms of any contractual engagement, whether upon the same contract or upon some independent contract into which he has entered". Bowstead.

The question whether an agent who has made a contract on behalf of his principal is deemed to have contracted personally and, if so, the extent of his liability, will depend on the intention of the parties which will be deduced from the nature and terms of the particular contract and the surrounding circumstances, including any binding custom.

This can be seen most easily in the case of written contracts where the use of a particular form of words may constitute the agent as a contracting party.

"The fact that agents may often be of more substance than their principals suggests that such involvement in the contract may be more appropriate nowadays than in former times". Chitty on Contracts 26th edition

(a) **Agent's Liability**

There are no general rules which have been laid down in situations where the agent is potentially liable. The possibilities, as expounded by Bowstead appear to be as follows:
(i) **Sole Liability of the Agent**

The agent may, in certain situations, be solely liable, e.g. although perhaps authorised to do so, he has not created any contract binding his principal at all but has made the contract in his own name. The agent may also be solely liable by virtue of a trade custom, lien or special property. This would not prevent the agent's position vis-a-vis his principal still being regulated by the laws of agency.

Additionally, there is nothing to prevent an agent from entering into a contract on the basis that he himself is liable to perform it as well as the principal.

(ii) **Joint or Joint and Several Obligations**

The agent may be held jointly or jointly and severally liable together with his principal.

(iii) **Suretyship**

An agent may be a surety for his principal, i.e. he may contract to indemnify the third party in respect of its non-performance or guarantee the principal's obligation.

(iv) **Collateral Contract**

The agent may undertake a separate liability on a separate or collateral contract which is not one of suretyship, e.g. in the case of breach of warranty of authority.
(v) Alternative Liability

The agent may undertake a liability alternative to that of the principal, the choice to lie with a third party.

Election: When principal and agent are both liable, the doctrines of merger and election may apply. Therefore, the third party may be debarred from suing one by obtaining judgment against, or it perhaps even simply electing to look to, the other. However Bowstead believes that this only operates where the two remedies available to the third party are inconsistent, which, it considers, may not always be the case. The nature of the liability assumed by the agent may therefore be crucial but Bowstead believes that this has received insufficient attention in the cases.

(b) Agent's Right to Sue

Conversely, as the agent may be shown to be liable on a contract, the question also arises of whether the agent has the right to sue. Where the agent makes a contract as sole contracting party, he can sue on it as well as be liable. Certain of the situations referred to above involve the agent having the right to sue.

Whilst there is certain dicta in connection with the agent suing on behalf of the principal (and recovering his principal's loss), this is beyond the scope of this paper.

(c) The Undisclosed Principal and the Unnamed Principal

It is worthwhile considering, in relation to the agent's liability the special situations of the undisclosed principal (considered further in Section 8) and the unnamed principal.
(i) **Undisclosed Principal**

Whilst this will be discussed further in Part 8, where the principal is undisclosed (i.e., the very existence of a principal is unknown) at the time of contracting, the contract is made with the agent, and he is personally liable and entitled on it. The principal may also intervene to sue, and may be sued, but the latter only subject to the general rules discussed below that nothing must prejudice the right of the third party to sue the agent if he so wishes. Therefore both the agent and the principal are liable and entitled.

(ii) **Unnamed Principal**

This area gives the most concern. Where the agent gives a third party to understand that he acts for another, there may be cases where the third party can be regarded as willing to deal with the principal whoever he is. Indeed, in the case of *Teheran-Europe v S T Belton Tractors* [1968] 20854, it was said that in an ordinary commercial transaction such willingness may be assumed by the agent in the absence of other indications. However, Bowstead considers this may not be correct, and considers that, at the other end of the scale, the third party deals only with the agent, the problem of the agent's position vis-a-vis his principal being irrelevant to the third party.

Many academic writers favour a middle course, that being the course suggested by the Restatement. This suggests a rule as follows:

"When the agent acts for a principal whose existence is known but who is not identified at
the time of contracting, the agent is, unless otherwise agreed, a party to the contract, and the inference is that he is liable, in addition to, and not in substitution for, the principal (though sometimes his liability may cease on disclosure of the principal’s identity)." Bowstead.

This general proposition however has been rejected in England in respect of unwritten contracts, N.F. Vlissopoulos Limited v Ney Shipping Company (the Santa Carina) [1977] 1 Lloyd's Rep 478 although the wording of written contracts may give rise to the agent being a party to the contract in such a case. In The Santa Carina it was held that it was clear that the [third party] plaintiffs knew that the defendants [the agents] were acting as agents and it was for the third party to prove those facts from which an inference might be drawn on a balance of probabilities that the defendants were personally liable notwithstanding that the plaintiffs knew that the defendants were contracting as agents. The plaintiffs and defendants were both brokers. Each knew that they were brokers, and, by virtue of the rules of membership of the Baltic Exchange, were also aware that they could not act as principal. There was also no custom or trade on the Baltic Exchange whereby a broker was liable.

Denning M.R said "There are cases where although the man who supplied the goods knows that the other is an agent and does not know his principal, nevertheless he may be content to look at the credit of the principal whoever he may be".

Support for this argument is also found in the Teheran Europe case where Diplock L.J. said:
"he may be willing to treat as a party to the contract anyone on whose behalf the agent may have been authorised to contract."

Additionally, courts may recognise a trade usage that a commercial agent is personally liable, eg a broker being personally liable, particularly if his principal is unnamed. In trade custom cases, an agent's liability may be additional to that of his principal.

Difficult situations concern areas where a third party deals with an agent who is known normally to act for principals or in a situation where the persons dealing frequently act for a principal but there is no indication whether they do so or not on the relevant occasion.

Bowstead states that "if there is in unnamed principal cases not even a prima facie rule that the agent is liable together with the principal, the agent may sometimes appear to be free from liability in cases where he should arguably be regarded as undertaking it. In such cases, the courts may therefore classify the principal as undisclosed rather than unnamed in order to secure liability of the agent". This in turn causes confusion on the undisclosed principal doctrines because the same considerations do not necessarily apply.

Therefore, Bowstead submits that "the courts should be willing to adopt a rule that at least prima facie liability of the agent together with an unnamed principal".

F M B Reynolds, in his article Practical Problems of the Undisclosed Principal [CLP 1983] concludes as follows:-
The undisclosed principal situation and the unnamed principal situation are very close together, and the old books which appear to us to have blurred the distinction had some reason for doing so. In both situations the appropriate result is reached by regarding both agent and principal as liable and entitled, on the ground that the third party in both situations looks, whether partly or exclusively, to the credit of the agent. But the unnamed principal is someone who to a degree has always been contemplated as being involved in the contract; he does not "intervene." Hence rules based on the notion that the contract is with him are not surprising: he is not subject to the third party's set offs unless he is in some way at fault, and cannot safely pay the agent unless the third party has in some way encouraged him to do so. The true undisclosed principal, on the other hand, intervenes on a contract which he did not make and in respect of which his intervention is not contemplated.

It is submitted therefore that the similarity of these two situations and also their differences would be better exposed if a prima facie rule were established for unnamed principals which was much closer to that for undisclosed principals. It should take the form that the agent is prima facie liable as well as the principal. Whether The Santa Carina is to be regarded as right or wrong on its facts, the dicta in it, I submit, lean too far towards treating the unnamed principal situation on the same footing (viz. the agent prima facie drops out) as that of the named principal. If an only slightly different slant is given to the way in which the law is formulated, similar to that in section 321 of the Restatement...

... [ie "unless otherwise agreed, a person purporting to make a contract with another for a partially disclosed principal is a party to the contract"] it will be possible to concentrate on the merits of the different situations, and it will no longer be necessary to use the undisclosed principal rules, which make the agent a party to the contract, to give
appropriate results in cases to which they are otherwise inapposite. In particular, two situations usually treated, to the confusion of doctrine, as undisclosed principal situations (situations (i) [the intermediary sometimes deals as agent and sometimes as principal. The third party knows this, but on the facts it is not make clear which is the case on this occasion] and (ii) [the intermediary sometimes deals as agent and sometimes as principal. The third party is aware of this and of the fact that there is another person involved, but he is not clear whether the other person is a principal to the intermediary or has another legal relationship with him (for example, is buying from him)] can be classified as unnamed principal situations.

7 Oral Contracts

Bowstead, in connection with oral contracts, states as follows:-

"Where an agent makes a contract which is not reduced to writing, the question whether he contracted personally, together with his principal or solely in his capacity as agent is a question of fact".

Whilst the Restatement states that when a principal is unnamed the agent is prima facie liable with him, in the case of the *Santa Carina*, the Court of Appeal refused to accept this argument and argued that the question was entirely one of fact and for the agent to have liability there would have to be some indication, from trade custom or special facts, to this end. Accordingly, the current position is that the agent is not liable unless there are indications to displace that.

However, Bowstead submits there is a good case to argue that there should be such a rule that the agent is liable and entitled with the principal.
8 Undisclosed Principal

8.1 Rights and Liabilities

The rules regarding the rights and liabilities of undisclosed principals which are important for this paper are as follows:

A: "An undisclosed principal may sue or be sued on any contract made on his behalf, or in respect of money paid or received on his behalf by his agent acting within the scope of his actual authority". Bowstead.

This is subject to special rules, for example that the third party cannot be prevented from suing the agent, and the third party can use against the principal defences which he had against the agent.

Accordingly whilst the general rule remains, the area is fraught with unsolved problems particularly in connection with the area of the undisclosed principal's liability to be sued.

(a) Authority:

The agent must have actual authority, be it express or implied.

Ratification cannot occur, and even where the agent has acted outside the scope of his authority, the leading case of Keighley Maxted held that a principal was not liable when the undisclosed principal purported to ratify the transaction which was outside the scope of the agent's authority.

The nature of the authority conferred upon the agent by an undisclosed principal is subject to conflicting views.

The first view is that for the doctrine to operate, the principal must have authorised the agent to bring him into contractual privity with the third party. However, Bowstead
states that if this is correct, it appears that the application of the doctrine would be confined to two types of cases. Bowstead considers that these cases would be:

(i) where the principal wishes to be a party to the contract but wishes to conceal the fact that he is doing so, e.g. because the principal does not wish it to be known that he has entered the market; or

(ii) where the agent does not disclose the existence of his principal, perhaps because he does not wish the third party on the next transaction to bypass him and go direct to the principal, and the principal either acquiesces in this or makes no inquiry as to this state of affairs.

Bowstead states that the second view is that, whatever the principal's intentions, he is affected by the undisclosed principal doctrine whenever he uses the services of an intermediary who works on an agency basis, even though the principal does not intend to be a party to any contracts made. Bowstead considers that on this second interpretation it would bring into the scope of the undisclosed principal doctrine situations where the principal was using the services of an intermediary who deals with the outside world as principal, but as regards his own principal, acts as agent (interestingly, the indirect agency of civil law). "In such a case, the entitlement and liability of the principal would be superimposed by the law irrespective of the intentions of the parties, and contrary of course to the normal result in civil law countries recognising this notion" [indirect agency] Bowstead.

Bowstead considers that the majority of the dicta favour the first view although there is also authority for the second. This area is clouded in uncertainty but if the doctrine is
confined to the first view, the existence of such situations would happen only rarely.

(b) Intention of the Agent:

In undisclosed principal cases, the intention of the agent is clearly relevant. If the agent intended to act for his own profit and not on the principal's behalf, the principal cannot intervene or be sued.

(c) Degree of knowledge by Third Party:

The obvious situation where the doctrine of an undisclosed principal would apply is where a third party has no knowledge of the involvement of the principal. Whilst many cases suggest or imply that a third party dealing with an apparent principal has no duty of inquiry to ascertain whether there is another person behind him, the undisclosed principal doctrine has been held to apply in the following situations:

(i) where a third party is actually aware that the agent sometimes deals for himself and sometimes on behalf of others but does not know which is true on this occasion: Raring v Corrie (1816) 2 B & A 137;

(ii) situations where the third party is aware of the existence (possibly even the name) and involvement with the principal but is not clear as to the principal's exact relationship with the agent: Teheran-Europe Co Ltd v S T Beltham (Tractors) Ltd; and

(iii) where the third party is aware that the principal is using the intermediary services on an agency basis but does not wish to become a party to the agent's

In all these scenarios, for the transaction to have certainty the agent must have been liable as contracting party. As discussed above, Bowstead considers that situations (a) and (b) above are better analysed on the unnamed but disclosed principal doctrine but they were brought under the undisclosed principal doctrine by a desire to hold the agent liable and entitled as well as the principal. "Here again there are significant uncertainties as to the application of the doctrine". Bowstead.

(d) Capacity of the Agent:

It is considered that it is not necessary for the agent to have capacity, and each case will be looked at on its own merits. If the agent's contract is unenforceable for lack of capacity, it is possible that the principal may nevertheless be able to intervene, and be liable, although the agent could not sue or be sued.

B: "(Perhaps), an undisclosed principal may also be sued on any contract made on his behalf, or in respect of money received on his behalf, by his agent acting within the authority usually confided to an agent of that character, notwithstanding limitations put upon that authority as between the principal and agent". Bowstead.

This rule is based on the case of Matteau v Fenwick (1893) 10B 346. In this case an undisclosed principal was held liable on a contract made by his agent within such powers as would usually be possessed by a person in such a position, where that authority had in fact been withdrawn. However, where the agent's powers were limited, the agent would not have actual authority and as the principal was undisclosed, it cannot have had apparent authority. Therefore, there has been much criticism of the case (with commonwealth jurisdictions declining to
follow it, or alternatively casting doubt as to its correctness) although some commentators argue that this may give rise to a new type of authority called "usual" authority. Bowstead submits that the case is "inconsistent with the basic principles of agency law as subsequently established, which make it clear that liability can only be based on actual or apparent authority."

C: "Where an agent enters into a contract, oral or written, in his own name, evidence is admissible to show who is the real principal, in order to charge him or entitle him to sue on the contract". Bowstead.

Where the contract is in writing, (and notwithstanding the case of Humble v Hunter (1848) 12 QB 310, which provided that the intervention of an undisclosed principal would be prevented under the parol evidence rule), it is considered that the undisclosed principal can only be excluded from intervening pursuant to D below, and that evidence of such a principal will be admitted unless the exclusion of such principal is expressly or impliedly excluded by the terms of the contract.

D: "The rights of the undisclosed principal to sue and his liability to be sued on a contract made by his agent may be excluded if inconsistent with the terms of the contract, express or implied". Bowstead.

Where there is an express term in the contract that the agent is the only party to it, there can be no intervention by the undisclosed principal.

Also, in exceptional cases, the agent may impliedly contract that he is the principal. This can be from interpretation of the words descriptive of the agent or from the contract as a whole where it would be inconsistent for the principal to intervene. However, Bowstead takes the view that these are exceptional cases and the
undisclosed principal can intervene on a contract without extreme difficulty.

This point was considered in the recent case of Siu and Another v Eastern Insurance Company Limited, The Times 16 December 1993. In this case the House of Lords considered the main features of the law relating to an undisclosed principal and summarised it as follows:

"1 An undisclosed principal could sue and be sued on a contract made by an agent on his behalf, acting within the scope of his actual authority.

2 In entering into the contract, the agent had to intend to act on the principal's behalf.

3 The agent of an undisclosed principal could also sue and be sued on the contract.

4 Any defence which the third party might have against the agent was available against his principal.

5 The terms of the contract might, expressly or by implication, exclude the principal's right to sue, and his liability to be sued. The contract itself, or the circumstances surrounding the contract, might show that the agent was the true and only principal."

The case concerned the fifth feature and it was held that since the contract was an ordinary commercial contract, [A] were entitled to sue as undisclosed principal unless [the agent] should have realised that [the third party] were unwilling to contract with anyone other than themselves [the agent]. It was noted that the language on the proposal form did not exclude the right of [A] to sue as undisclosed principal. Their Lordships held "there was nothing in the terms of the proposal form, or the policy, which expressly or by implication excluded [A's] right to sue as undisclosed principal".
The argument was also raised that as the doctrine of undisclosed principal bore some resemblance to the assignment of contractual rights, if the contract was one that could not be assigned, because it was personal by nature, neither should it be capable of being enforced by an undisclosed principal. It was argued that an employer's liability policy (the subject matter of the case) was a contract of personal indemnity. However, the judge found that the actual identity of the employer was a matter of indifference and not material to the risk. Accordingly, it was impossible for [the third party] to contend that it was a personal contract of the kind that excluded the rights of an undisclosed principal.

8.2 Settlement between the Principal and Agent

We have seen in the earlier section the effect of settlement between the principal and agent in the disclosed principal situation. In the case of an undisclosed principal, it appears that where the undisclosed principal settles with his agent at a time when the third party still does not know that the agent has acted for a principal, the principal is discharged Armstrong v Stokes (1872) LR6CB50.

In a true undisclosed principal situation where the third party deals on the credit of the agent alone, such that at the time of the payment the third party still gave credit to the agent, and knew of no principal, the principal should be discharged. This was the position in Armstrong v Stokes and the judge in the case expressly excluded from such rule the case of a broker who admits that he acts on behalf of another, albeit, unnamed person.

8.3 Settlement with or Set-Off Against the Agent Affecting Rights of Principal

As noted in part 5 above, the general rule is that the third party in an action by the principal, has no right to set-off any claim he may have against the agent personally; and the principal is not bound by a payment to or settlement with the agent unless that payment or
settlement was made in the ordinary course of business and in a manner actually or apparently authorised by him.

However, this is subject to the following rule:

"A person who, in dealing with an agent, reasonably believes that the agent is the principal in the transaction is discharged from liability by payment to or settlement with the agent in any manner which would have operated as a discharge if the agent had been the principal, and is entitled, as against the principal, to the same right of set-off in respect of any debt due from the agent personally as he would have been entitled to if the agent had been the principal; provided that he had not, at the time when payment to or settlement took place, or the set-off accrued, received notice that the agent was not in fact the principal". Bowstead.

Therefore where the principal is undisclosed and the third party believes that the agent is dealing on his own account, the third party may use all the defences, including defences personal to the agent which had already accrued (whether on the original account or otherwise, whether previously or subsequently to the original transaction) against the agent, prior to the discovery of the principal and the third party is also discharged by any payment to the agent prior to such time.

Additionally, the third party, before notice of the principal's existence, may vary the contract with the agreement with the agent.

Various approaches are taken in considering this but Bowstead considers that notwithstanding the House of Lord's decision in the case of Cooke & Sons v Eshelby (1887) 12 Ap Cas 271 the best approach is that where the third party knows of no principal and this is reasonable in the circumstances (ie therefore it may not apply where the third party should have known that he may not be acting as principal, eg he was a broker) it seems inappropriate and unfair to
require fault in the principal before set-off can take place against the agent. Therefore set-off against the agent may be valid or settlement with the agent may be effective.

In the case of Cooke & Sons v Eshelby, an agent (a broker) sometimes dealt on his own account and sometimes as an agent, and third party did not know what was the case on the relevant occasion. Accordingly, Bowstead considers that it is not clear whether the principal should have been treated as undisclosed or disclosed but unnamed. Whilst the doctrine of constructive notice is not applicable in commercial transactions, the third party may be taken to have notice that the agent has or may have a principal, due to the nature of the agent's occupation eg a broker. Accordingly, care must be taken in relation to settlement with or set-off against an agent.

8.4 Merger and Election: Release of Principal

The two main rules which are important in connection with undisclosed principals are as follows:

(i) "Where an agent enters into a contract on such terms that he is personally liable on it and judgment is obtained against him on the contract, the judgment, though unsatisfied is, so long as it subsists, a bar to any proceedings against the principal, undisclosed or (semble) disclosed, on the contract". Bowstead.

Therefore where an agent contracts for an undisclosed principal, the third party can, on discovery of the facts, sue either the agent or the principal. However if judgment is obtained against the agent, he can no longer sue the principal even though he obtained judgment in ignorance of the fact the agent had been acting for another and even though the judgment is unsatisfied.

(ii) "(Semble) Where an agent enters into a contract on such terms that he is personally liable on it together with his principal, or enters into a contract on behalf of an undisclosed
principal, and the other contracting party, knowing or discovering who is the real principal, elects to pursue his rights against the agent, he is irrevocably bound by his election and cannot afterwards sue the principal on the contract. The question whether or not he has so elected is a question of fact". Bowstead.

Bowstead however submits that a third party should only be disbarred from suing an undisclosed principal, short of judgment against the agent, by an act which raises an estoppel against him, eg where after discovery of the principal he does an act, leading the principal to suppose that he relied on the agent, or has been paid by the agent, or waives the liability of the principal.

8.5 Rights and Liabilities of the Agent

Where the principal is undisclosed at the time of contracting, the contract is made with the agent, and he is personally liable and entitled on it. The principal may also intervene to sue, and may be sued, but the latter only subject to the general rule that nothing must prejudice the right of the third party to sue the agent if he so wishes.

9 Where agent is the real principal

It is worth considering the rules expounded by Bowstead in relation to those situations where the agent is shown to be the real principal. However, Bowstead states that these have slender authority and are very difficult to justify in principle:

(1) "Where a person professes to contract as agent, whether in writing or orally, and it is shown that he is, in fact, himself the principal, and was acting on his own behalf, he is (perhaps) personally liable on the contract."
Where a person who enters into a contract professedly as an agent is in fact the real principal, he may (perhaps) sue on the contract:

(a) where the identity of the contracting party is not a material element in making the contract, provided that he gives notice to the other contracting party, before action, that he is the real principal;

(b) where it has been partly performed or otherwise affirmed by the other contracting party with knowledge that he is the real principal".

Bowstead

Therefore it is appropriate to consider the first rule of liability and the second rule of the right to sue in relation to the unnamed principal. Before turning to these rules, it is worth noting that in a case where an agent states that he is acting for a named principal, but is in fact acting for himself (and therefore has no authority (actual or apparent) to act for the named principal), the appropriate action would be for breach of warranty of authority or in tort. However whilst there are certain cases to support the rule in Bowstead that the agent is personally liable on the contract, the justification is queried.

First, as regards liability, as discussed previously if the agent does not name his principal, there is a possibility that he may have contracted personally. Bowstead argues that where the agent contracts as agent only, and has no principal, analytically the agent's liability should be in a collateral contract that he has a principal fitting the description (if any) given, presumed to be a solvent person unless he can prove he was agent for an insolvent person, although the concept that an agent would be liable on the contract was however accepted in Hersom v Barnett [1955] 108 98. In this case, the plaintiff bought from a defendant, who is purporting to act as agent for an undisclosed principal, certain goods which had been stolen by a person unknown.
The defendant pleaded that his principal was X and gave evidence to that effect but the court rejects this as false. In this case the defendant was held personally liable on the contract. (Bowstead however considers that this case may have been "a quick route to a desired result"). "But the mere fact that the agent's act does not bind the purported principal does not mean that he is to be regarded as acting for himself; there must be evidence that he is actually doing so, or (as in Hersom v Bennett) other circumstances preventing him from denying it". Bowstead.

In relation to the right to sue, Schmultz v Avery (1851) 16QB 655 decided that where an agent who signed a charterparty containing a cesser clause purportedly as agent could show that he was himself the principal and sue on the contract. Bowstead argues that "the true analysis is that the contract in such cases is with the unnamed principal, and that the agent can only intervene if he fits such description (if any) as has been given of the supposed principal. If a third party can establish that he would not be willing to contract with the agent, he should be able to say that he has no agreement with the agent". Therefore, where the identity of the contracting party is material, this may prevent the agent suing as principal.

However Bowstead considers that this case relates to a particular form of cesser clause, and also considers that the whole of the rule should be considered with caution.

**Conclusion**

As can be seen from this paper, there are many areas where the law is unclear and the judgments over a century old. As has also been shown, the distinction between the disclosed and undisclosed principal is also far from clear. "On existing doctrine ...... the question whether the undisclosed principal rules or the unnamed principal rules apply cannot be solved by asking simply whether the person concerned is in ordinary speech to be described as completely undisclosed or merely as unnamed: it has to be answered by considering which starting-point
as to the liabilities of those involved seems to be more appropriate."

F M B Reynolds: Practical Problems of the Undisclosed Principal
Doctrine CLP 1983

Financial Law Panel
20 December 1993