
When does a Director have Power to Bind a Company?

The customary authority of one director of a board of several, acting alone, is very limited: there needs to be some evidence of customary authority

The recent Court of Appeal decision in *Bishop Warden Property Holdings Limited v Autumn Tree Limited*,[\[1\]](#) upholding an earlier High Court finding,[\[2\]](#) has alarmed some in the legal and business community.

Contrary to some suggestions, the case is not authority at Court of Appeal level for the novel proposition that one director alone cannot bind a company to a contract. Nor are its particular findings expected to change too much for most ordinary business contracting, as it appears to have been decided very much on its own facts.

The case is nonetheless significant in terms of company contracting. It reaffirms existing law and the correct interpretation of section 18 of the Companies Act 1993. It also sends a salutary reminder to those involved in negotiating and settling contracts as to the extent of a director's authority and as to when care should be exercised in assuming actual or apparent authority.

Key facts

The case involved an application by Autumn Tree to remove a caveat from land it owned that was subject to an unconditional sale and purchase agreement with Bishop Warden.

Autumn Tree was a company formed solely for the purpose of owning and subdividing some residential land in Meadowbank, Auckland. This was its sole property. The company was owned by 3 shareholders, with a Mr Zhao holding 50%, Anna 30% and Tina 20%. Tina was sole director, seemingly as nominee for all 3 shareholders.

Removal of the caveat depended on whether or not the Agreement was valid (ie.

had been validly entered into). It was accepted that if the Agreement wasn't valid, Bishop Warden had no interest to support its caveat and the caveat should therefore be removed.

In the space of one afternoon, late on 3 August 2017, Mr Blomfield (representing Bishop Warden) and Tina negotiated a sale and purchase of the land, valued post-subdivision at some \$3.35M, for \$1.1M. Tina had explained she wanted to exit the company and did not want to proceed with the subdivision. Mr Blomfield alleged he believed at the time, based on a company search undertaken that morning, that Tina was the sole director of Autumn Tree.

Unbeknownst to Mr Blomfield, some sort of disagreement existed between the Autumn Tree shareholders as a result of which the Companies Office records were adjusted by Autumn Tree's accountants on instruction from Mr Zhao. The companies register showed a transfer of Tina's shareholding in Autumn Tree to Anna being registered just before midday on 3 August, and Anna registered as a new director around 1 pm. Tina's removal as a director was not recorded until 5 August, but was effective from 3 August.

The legal issue

The legal argument centred around section 18(1) of the Companies Act and its codification of the common law "indoor management rule" and the doctrine of apparent authority. Applied to the facts, the question was whether, as one of two directors, Tina had authority to bind Autumn Tree to the Agreement.

Section 18(1) and the indoor management rule

Section 18(1) is based on the proposition that a person dealing with a company is entitled to assume that the company's internal requirements have been complied with and its officers are acting lawfully. Otherwise, business interactions would be greatly complicated.

To this end, section 18(1) restricts the circumstances in which a company can assert against a person dealing with it that the company, or the person held out by it as acting on its behalf, lacked authority to enter into the relevant transaction. The company cannot cite:

1. non-compliance with the Companies Act or the Constitution;
2. that someone named as a director on the Companies Office records is not a director, has not been duly appointed, or does not have authority to exercise a power which a director of such a company customarily has;
3. that a person held out by it as a director, employee or agent has not been duly appointed or does not have authority to exercise a power which such persons customarily have in businesses of that type; or
4. that a document issued on behalf of the company by a director, employee or agent with actual or usual authority to issue the document is not valid or genuine,

unless, in each case, unless the person has, or ought to have, by virtue of his or

her position with or relationship to the company, knowledge of the relevant defect.

The courts' decisions

Both the High Court and Court of Appeal found that at the time the Agreement was concluded (around 6 pm on 3 August), for all intents and purposes Autumn Tree was holding out both Tina and Anna to be directors. This was what at the time was showing on the companies register and that amounted to "holding out". Mr Blomfield could not rely on his belief that Tina was the sole director, in reliance on his earlier search.

Bishop Warden was found to have failed to establish that Tina had actual authority. The case therefore fell to be decided on the question of her apparent authority. Section 18(1) did not assist Mr Blomfield in the circumstances, and Autumn Tree won on its claim that Tina lacked actual or apparent authority and the sale and purchase transaction was therefore invalid.

Both courts found that the position as to customary authority (in terms of section 18(1)(b) and (c)) varies significantly between the customary authority of a sole (or managing) director and that of a director who is one of a board of two or more directors. The customary authority of one director of a board, acting alone, is very limited.

Citing ample respected academic and judicial authority, the courts noted that a director acting solely in that capacity must act as part of a board in order to bind the company. Directors can act only collectively as a board. The function of an individual director is to participate in board decisions. Absent some express or implied representation made by the company, a director has no ostensible authority to bind it. Moreover, it is not sufficient for the person claiming authority simply to assert it. There has to be some representation or holding out by the company.

In this case, the courts held that one of two directors of a property development company, acting unilaterally, does not customarily have authority to enter into a significant property transaction.

It is all a question of what is customary, or usual, director authority for a company of the type in question. Here, with a company owned by three distinct shareholders, whose sole purpose was to hold this one land asset, it would not be customary for one director acting alone to have authority to dispose of that asset. Major transaction approval by shareholders would be required. Moreover, found the High Court, Mr Blomfield was aware of sufficient suspicious circumstances (including the sale price at an obvious under-value) as to have deemed knowledge that Tina would lack authority to transact. That he was operating under the possibly mistaken impression that Tina was the sole director was no excuse.

Helpfully, the Court of Appeal confirmed the effect of the proviso to section 18(1), reaffirming the High Court's finding on the proviso in *Equiticorp Industries Group Limited (in statutory management) v Attorney-General (No 47)*^[3]. The proviso creates two classes of knowledge which preclude reliance by the third party on section 18(1): actual knowledge (including wilful blindness) and constructive

knowledge. Constructive knowledge will only be imputed where there is something in the third party's position with or relationship with the company to justify it. This has to be an on-going relationship, rather than that around a one-off transaction.

This limitation on the proviso's effect means that more often than not, parties will be able to rely on the protection afforded by the indoor management rule as embodied in section 18(1).

Commentary and practical suggestions

The case reminds us of the need for caution, but at the same time we have to be able to go about business sensibly.

The key take-out for lawyers and clients is not that all manner of solicitors' certificates, additional signatories, warranties and due diligence checks are required. It will not be a case of requiring all directors, and only directors, of a company to sign contracts. You will not be needing to vet the company's corporate authorisation resolutions or delegations (though if you choose to, do correct them if deficient!).

The point is to be aware of the governance limitations as a matter of law (which are both sensible and well-established), consider each set of circumstances on its merits, ask sensible questions of clients, agents and advisors (including about corporate authorisation of the transaction and similar transactions, what is customary for this company and what delegations or powers of attorney are in place). Undertake what should be regarded as basic housekeeping due diligence (for example, obtaining company searches and updating these just prior to signing, checking what the constitution says about signing of documents). Check the signatures on the executed document.

Importantly, consider whether there is anything in the circumstances, or through your or the client's relationship with the company, that means you may not be able to rely on the proviso to section 18: might you be imputed with some actual or constructive knowledge of a defect in authority, by virtue of your relationship with the company?

Where the consequences of any invalidity are significant, you may want to insist on two directors signing, thus reducing any risk.

From the company's perspective, as a matter of best practice make sure that transactional authorisations are in place, management are complying with corporate delegations and Companies Office records are up to date.

If you are dealing with a company that has only one sole director, relax. That director is the board and the voice of the company. You can rely on that person's signature unless there is something in the circumstances, or some "holding out" by the company to the contrary. Be wary nonetheless of the possible need for major transaction approval.

[\[1\]](#) [2018] NZCA 285

[\[2\]](#) *Autumn Tree Limited v Bishop Warden Property Holdings Limited* [2017] NZHC 2838

[\[3\]](#) [1998] 2 NZLR 481
