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UNDISCLOSED PRINCIPAL—HIS RIGHTS AND LIABILITIES

The doctrine that an undisclosed principal may sue and be sued upon contracts made by his agent, as ostensible principal, with third parties, is so firmly established in the law of England and of this country, that it would be quixotic to attack it in the courts. Nevertheless, whenever an established doctrine ignores, as this doctrine of the undisclosed principal ignores, fundamental legal principles, it is highly important that it should be recognized as an anomaly, to be reckoned with of course, but not to be made the basis of analogical reasoning. Unfortunately, a majority of the judges and of the writers upon Agency and Contracts state the rule as to the right and liability of the undisclosed principal without any discussion of its soundness. Lord Cairns,¹ indeed, and Sir William Anson² accept its soundness as self-evident.

On the other hand, Lord Davey,³ Lord Lindley⁴ and Smith, L. J.,⁵ in their judgments have treated the rule as an anomaly, and Mr. Tiffany,⁶ Mr. Huffcut,⁷ Mr. Lewis⁸ and Sir Frederick Pollock have expressed a similar opinion in their writings. The latter condemns it in these strong terms: "The plain truth ought never to be forgotten that the whole law as to the

¹ *Kendall v. Hamilton*, 4 App. Cas. 504, 514.

² Anson, *Cont.* (2nd Ed.), 346.

³ *Keighley v. Durant* [1901], A. C. 240, 256.

⁴ *Keighley v. Durant* [1901], A. C. 240, 261.

⁵ *Durant v. Roberts* [1901], 1 Q. B. 629, 635. See also Lord Blackburn's words in *Armstrong v. Stokes*, L. R. 7 Q. B. 598, 604.

⁶ Tiffany, *Agency*, 232-233.

⁷ Huffcut, *Agency*, 166.

⁸ *9 Columbia Law Review*, 116, 130.

rights and liabilities of an undisclosed principal is inconsistent with the elementary doctrines of the law of contract. The right of one person to sue another on a contract not really made with the person suing is unknown to every legal system except that of England and America."⁹

This language, it is submitted, is not at all too strong. Let us analyze the common case of a sale on credit of specified goods by A to B, who, without A's knowledge, is buying for the benefit of C. The title to the goods sold must pass from A to B, because that was the declared intention of both parties. The actual transaction is, therefore, a sale by A to B. But this sale by A to B excludes the possibility of the sale of the same goods by A to C.¹⁰ In other words, A could prove a count for goods sold to B in an action against B, but could not prove a count for goods sold to C in an action against C. The rule, therefore, which permits A to charge either B or C at his option, permits a plaintiff to recover on his allegation regardless of his evidence.

But although B, and not C, acquires the legal title from A, B holds that title from the outset for the benefit of C. The truth of the matter is, therefore, that B, in buying for an undisclosed principal, is not acting as an attorney or representative of his employer, but as his trustee. If we suppose the subject of the purchase to be land, this statement may be more convincing. When A conveys the land to B, no one will say that the title passes to C. But B, who gets the title, does not hold it for himself, but as trustee for C. To say that A may charge C upon B's contract of purchase, is to maintain what no one would maintain, that a *cestui que trust* may be sued, and at law, upon contracts between the trustee and third persons.

The rule which permits the undisclosed principal to sue the third person, who has contracted with the agent, in ignorance of

⁹ 3 *L. Q. Review* 359. See also 14 *L. Q. Review* 5.

¹⁰ The impossibility of the sale of the same goods at the same moment both to the agent and to his principal, is illustrated by *Hinson v. Berridge*, Moore 701, pl. 975, decided in 1595, when an action of assumpsit was not allowed, if the facts would support a count in debt. In this case, C, in consideration of the sale of 200 lambs by A to B, the factor of C, at a price to be agreed upon by A and B, promised to pay A the said price. To an action of assumpsit on this promise C objected that the action should have been in debt, as the sale was to him. "But all the judges *contra*, for the words are that he should sell to B to the use of C, so the sale was to B, and the use is only a confidence, which does not give a title (property) at law, so that debt lies not against C, but assumpsit."

the agency, is no more defensible than that which sanctions a direct action by the third person against the undisclosed principal.

Suppose, for example, mutual promises by A to sell and convey and by B to buy a tract of land, B acting for the benefit of C, but A having no knowledge of this fact. A certainly becomes bound to B. This is the necessary result of their declared intentions. It is equally clear that neither intended that A should assume more than one obligation. It follows, therefore, that there can be no direct obligation of A to C. Indirectly, indeed, C may reap the fruits of this contract, for B having acquired A's obligation for the benefit of C holds it, from the moment of its acquisition, as a trust-*res*. Here again B is acting not as the attorney, or representative, but as the trustee of C.

Logically, then, there is no direct relation between the undisclosed principal and the third person with whom the agent contracts. Only with the agent does the third person stand in the relation of obligor and obligee. Only the agent should sue, or be sued by, the third person. The soundness of these logical conclusions, and the unsoundness of the English and American doctrine to the contrary, find confirmation in the law of other countries. By the German law, the undisclosed principal cannot maintain an action against the third person with whom his agent has contracted unless the agent has assigned the claim to the principal;¹¹ and on the other hand, no action can be maintained by the third person against the undisclosed principal.¹² The French law is to the same effect,¹³ as is the law of Spain¹⁴ and other European countries.¹⁵

Even in England and America the anomalous rule by which one may sue or be sued upon a contract to which he is not a

¹¹ 1 *Entscheidungen d. Reichs-Gerichts*, No. 116; Staub, *Commentar z. Handelsgesetzbuch*, 1739.

¹² 2 *Entscheidungen des Reichs-Gerichts*, No. 43; 16 *Entscheidungen des R. O. H. G.*, No. 24.

¹³ "Les tiers ne connaissent, ou sont censés ne connaître que le prête-nom: c' est lui qui est leur créancier, lui qui est leur débiteur, lui qui est propriétaire des biens mis sous son nom. Ils ont donc le droit de le poursuivre et ils peuvent être poursuivis par lui; et, d'autre part, ils ne peuvent poursuivre que lui ou n' être poursuivis que par lui." 2 Planiol, *Droit Civil*, Sect. 2271. See also 21 Baudry-Lacantinerie, *Droit Civil*, Sect. 897.

¹⁴ *Mildred v. Maspons*, 8 App. Cas. 874, 887.

¹⁵ For the law of Lower Canada see *V. Hudon Co. v. Canada Co.*, 13 Can. S. C. R. 401.

party, is of limited scope. No action may be brought, in those countries, by or against an undisclosed principal upon a contract under seal, upon a bill of exchange or promissory note, nor for dividends or assessments due to or from a shareholder of a corporation¹⁶; nor even upon a simple contract when the agent, acting for several undisclosed principals, instead of making separate contracts in behalf of each, makes a single lump contract in behalf of all.¹⁷ Moreover, this anomalous doctrine is a modern notion. There is no trace of it in the days when the action of debt was the normal remedy upon simple contracts. The agent of the undisclosed principal received the *quid pro quo* from the third person; he, therefore, and he only could be the debtor.¹⁸ The first judicial sanction of the doctrine is by Lee, C. J., as late as 1743, in the *nisi prius* case of *Schrimshire v. Alderton*,¹⁹ This case is instructive by reason of the reluctance of the jury to accept the direction of the judge. The action was brought by the undisclosed principal for the price of goods sold by his factor. The buyer paid the factor, although the latter had failed and the principal had sent him notice not to do so. The judge "directed the jury in favor of the plaintiff. They went out and found for the defendant; were sent out a second, and a third time to reconsider it, and still adhered to their verdict; and being asked man by man, they separately declared they found for the defendant." Upon this a new trial was granted. "And at the sittings after this term, it came again before a special jury; when the Chief Justice declared that a factor's sale does by the general rule of law create a contract between the owner and the buyer. But notwithstanding this, the jury found for the defendant; and being asked their reasons, declared that they thought from the circumstances no credit was given as between the owner and the buyer, and that the latter was answerable to the factor only, and he only to the owner." This case recalls the earlier struggle of Lord Holt with the merchants as to the negotiability of promissory notes. In the later case as in the earlier one, the business men, although overridden by a masterful judge, were in the right. Alderton, the buyer, was the debtor of the factor, the latter holding his claim as trustee for the principal. The debtor

¹⁶ See *Hinson v. Berridge*, summarized, *supra*, 444 n. 10

¹⁷ *Roosevelt v. Doherty*, 129 Mass. 301.

¹⁸ See *Hinson v. Berridge*, summarized, *supra*, 444 n. 10.

¹⁹ 2 *Stra.* 1182.

was justified in paying the factor unless he had reason to suppose that the latter would use the money for his own purposes, and even in such a case his payment would make him liable to the principal, not at law, but only in equity for confederating with a delinquent trustee. The right to charge the undisclosed principal as a defendant was established in the last quarter of the eighteenth century.

Why, it may be asked, did the English and American courts sanction a doctrine, logically indefensible, and not recognized in other countries? No better answer has been found in the books than this statement of Lord Lindley: "The explanation of the doctrine that an undisclosed principal can sue and be sued on a contract made in the name of another person with his authority is, that the contract is in truth, although not in form, that of the undisclosed principal himself. Both the principal and the authority exist when the contract is made; and the person who makes it for him is only the instrument by which the principal acts. In allowing him to sue and be sued upon it, effect is given, so far as he is concerned, to what is true in fact, although that truth may not be known to the other party.

"At the same time, as a contract is constituted by the concurrence of two or more persons and by their agreement to the same terms, there is an anomaly in holding one person bound to another of whom he knows nothing and with whom he did not, in fact, intend to contract. But middlemen, through whom contracts are made, are common and useful in business, and in the great mass of contracts it is a matter of indifference to either party whether there is an undisclosed principal or not. If he exists it is, to say the least, extremely convenient that he should be able to sue and be sued as a principal, and he is only allowed to do so upon terms which exclude injustice."¹⁹

Lord Lindley makes it clear that the English doctrine was the outcome of the feeling that it was just that the undisclosed principal should have the benefits and the burdens of the contract made in his behalf. But although he sees the anomalous character of the doctrine, it seems not to have occurred to him or to the judges who introduced it, that a more perfect justice might have been worked out without any sacrifice of the elementary principles of the law of contract. The failure to see how the desired justice could be brought about in any other way is the

¹⁹ *Keighley v. Durant* [1901], A. C. 240, 261.

true explanation, it is believed, of the rule permitting the undisclosed principal to sue and be sued upon contracts made by his agent.

Let us see what measure of justice might have been attained, if actions by and against the undisclosed principal had not been allowed. Obviously there would have been the same relation between the third person and the agent in the case of simple contracts, which now exists in the case of contracts under seal and of bills of exchange and promissory notes. As to claims against the third person, the agent, and the agent only would be the obligee; as to claims in favor of the third person, the agent and the agent only would be the obligor.

To take up first claims in favor of the agent. The agent holds the legal title to the claim against the third person as he would hold the title to a covenant or note. But as he acquired it for the benefit of the undisclosed principal, he is trustee of it for the latter. The undisclosed principal as *cestui que trust* would realize indirectly through the trustee all that under the actual law he now obtains from him by a direct action against him. The third person would have the same defenses against the trustee suing for the principal, his *cestui que trust*, which he now has against the principal suing in his own name. The only difference would be this, that his defenses to an action by the agent suing as trustee would be legal defenses, whereas his defenses to an action by the principal in his own name are, strictly speaking, equitable defenses based upon estoppel. If the agent should become bankrupt before collecting the claim against the third person, the claim being held by him as trustee would not pass to his assignee in bankruptcy, but would continue to be held by him in trust for the principal, and if the claim should be paid to the assignee in bankruptcy, the latter would have to account for it in full to the principal. One case may be put in which the existing anomalous doctrine and the trust theory here suggested would lead to opposite results. Suppose A has contracted to sell a tract of land to B, who was acting for C, an undisclosed principal, and that B, in violation of his duty to C has sold his claim against A to P, a purchaser for value without notice of C's interest therein. Under the rule which gives C a direct right against A, P must give way to the prior claim of C. But if C is only *cestui que trust* of the claim held by B against A, P will prevail over C in the numerous jurisdictions in this country in which the *bona fide* purchaser of a

choses in action takes it free and clear of equities in favor of persons other than the obligor. The preference of the *bona fide* purchaser over the undisclosed principal, it is submitted, is more satisfactory than the opposite result.

But the real difficulty is not in giving the undisclosed principal the benefit of the third person's contract with the agent, but in imposing upon the principal the burden of the agent's contract with the third person. If we accept the sound view that the agent alone can be charged directly upon the contract with the third person, is it true, as the courts seem to have assumed, that there is no way by which the third person may indirectly hold the undisclosed principal responsible for the fulfilment of the agent's contract? No, the assumption of the judges is not well-founded. There is a mode of legal procedure, which, without any departure from legal principles, would give the third person whenever he needs and, in justice, is entitled to it, the power to compel the undisclosed principal to make good the contract of his agent. The relation of principal and agent carries with it without any express agreement, the obligation on the part of the principal not only to repay the agent for all legitimate disbursements, but also to save him harmless from all authorized undertakings made by him as agent. In other words, the principal is subject to two distinct duties, the duty of reimbursement and the duty of exoneration.²⁰ Accordingly, if the agent has entered into a contract with a third person for the purchase of the latter's land for \$10,000, although the agent, and the agent only, is chargeable on the promise to the seller to pay the purchase money, the undisclosed principal is also liable on his separate promise to the agent to pay, or to provide the funds with which the agent may pay, the seller. This right of the agent to exoneration by the principal is a thing of value, is property, a part of his assets. It is, therefore, like other property subject to execution at the suit of the third person who sold the land to the agent of the undisclosed principal. Choses in action, it is true, were not subject to common law execution until made so by comparatively modern legislation. But before such legislation they were accessible to credi-

²⁰ Le mandant doit indemniser entièrement le mandataire de la gestion de l'affaire, dont il a bien voulu se charger. Cette indemnité ne consiste pas seulement à rembourser le mandataire des déboursés qu'il a faits; il faut pour que l'indemnité soit entière, qu'il soit déchargé des obligations qu'il a contractées pour l'exécution du mandat." Pothier, Mandat, § 80.

tors by equitable execution.²¹ Even since such legislation, the right of exoneration can be reached only by equitable execution. For there is one important difference between a debtor's right of exoneration and his other choses in action. In general, when the claim upon a chose in action is satisfied, it is the obligee who receives the fruits of the claim, and when a debtor's chose in action against another is sold under execution, the execution purchaser receives these fruits, as successor to the execution debtor. But when a claim for exoneration is satisfied, the performance is not to the obligee but to a third person, the obligee profiting not by a positive addition to his resources, but by the extinguishment of a liability to the third person. This right is not the subject of a common law execution. By its nature it is not marketable, for the buyer would get nothing of value to him by its purchase. Such a right can be realized only by specific performance, and it is well settled that equity will compel specific performance of the obligation to exonerate.²² Furthermore, it would be idle for the ordinary creditors of the one entitled to be exonerated from his liability to the third person to seek, by an equitable execution, to compel their debtor to realize this right of specific performance. The performance would not inure to their benefit, but to the advantage of the third person. But this third person, unlike the other creditors, is vitally interested in the exercise by his debtor of the latter's right of exoneration. He, therefore, is clearly entitled to maintain a bill for equitable execution to compel the debtor to realize his asset, that is, his right of exoneration.

The reasoning just suggested has been applied in giving a remedy against the trust estate to one who has furnished supplies to the trustee for the benefit of the estate. It goes without saying that the trustee alone is liable on the contract with the third person. But the trustee has the right to apply the trust property in exoneration of liabilities reasonably incurred by him in the administration of the trust. If he is unwilling to exercise this right, the creditor may treat the right as an asset of the trustee and, by a bill for equitable execution, compel the trustee to apply the trust property in payment of the liability.²³ But the trustee has not only the right to exonerate himself out of the

²¹ *Bayard v. Hofman*, 4 John Ch. 450; *Drake v. Rice*, 130 Mass. 410.

²² 1 Ames, *Cases in Eq. Jurisd.*, 64, n. 1.

²³ Ames, *Cases on Trusts* (2nd Ed.), 423, n. 1.

trust property; he has also a right to be exonerated by the *cestui que trust* out of the general assets of the latter:²⁴ that is to say, the duty of the *cestui que trust* to exonerate the trustee is just like the duty of the principal to exonerate the agent. It seems clear that the courts which allow the creditor of the trustee to reach and apply the trustee's right of exoneration out of the trust property, could not consistently refuse to allow him to reach and apply the trustee's right of exoneration out of the general substance of the *cestui que trust*. *Clavering v. Westley*,²⁵ is a case in point.

The right of equitable execution upon a debtor's right of exoneration is illustrated by another class of cases. If C promises B to pay B's debt to A, C's undertaking is similar to the obligation of the principal to exonerate the agent. If C's promise is under seal, A is generally not allowed to sue C at law even in jurisdictions which allow such an action upon a promise not under seal. But A is allowed, nevertheless, to treat C's promise to pay B's debt as an asset of B's, and to enforce B's right of exoneration through a decree for its specific performance.²⁶

It is evident from these illustrations, that, if the courts had seen their way to charge the undisclosed principal upon the theory of equitable execution against the agent's right of exoneration, they would not have been invoking a novel and untried equitable principle. It is now too late, of course, to apply this theory to simple contracts made by the agent of an undisclosed principal. But there seems to be no good reason why it should not be applied in cases where the agent contracts under seal or by bill or note, or as a shareholder of a corporation, or by one simple contract in behalf of several independent principals²⁷.

It should be observed, however, that the working out of the right against the undisclosed principal through the agent's right

²⁴ *Hardoon v. Belilos*, [1901], A. C. 118.

²⁵ This case does not stand for the general principle to which Lord Cransworth objected in *Walter v. Northern Co.*, 5 D. M. & G 629, 646.

²⁶ *Crowell v. Hospital*, 27 N. J. Eq. 650. See also Williston's *Wald's Pollock on Contracts*, 245.

²⁷ The principle of equitable execution upon the debtor's right of exoneration is equally applicable to cases of disclosed agency, in which the agent only is directly liable on the contract with the third person, as when the contract is by instrument under seal, or by a negotiable instrument, or when, in the case of a simple contract, the third person and the agent agree that the latter, and not the principal, shall be liable on the contract.

of exoneration, will not always lead to the same practical results in the case of contracts under seal, that have been reached by the anomalous actual doctrine governing simple contracts.

If, for example, the principal has paid the agent in discharge of his duty to him, that ends the agent's right to exoneration and, consequently, the third person's right to equitable execution. But in England, the undisclosed principal presumably continues liable notwithstanding his payment to the principal unless the conduct of the third person led him to suppose that such payment would terminate his liability.²⁸

The right of exoneration might also be neutralized by the agent's misconduct after contracting with the third person. He might, for instance, misappropriate the goods he had bought on credit for the undisclosed principal. In such a case the third person would take nothing by his bill for equitable execution.²⁹ But under the existing anomalous rule the undisclosed principal would be liable on the agent's contract notwithstanding the agent's misconduct.

If, again, the agent's right of exoneration never arose, there could be, of course, no equitable execution for the third person. If, for example, an agent for an undisclosed principal made a contract in violation of his instructions, but a contract which would have been within the scope of his apparent authority, had the agency been disclosed, the third person could obtain no relief against the principal upon the theory of equitable execution. For the agent having disobeyed his instructions would have no right of exoneration against the principal. But in *Watteau v. Fenwick*³⁰, the undisclosed principal was charged upon the agent's contract in just such a case.³¹

In the three instances of simple contracts just considered, the third person, under the anomalous English and American rule,

²⁸ *Heald v. Kenworthy*, 10 Ex. 739; *Irvine v. Watson*, 5 Q. B. Div. 414, criticising the statements in *Armstrong v. Stokes*, L. R. 7 Q. B. 598. Probably the rule of America is the other way.

²⁹ Similarly, a creditor of a trustee seeking to charge the trust estates or the contingent trust will be defeated in whole or in part if the trustee is in arrears to the trust estate. R. Johnson, 15 Ch. D. 548; Ames, *Cases on Trusts* (2nd ed.), n. 1, par. 2.

³⁰ (1893) 1 Q. B. 348.

³¹ See criticisms of this case in *Bechere v. Asher*, 23 Ont. App. 210, by Osler, J. A.; in 9 L. Q. R., 111 by Sir Frederick Pollock; in Ewart, *Estoppel*, 246; and in 37 Sol. J., 280.

profits unjustly at the expense of the undisclosed principal. On the other hand, under that same rule, in at least one case of simple contract, the third person suffers unjustly to the undeserved advantage of the principal. This is true when the agent, acting for several principals, strangers to each other, instead of making separate contracts in behalf of each, makes a single lump contract in behalf of all. The principals cannot be sued jointly upon the contract, nor can any one of them be sued alone upon the entire contract. But by bills for equitable execution the third person could reach and apply, towards the satisfaction of his claim against the agent, the latter's separate rights of exoneration against the independent principals to the extent of each one's interest in the contract.

If the reasoning of this article is sound, the anomalous, but established English and American rule is open to these three objections. First, it violates fundamental principles of contract. Secondly, it gives the third person no relief against the principal upon the agent's contracts under seal, his negotiable contracts, or his liability as a shareholder, although, in point of justice, relief is demanded as much upon contracts in these forms, as upon simple contracts. Thirdly, as a practical working rule in the case of simple contracts, it frequently operates unjustly, sometimes putting unmerited burdens upon the principal and sometimes denying the third person merited relief.

The doctrine of equitable execution upon the agent's right of exoneration, on the other hand, has these three merits. It accords with legal principle, it applies uniformly to all forms of contract, and produces just results.

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