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Kelly v. Fraser compared to the Allocation of Risk in Agency Law in the Netherlands

1. Introduction

Apparent authority is an interesting subject. In the common law it is at a crossroads, according to Colm Kelly.[1] He states that ostensible authority has been pushed to its limits and therefore he sees a need to recalibrate the conception of ostensible authority.[2] The cause of this statement was the ruling in *Kelly v. Fraser*[3] which will be discussed in this article.

In the Dutch case law concerning apparent authority, much emphasis has been put on the allocation of risk. In this article I will point out various rulings by the Hoge Raad (Supreme Court NL) to show how the argumentation developed over time. I will compare the two legal systems and I will discuss *Kelly v. Fraser* using the Dutch concept of allocation of risk.

2. Competing concepts in the common law on apparent authority

In *Freeman and Lockyer (A Firm) v. Buckhurst Park Properties (Mangal) Ltd & Anor* Diplock L.J. stated that four requirements are necessary to establish apparent authority:

- a representation made to the third party,
- by somebody with actual authority to make it,
- that was relied upon by the third party to his detriment,
- where it was within the capacity of the company to make such a representation.[4]

When these four requirements are fulfilled, the conclusion is that the principal is bound.

Following this judgment, other cases have been decided on the matter of apparent authority. A question that has arisen in some cases is whether an agent can have apparent authority to communicate the approval of the principal if that agent had no apparent authority to enter into that specific transaction.

In *Armagas Ltd v. Mundogas SA ('The Ocean Frost')*[5] the House of Lords held that if an agent has no actual or apparent authority to contract, he also cannot falsely represent that he has gained the principal's approval since that would be the same as saying he has apparent authority to contract. Lord Keith declared that he was not willing to accept 'the general proposition that ostensible authority of an agent to communicate agreement by his principal to a particular transaction is conceptually different from ostensible authority to enter into that particular transaction'.[6]

To accept that a third party may rely on a representation of approval by an unauthorised agent would offend the fundamental principle that an agent cannot hold himself out as having authority.[7]

In *First Energy (UK) v. Hungarian International Bank Ltd ('First Energy')*[8] the appellant negotiated a credit agreement with the regional manager of a bank. This manager had authority to negotiate the terms, but had informed the appellant that he had no authority to approve the final deal. The head office held that authority. Nonetheless the regional bank manager confirmed that the head office had approved the transactions. The English Court of Appeal held that the appellant was entitled to rely on that representation. While the regional bank manager had no authority to grant credit facilities, he did have apparent authority to communicate the decision of the head office since:

'the head office had put him in a position where one could expect him to have such authority'.[9]

In the *First Energy* case the regional bank manager was a senior manager and the highest-ranking personnel at the branch. Protection of a third party on the basis of the position of the agent was not new. I would like to point out the dictum of Atkin L.J. in *Kreditbank Kassel GmbH v. Schenkers Ltd*:[10]

'If you are dealing with a director in a matter in which normally a director would have power to act for the company you are not obliged to inquire whether or not the formalities required by the articles have been complied with before he exercises that power. Those are

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1. Colm Kelly, 'Reconciling the Irreconcilable: Ostensible Authority after *Kelly v Fraser*', *King's Inn Student L. Rev*. 3 (2013), 1.
2. *Ibid*., at 2.
3. [2012] UKPC 25; [2013] 1 AC 450.
4. [1964] 2 QB 480 at 506. On *Freeman and Lockyer* see e.g. G.H.L. Fridman, 'The Self-authorizing Agent', *Manitoba Law Journal* 13 (1983), 1.
5. [1986] 1 AC 717.
6. [1986] 1 AC 717 at 779.
7. E.g. Peter Watts, 'Deeds and the Principles of Authority in Agency Law', *Oxford U. Commw. L.J.* (2002), 93.
8. [1993] 2 Lloyd's Rep 194.
9. [1993] 2 Lloyd's Rep 194 at 204.
10. [1927] 1 KB 826 at 844.

matters of internal management which an outsider is not obliged to investigate.'

In *First Energy* Steyn L.J.'s judgment holds the passage:[11]

'A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected. It is not a rule or a principle of law. It is the objective which has been and still is the principal moulding force of our law of contract. It affords no licence to a Judge to depart from binding precedent. On the other hand, if the prima facie solution to a problem runs counter to the reasonable expectations of honest men, this criterion sometimes requires a rigorous re-examination of the problem to ascertain whether the law does indeed compel demonstrable unfairness. These general considerations are of some relevance to a question of ostensible authority which is the principal matter to be considered on this appeal. If we were to accept the implications which the appellants have placed on observation, the House of Lords in *Armagas Ltd v. Mundogas SA* our decision would in my view frustrate the reasonable expectations of the parties. Moreover, our decision would have to be based on an unreal premise as to the way in which commercial men transact business of the particular kind involved in this case. I shall attempt to show that the application of orthodox principles does not compel such a result.'

Peter Watts, while explaining *First Energy*, states that there is a line of authority for the proposition that if a principal knows that an agent is overstating his authority and takes no action to prevent this, the principal can be estopped from relying on the agent's lack of authority.[12] This argument, however, turns on the knowledge of the principal. If the principal did *not* know that the agent was overstating his authority, the third party would not automatically be protected. While this may sound harsh, it really is not. In very many cases the holding out by the principal can basically already be found in a business card given by the principal to the agent, or attendance at a meeting by the third party at the principal's premises. In these cases, the third party is protected if he relied on this (implicit) holding out by the principal.

3. *Kelly v. Fraser*[13] in line with First Energy

What was the case in *Kelly v. Fraser*? Michael Fraser became President and Chief Executive of the Island Life Insurance Company in 2000. He had previously been employed by Life of Jamaica Ltd. and had contributed to its pension scheme. He now wanted to transfer the accrued value of his entitlement under the Life of Jamaica scheme to the Island Life Plan and discussed this with Clive Masters, the Vice-President of Island Life Insurance Company, responsible for the Employee Benefits Division. The discretion to accept funds from other schemes was vested in the trustees personally. Clive Masters was not authorised to approve the transfer. However, the trustees could delegate the daily administration of the Island Life Plan to the employee benefits division and this they did. The pension administrator of Life of Jamaica sent a cheque representing Mr Fraser's accrued contributions to the trustees of the Island of Jamaica Plan. The money was credited and invested with the other funds of the Plan without the trustees' approval or knowledge. Michael Fraser received a letter from Clive Masters confirming the transfer. Also, he received periodic statements from the Employee Benefits Division of Island Life recording the accumulated value of his units in the fund.
In 2003 Island Life merged with Life of Jamaica and the Plan was terminated. Of course, Michael Fraser was entitled to recover his contributions. The problem was the surplus. It was decided that, since Michael Fraser's transfer from Life of Jamaica had not been approved by the trustees, Mr. Fraser's share of the surplus should be calculated without regard to any benefit attributable to it. He was only entitled to JMD 866,688.43. Had the whole of his entitlement been taken into account, he would have received JMD 6,809,571.00.
The question arises as to whether the trustees were bound. Lord Sumption states:

'The Board approaches the question whether the trustees were bound by these statements on the footing that neither Mr Masters nor any one else in the Employee Benefits Division had authority of any kind to approve the transfer into the Plan. Nor did they purport to have done so. Equally, none of them had any actual authority to tell Mr Fraser that everything was in order if it was not. The question, therefore, is whether they had ostensible authority to tell Mr Fraser that whatever steps needed to be taken to carry out his transaction regularly had been duly performed, if they had no authority to perform those steps themselves.'[14]

Lord Sumption furthermore states that the judgments in *First Energy* and *Armagas v. Mundogas* are consistent.

'Lord Keith's speech remains the classic statement of the relevant legal principles. An agent cannot be said to have authority *solely* on the basis that he has held himself out as having it. It is, however, perfectly possible for the proper authorities of a company (or, for that matter, any other principal) to organise its affairs in such a way that subordinates who would have no authority to approve a transaction are nevertheless held out by those authorities as the persons who are to communicate to outsiders the fact that it has been approved by those who are authorised to approve it or that some particular agent has been duly authorised to approve it. These are representations which, if made by some one held out by the company to

11. [1993] 2 Lloyd's Rep 194 at 196.
12. Peter Watts QC, 'Some Wear and Tear on *Armagas v Mundogas* – The Tension Between Having and Wanting in the Law of Agency', *Lloyd's Maritime and Commercial Law Quarterly* (2015), 36 at 43.
13. [2012] UKPC 25; [2013] 1 AC 450.
14. [2012] UKPC 25 at [11].

make representations of that kind, may give rise to an estoppel.'[15]

In this case the trustees are the ultimate source of authority. But pension fund trustees hardly ever communicate personally with contributors. Their decisions are communicated and applied by professional managers. On the basis of these facts, Lord Sumption concludes that:

'Mr Masters was the senior officer of the relevant department of the company. He never professed to have authorised the acceptance of the transfer funds himself, but the plan could hardly have been operated if he did not have the authority to write letters informing contributors that they had been duly accepted and in respect of what contributions. Moreover, with or without the trustees' approval, the transfer funds were in fact accepted, and accruals to the transfer funds notified in successive benefit statements. Subject to the question of reliance, the trustees cannot now disclaim all of this and treat the transfer funds for some purposes as if they had been received and for other purposes as if they had not.'[16]

In other words, the trustees are bound because they put Clive Masters in the position of Vice-President of the Employee Benefits Division. Michael Fraser could (and actually did) rely on the apparent authority to communicate decisions by the trustees, created by this position. The source of the agent's apparent authority is not founded in his own representation but in the principal's conduct, the principal's adoption of an operational structure that involves delegating to intermediaries the authority to communicate its decisions to third parties.[17] Secondly, the trustees are bound on the basis of apparent ratification, since the funds were in fact accepted and Mr Fraser even received periodic statements from the Employee Benefits Division of Island Life recording the accumulated value of his units in the fund.

Colm Kelly justly points out that 'essentially the law is trying to achieve a fair allocation of risk between the principal and the third party' and that furthermore 'Apparent authority was conceived as a means of achieving fairness and for that reason we should focus on the position of the third party'.[18]

In Dutch case law concerning apparent authority much emphasis was put on the allocation of risk in *ING Bank NV v. Bera Holding NV*.[19] Therefore I would like to point out the gradual development of this concept of allocation of risk in the following paragraphs.

4. Apparent authority in Dutch Law

In 1926 the Supreme Court of the Netherlands (Hoge Raad der Nederlanden, hereafter referred to as Supreme Court NL)[20] had to address the problem of apparent authority in the case *Vas Dias v. Salters*, where an architect had promised repairs. The principal stated he had never given the architect the authority to make this promise. The Supreme Court NL found that the principal is bound when he has disclosed his will to that effect, either directly (verbally) or indirectly (by his behaviour). Furthermore the demands of social intercourse must allow that on the basis of these words or conduct of the principal, the third party could indeed trust that the agent had been authorised.

In 1968 the Supreme Court NL went one step further. In the case of *Molukse Kerk v. Clijnk*[21] the Supreme Court NL found that apparent authority not only has to be based on words or conduct of the principal, but also non-conduct of the principal can create apparent authority of the agent. The case was as follows. Molukse Kerk commissioned architect Porsius to perform construction work on a church building. The maximum amount of the work was set at NLG 58,100. The architect in turn commissioned contractor Clijnk. Clijnk started work. Only when Clijnk was almost finished, did he find out about the cost limitation. His bill at that moment reached NLG 98,000. Molukse Kerk, the principal, stated she had done nothing at all. The Supreme Court NL found that Molukse Kerk had neglected to inform Clijnk about the limitation of the costs. Also Molukse Kerk should have realised how expensive and fundamental the construction job was; she should have interfered. Therefore since 1968 non-conduct of the principal can be the basis of apparent authority of the agent.

In 1992 a major agency case was ruled upon. *Felix v. Aruba*[22] was an Aruban case. In 1984 Felix acted on his plan to start an air cargo handling business at the Aruban airport. To do this, he needed a building. He contacted the aeroclub. The aeroclub and Felix requested permission from the airport commander for Felix to exploit the building of the aeroclub. Permission was apparently tacitly granted. Felix employed staff, renovated the building and started to handle air cargo. In November 1986 the Minister of Transport and Communication decided that handling of air cargo would only be allowed by Air Aruba. Felix closed his company in December 1986 and requested damages. The airport commander had not been authorised to bind Aruba.

The Supreme Court NL ruled that the government can be legally bound by an unauthorised agent. Important facts in deciding whether the principal is bound are:

1. not only a manifestation by somebody with authority to make it, but also:
2. the position of the acting staff member in the governmental organisation,
3. his conduct,

15. [2012] UKPC 25 at [15].
16. [2012] UKPC 25 at [16].
17. Pey Woan Lee, 'The Apparent Authority of the Unauthorised Agent', *SAcLJ* 26 (2014), 258 at 263.
18. Kelly, 'Reconciling the Irreconcilable' 2013 (n. 1), 9.
19. HR 19 February 2010, *NJ* 2010, 115, ECLI:NL:HR:2010:BK7671.
20. HR 6 May 1926, *NJ* 1926, 721.
21. HR 1 March 1968, *NJ* 1968, 246.
22. HR 27 November 1992, *NJ* 1993, 287.

4. the circumstance that the organisation and/or the authorities of its organs are not transparent to outsiders,
5. possible negligence of the government to alert the third party concerning the fact that the agent has no authority to bind the principal.

In the abovementioned list only the first point refers directly to the original requirement necessary to establish ostensible authority (a representation made by somebody with authority to make it). The other points refer to the agent (2 and 3), the organisation of the principal (4) and non conduct by the principal (5).
Another landmark case on agency took place in 2010. *ING Bank v. Bera Holding*[23] came about as follows. Berner was the director of Bera Holding. He lived in Surinam and was the only person authorised to bind Bera. At the request of Ramkalup (joint founder of Bera), ING Bank made an offer to start a banking relationship. Berner came to the bank, together with Ramkalup, to sign the signature card on behalf of Bera Holding. Berner asked the bank to send the bank statements to the Dutch address of certain companies that belonged to Ramkalup. At the request of Ramkalup, ING Bank transferred EUR 210,000 from the account of Bera Holding to those of Bera BV and Bera Commercials BV.
Bera Holding stated that ING Bank transferred the funds to Bera BV and Bera Commercials Bv without authorisation from Bera Holding or its agent. ING Bank did not hold that Ramkalup was an authorised agent of Bera Holding. ING Bank held that, on the basis of Bera Holding's conduct, it could (and did) believe that Ramkalup was authorised to represent Bera Holding. ING Bank supported this statement with the following arguments:

– the bank account was opened on Ramkalup's intervention,
– contacts between ING Bank and Bera Holding were mainly via Ramkalup,
– the bank statements were sent to the address of Ramkalup's companies at the request of Berner,
– Bera Holding did not complain (in time) about the transfer of funds ordered by Ramkalup,
– even after Berner complained about the transfer of funds, another EUR 50,000 had been transferred, again via Ramkalup.

The courts in first instance and on appeal ruled that ING Bank, as a professional bank, should have done more research into Ramkalup's authority before it transferred the funds. It is a fact that ING Bank did not do this research. The Supreme Court NL decided that the starting point must be that a principal is estopped to hold that an agent has no authority to represent him,

– if the third party has trusted the agent's authority on the basis of circumstances which *allocate risk to the principal*, and
– if these circumstances, *according to social intercourse*, could lead to the belief that the agent had apparent authority.

In 2012 a landmark ruling on agency was given by the Supreme Court NL. *Fujitsu v. Excel*[24] repeated the *ING v. Bera* ruling. The risk factor was stressed and the Supreme Court NL stated explicitly that a representation by the principal is not required.

In 2017 again two important court rulings were given by the Supreme Court NL on the subject of apparent authority. In the *Aventura Real Estate* case the Supreme Court NL ruled that the 'allocation of risk principle' does not stretch so far as to include cases in which the representation is based solely on the words or behaviour of the agent.[25] In addition to the words of behaviour of the agent there must be circumstances that allocate risk to the principal.
These are the facts of the second court ruling of 3 February 2017.[26] The principal supplied the agent with all the required documents for the sale of a real estate portfolio. On top of that the principal had agreed to the fact that the agent would look for potential buyers in his own network. Lastly, it can be of importance that the third party knew that the agent was acting as attorney for the principal. These additional circumstances have to be taken into account to conclude whether the principal is bound on the basis of apparent authority.

5. The background of Agency Law in the Netherlands, links with Common Law?

Apparent authority has been codified in Article 3:61 sub 2 Dutch Civil Code. It is a rule of third party protection, a specific agency rule on the protection of trust.[27] It reads as follows:

'If a juridical act has been performed in the name of another person, then it is not possible for the opposite party, who assumed and in the given circumstances reasonably could have assumed on the basis of a statement or the behaviour of that other person that an adeqaute authority for representation was granted, to appeal to the incorrectness of this assumption.'

Whereas this article only mentions 'a statement or behaviour' of the principal, I have argued in the previous section that the case law holds a broader view. Article 3:61 sub 2 Civil Code only holds the first of the factors mentioned in *Felix v. Aruba*: 'a manifestation by somebody with authority to make it'. I would like to have a closer look at the other factors of this court ruling, since the Supreme Court NL in cases such as *ING Bank v. Bera Holding* and *Fujitsu v. Excel* has used *Felix v. Aruba* as

23. HR 19 February 2010, ECLI:NL:HR:2010:BK7671, *NJ* 2010, 115.
24. HR 3 February 2012, ECLI:NL:HR:2012:BU4909, *NJ* 2012, 390.
25. HR 3 February 2017, ECLI:NL:HR:2017:143.
26. HR 3 February 2017, ECLI:NL:HR:2017:142.
27. General protection of trust can be found in Arts. 3:35 and 3:36 Civil Code.

a stepping stone to create a wide basis for apparent authority; wider than article 3:61 sub 2 Civil Code provides.[28]

The position of the acting staff member in the governmental organisation,

This factor, I think, is what in common law is known as 'usual authority'. In the case law of the Netherlands there are, for example, Supreme Court NL rulings concerning the position of an attorney,[29] a director,[30] a bailiff,[31] a carpenter,[32] and a general manager.[33]

His conduct,

The factor 'conduct of the agent' seems to refer to the forbidden notion that an agent cannot hold himself out as having the necessary authority to represent the principal. However, this is not correct. One should bear in mind that an agent cannot be said to have authority *solely*[34] on the basis that he has held himself out as having it.[35] Nonetheless the agent's conduct can be one of the factors on which the third party bases his trust.

The circumstance that the organisation and/or the authorities of its organs are not transparent for outsiders,

In *Mahony v. Est Holyford Mining Co*[36] Lord Hatherly phrased the indoor management rule thus:

'When there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the articles of association, those so dealing with them externally are not to be affected by irregularities which may take place in the internal management of the company.'

This indoor management rule seems to me to be a relative of the idea in the Netherlands that the fact that the organisation and/or the authorities of its organs are not transparant for outsiders, can be a factor to bind the principal.

Possible negligence of the government to alert the third party concerning the fact that the agent has no authority to bind the principal.

First, although the case is about the government of Aruba, a body governed by public law, it is accepted in the Netherlands that the case *Felix v. Aruba* also applies to bodies governed by private law.[37] Secondly, in my view, the negligence can be found in non-conduct by the principal and also in (apparent) ratification. In *Kelly v. Fraser* Michael Fraser received periodic statements from the Employee Benefits Division of Island Life recording the accumulated value of his units in the fund. This can be seen as apparent ratification.

In addition to *Felix v. Aruba*, *ING Bank v. Bera* holds the notion of 'risk'. Two factors are considered:

A. The third party has trusted the agent's authority on the basis of circumstances which allocate risk to the principal

First and foremost, it has to be mentioned that the third party bears the onus of proving that the agent had actual or apparent authority. How he can prove this, however, implies more factors than just words or conduct of the principal. A broad range of facts and circumstances are at his disposal. Examples in the case law of the Netherlands include:

- The third party and the agent had worked for two years on the implementation of a project, the principal had already paid substantial sums to the third party for this job. Also, the third party in this case had done previous business with the principal, concerning these previous contacts the third party also dealt with the agent and the contracts were later honoured by the principal.[38]
- The agent was the manager of the WIA Service Desk. The services in this case were within the scope of the tasks of the service desk. The third party had already performed various pre-contractual duties and was paid by the principal for these.[39]
- The station manager held a job interview with the third party. The station manager was part of the management of the principal and the station manager handed the third party the labour contract. On the basis of these circumstances the third party could trust that the station manager was authorised to hire him.[40]

28. A.L.H. Ernes, 'Het leerstuk onbevoegde vertegenwoordiging sinds het arrest Felix/Aruba', in: Witjens, Van Bogaert, Bollen (eds.), *E hofi di Ley*, Feestbundel ter gelegenheid van 25 jaar Faculteit der Rechtsgeleerdheid van de Universiteit van Aruba (Den Haag: Boom Juridische Uitgevers, 2014) 341-355.
29. HR 18 June 1926, *NJ* 1926, p 1021 (*Altena v. Van der Horst*) and HR 16 June 1967, *NJ* 1967, 340 (*Cornelissen v. Wagemakers NV*).
30. HR 19 March 1942, *NJ* 1942, 445 (*De Gruyter*).
31. HR 24 April 1992, *NJ* 1993, 190 (*Kuyt v. MEAS*).
32. HR 9 October 1998, *NJ* 1999, 581 (*Hartman BV v. Bakker*).
33. HR 23 October 1998, *NJ* 1999, 582 (*Nacap v. Kurstjens*).
34. Lord Sumption in *Kelly v. Fraser* [2012] UKPC 25; [2013] 1 AC 450 at [15].
35. Hoge Raad 3 February 2017, ECLI:NL:HR:2017:142 and Hoge Raad 3 February 2017, ECLI:NL:HR:2017:143.
36. [1875] LR 7 HL 869.
37. A.L.H. Ernes, *Onbevoegde vertegenwoordiging*, PhD Thesis Open University The Netherlands (Deventer: Kluwer, 2000), 107; *De Vertegenwoordiging*, Asser-Van der Grinten-Kortmann 2-I (Deventer: Kluwer, 2004) 42.
38. Hof Amsterdam 6 April 2010, ECLI:NL:GHAMS:2010:BM1231.
39. Rechtbank Rotterdam 18 March 2010, ECLI:NL:RBROT:BL9375.
40. Rechtbank Zeeland-West-Brabant 25 February 2016, ECLI:NL:RBZWB:2016:1200.

– The third party could rely on the apparent authority of the agent because the rental contract mentioned that the agent represented the principal, the rental contract was (on request of the agent) put in the name of the principal, the agent often represented the principal and the principal paid the rent.[41]

B. The abovementioned facts and circumstances, *according to social intercourse*, could lead a third party to believe that the agent had apparent authority.

In my opinion, the notion 'according to social intercourse', is related to the notion 'reasonableness of the third party'. A third party cannot assert a contract against a principal when this third party was reasonably led to inquire as to the lack of authority in an agent or as to other important circumstances of the case. If the circumstances are thus that they should ring alarm bells, the third party cannot ignore them and merrily continue to trust the agent.
On the other hand, if a situation is 'usual' according to social intercourse, there is no reason for a third party to make further inquiries concerning the authority of the agent. The third party is then exempted from this research obligation.

6. Conclusion

Apparent authority is a concept known in common law as well as in the law of the Netherlands. The approach of the subject is definitely not the same, but some aspects are similar in both legal systems. In both legal systems an agent cannot be said to have authority solely on the basis that he held himself out as having it. In both legal systems this cannot be the sole reason to bind the principal!
The question as to whether an agent who has no apparent authority to bind the principal, can nonetheless communicate decisions by the principal is a question which has not yet been addressed explicitly by the Supreme Court NL. The Dutch legal system therefore might learn from the common law system on this subject.
On the other hand, *if* the problem would arise in Dutch case law, the problem would very likely be solved using the concept of allocation of risk as described above. This might be a concept helpful to common law case law.

41. Hof Den Haag 5 July 2016, ECLI:NL:GHDHA:2016:1788.