Ratification and Undisclosed Principals

Arnold Rochvarg*

In the law of agency, ratification by undisclosed principals is treated differently from ratification by disclosed or partially disclosed principals. The generally accepted rule is that undisclosed principals cannot ratify contracts that their agents have entered into on their behalf. After analyzing the rights and liabilities of undisclosed principals on authorized transactions, the rights of disclosed and partially disclosed principals to ratify unauthorized transactions, as well as analyzing various policy considerations, the author concludes that the traditional arguments derived from these areas are not sufficient to ground a rule precluding ratification by undisclosed principals. The author concludes that ratification by undisclosed principals should be allowed.

Le droit du mandat en *common law* traite la ratification par un mandant non divulgué différemment de celle d'un mandant divulgué ou partiellement divulgué. Il est généralement accepté que le mandant non divulgué ne peut ratifier un contrat conclu en sa faveur par le mandataire. L'auteur analyse les droits et responsabilités du mandant non divulgué à l'occasion d'opérations autorisées ainsi que les droits du mandant divulgué ou partiellement divulgué lors d'opérations excédant les limites du mandat. Il étudie aussi certaines considérations de politique judiciaire. L'auteur conclut que les arguments traditionnellement invoqués dans ces domaines ne peuvent suffire à justifier la règle qui veut que le mandant non divulgué ne puisse ratifier un contrat fait en sa faveur, et qu'en conséquence une telle ratification devrait être permise.

*Professor, University of Baltimore School of Law; B.A., University of Pennsylvania; J.D., George Washington University School of Law. The author would like to thank Mark A. Sargent, Robert H. Lande, and Joan Ardery for their comments on an earlier draft of this article; Virginia Baskin Kass for research assistance; and the University of Baltimore Educational Foundation for financial assistance.

Synopsis

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I. Introduction

In the law of agency, ratification by undisclosed principals is treated differently from ratification by disclosed and partially disclosed principals. The generally accepted rule is that undisclosed principals cannot ratify unauthorized contracts which their agents have made on their behalf. Although this rule has been accepted for almost one hundred years, the adequacy of the reasons advanced to justify it have been rarely examined. This article attempts to fill that void.

When a person chooses to transact business by using an agent, the person, known as the principal, can operate either disclosed, partially disclosed or undisclosed. In the first situation, the principal is disclosed if at the time of the transaction conducted by the agent, the other party, known as the third party, has notice that the agent is acting for a principal and knows the principal's identity.[1] The principal is partially disclosed if the third party has notice that the agent is acting for a principal, but does not know the principal's identity.[2] Finally, the principal is undisclosed if the third party has no notice that the agent is acting for a principal.[3] If the

[1]*Restatement (Second) of Agency* §4(1). See also: *Sweitzer* v. *Whitehead*, 404 Pa. 506, 173 A.2d 116 at 119 (1961); *Resnick* v. *Abner B. Cohen Advertising, Inc.*, 104 A.2d 254 at 255 (App. D.C. 1954); and *Accinanto, Ltd* v. *Cosmopointan Shipping Co.*, 99 F. Supp. 261 at 267 (D. Md. 1951).

[2]*Restatement (Second) of Agency* §4(2). See also: *Searl* v. *Earll*, 95 U.S. App. D.C. 151, 221 F.2d 24 at 28 (1954); and *In re Kaiser's Estate*, 217 Wis. 4, 258 N.W. 177 at 178 (1935).

[3]*Restatement (Second) of Agency* §4(3). See also: *Hidrocarburos y Derivados, C.A.* v. *Lemos*, 453 F. Supp. 160 at 168 (S.D.N.Y. 1977); and *Instituto Cubano de Estabilizacion del Azucar* v. *The S.S. Theotokos*, 155 F. Supp. 945 (S.D.N.Y. 1957).

principal has authorized his agent to enter a contract with the third party, the principal is liable to the third party regardless of whether the principal is disclosed, partially disclosed or undisclosed.[4] Moreover, whether the principal is disclosed, partially disclosed or undisclosed does not change the principal's right to enforce against the third party a contract which the principal authorized his agent to make,[5] except in a few circumstances.[6] These rules governing authorized contracts have often been described as anomalous[7] in that a third party is equally bound to a principal to whom he did not expect to be bound as he is to a principal to whom he did expect to be bound. Although at times criticized, these rules, which treat undisclosed principals almost identically to disclosed and partially disclosed principals in their ability to enforce and be held liable on contracts which they have authorized their agents to make, are nevertheless widely accepted.[8]

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[4]*Restatement (Second) of Agency* §§144, 186 and 188. See also: *Small* v. *CIAO Stables, Inc.*, 289 Md. 554, 425 A.2d 1030 at 1033 (1981); *United States* v. *Everett Monte Cristo Hotel, Inc.*, 524 F.2d 127 at 140 (9th Cir. 1975); and *United States Fidelity & Guar. Co.* v. *Coastal Service, Inc.*, 103 Ga. App. 133, 118 S.E.2d 710 at 713 (1961).

[5]*Restatement (Second) of Agency* §§292 and 302. See also: *Quick Erectors, Inc.* v. *Seattle Bronze Corp.*, 524 F. Supp. 351 at 356 (E.D. Mo. 1981); and *Hillbrook Apts, Inc.* v. *Nyce Crete Co.*, 237 Pa. Super. 565, 352 A.2d 148 at 154 (1975).

[6]For situations where the contract specifically excludes the undisclosed principal, see: *Restatement (Second) of Agency* §189; and *Mitchell* v. *Locurto*, 79 Cal. App. 2d 507, 179 P.2d 848 at 851 (1947). For sealed instruments, see: *Restatement (Second) of Agency* §191. But see: W.A. Seavey, "The Rationale of Agency" (1920) 29 Yale L.J. 859 at 880 [hereinafter "Seavey"] (rule is due to timidity of courts and there is no reason for it). See also: J.B. Ames, "Undisclosed Principal — His Rights and Liabilities" (1909) 18 Yale L.J. 443 at 452 [hereinafter "Ames"]; and W. Müller-Freienfels, "The Undisclosed Principal" (1953) 16 Mod. L. Rev. 299 at 304 [hereinafter "Müller-Freienfels"]. For negotiable instruments, see: *Restatement (Second) of Agency* §192; *Uniform Commercial Code* §403(2)(b); *Britton* v. *Mitchell*, 361 F.2d 922 at 925 (10th Cir. 1966); and *Lady* v. *Thomas*, 38 Cal. App. 2d 688, 102 P.2d 396 (1940). For contracts involving a personal trust or confidence in the agent, see: A.T. Wright, "Undisclosed Principal In California" (1919) 5 Cal. L. Rev. 183 at 188 [hereinafter "Wright"]; A.L. Goodhart & C.J. Hamson, "Undisclosed Principals In Contract" (1932) 4 Cambridge L.J. 320 at 356 [hereinafter "Goodhart & Hamson"]; *Mass. Bonding & Ins. Co.* v. *Higgins*, 117 Ark. 372, 174 S.W. 1150 (1915); and *Kelley* v. *Thuey*, 102 Mo. 522, 15 S.W. 62 (1891). For contracts where the third party would have refused to deal with the undisclosed principal had his identity been known, see: *Restatement (Second) of Agency* §304. See also: Note, "Personal Prejudice and the Doctrine of the Undisclosed Principal" (1930) 44 Harv. L. Rev. 1271 at 1273-74; and W.A. Seavey, "Undisclosed Principals; Unsettled Problems" (1955) 1 How. L.J. 79 at 79.

[7]See O.W. Holmes, "The History of Agency" in Association of American Law Schools, ed., *Select Essays in Anglo-American Legal History*, vol. 3 (Boston: Little, Brown,1909) 368 at 404. See also: Ames, *ibid.* at 443; W.D. Lewis, "The Liability of the Undisclosed Principal In Contract" (1909) 9 Colum. L. Rev. 116 at 118 [hereinafter "Lewis"]; Note, (1887) 3 L. Q. Rev. 358; Wright, *ibid.* at 183; Goodhart & Hamson, *ibid.* at 356; and Müller-Freienfels, *ibid.* at 311.

[8]In 1785, Lord Mansfield wrote that the rule that undisclosed principals could sue third parties who had contracted with their agents was "long settled": *Rabone* v. *Williams*, [1785] 7 T.R. 360, cited in O.W. Holmes, "Agency" (1891) 5 Harv. L. Rev. 1 at 19 [hereinafter

If a principal's agent makes a contract with a third party without prior authority, the principal is not bound to the contract. The principal is not liable on the contract, and concomitantly cannot enforce it against the third party. The principal, however, may decide to ratify the unauthorized contract. By ratifying the contract, the principal retroactively authorizes the agent and thus becomes bound to the agreement.[9] By ratifying the unauthorized contract, the principal accepts liability and gains enforcement rights against the third party.[10] Although ratification has also been criticized as creating an anomaly, in this case because a principal is allowed to enter into and enforce a contract which he authorized only after it was originally made,[11] the doctrine of ratification is widely accepted.[12]

Unlike the situations involving authorized contracts, undisclosed principals are treated differently from disclosed and partially disclosed principals regarding ratification of unauthorized contracts. The generally accepted rule is that undisclosed principals do not have the power to ratify unauthorized contracts which their agents make on their behalf.[13] Therefore, although disclosed and partially disclosed principals can enforce and be held liable on unauthorized contracts by ratifying them, undisclosed principals cannot. No rights or liabilities can be created for the undisclosed principals by ratification.

The purpose of this article is to analyze whether the rule which denies undisclosed principals the power to ratify unauthorized contracts which their agents make on their behalf should continue to be accepted, or whether

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"Holmes"]. See also: Ames, *supra*, note 6 at 443 (doctrine that undisclosed principal may sue and be sued upon contracts made by his agent is so firmly established in England and the United States that it would be "quixotic" to attack it); and Lewis, *ibid.* at 119 (doctrine is as "old as the Year Books", citing E.W. Huffcutt, *The Law of Agency Including the Law of Principal and Agent and the Law of Master and Servant*, 2d ed. (Boston: Little, Brown 1901) c.10 at 158 [hereinafter *Huffcut on Agency*]).

[9]*Restatement (Second) of Agency* §82, 143. See also: *C&K Coal Co.* v. *United Mine Workers of America*, 537 F. Supp. 480 at 495 (W.D. Pa. 1982); and *Bradley* v. *John M. Brabham Agency, Inc.*, 463 F. Supp. 27 at 32 (D.S.C. 1978).

[10]See generally, F.R. Mechem, "The Effect of Ratification As Between the Principal and the Other Party" (1906) 4 Mich. L. Rev. 269 [hereinafter "Mechem"].

[11]See Holmes, *supra*, note 8 at 14 (opposition of common sense intensified by additional absurdities introduced by ratification); E.C. Goddard, "Ratification By An Undisclosed Principal" (1903) 2 Mich. L. Rev. 25 at 40 [hereinafter "Goddard"]; Note, (1936) 1 Mo. L. Rev. 343 at 344; and *Fulton County Fiscal Court* v. *Southern Bell Telephone & Telegraph Co.*, 289 Ky. 159, 158 S.W.2d 437 at 439 (1942).

[12]Ratification has been referred to as being even older than the Year Books. See E. Wambaugh, "A Problem As To Ratification" (1895) 9 Harv. L. Rev. 60 at 60 n.1 [hereinafter "Wambaugh"].

[13]Reporter's Notes to *Restatement (Second) of Agency* §85 (although there was some early disagreement, it is now "almost universally" agreed that there can be ratification only if the agent purported to act for another). See also: D.J. Hill, "Some Problems of the Undisclosed Principal" (1967) J. Bus. L. 122 at 129 (rule is "well established"); and *infra*, notes 41-44.

it should be rejected in order to make the rule consistent with other areas of the law of agency. Consideration will be given to whether the theories which have been offered by various theorists over the last one hundred years to explain other areas of agency law in some way compel a conclusion about the power of undisclosed principals to ratify unauthorized contracts. No attempt will be made to harmonize the various theories; rather, each will be evaluated on its own merits as a possible source of support for a rule involving ratification by undisclosed principals. Even those theories whose merits have been challenged elsewhere will be treated as worthy of analysis, since an analysis of all possible theories of agency law must be considered before one can properly suggest that an established rule, such as that involving an undisclosed principal's ability to ratify, should be changed.

The article is structured as follows. First, it will describe the history of the rule and the current state of authority beginning with the landmark case of *Keighley, Maxsted & Co.* v. *Durant*,[14] which is generally considered to have established the ratification rule for undisclosed principals. In Part III, the article then will analyze whether the rule denying undisclosed principals the power to ratify can be supported by the theories which have been offered to explain why undisclosed principals are held liable and can enforce authorized contracts. This analysis will show that, for the most part, the law involving undisclosed principals and authorized contracts does not support the rule denying undisclosed principals the power to ratify, but rather one which permits ratification. Part IV will analyze whether any of the theories concerning ratification by disclosed and partially disclosed principals support the rule denying undisclosed principals the power to ratify. Once again, the conclusion reached is that for the most part, the law of ratification does not require a rule denying undisclosed principals the power to ratify, but rather provides greater support for permitting ratification. The article will then consider other arguments which might justify the current rule such as whether undisclosed principals should be discouraged and whether ratification should be discouraged. This analysis will also fail to provide support for the current rule denying undisclosed principals the power to ratify, and will support a rule permitting ratification. Finally, the article will argue that although the rule denying undisclosed principals the power to ratify is the view of the majority of legal participants, courts should not be unwilling to adopt a position to the contrary because there is no reliance on the old rule and because this new position is more theoretically consistent with other theories of agency law.

[14][1900-3] All E.R. 40, [1901] A.C. 240, 70 L.J.K.B. 662 (H.L.) [hereinafter *Keighley, Maxsted* cited to All E.R.].

II. The Current Law and Its Genesis

A. The Landmark Case

The 1901 decision of England's highest judicial body, the House of Lords, in *Keighley, Maxsted & Co.* v. *Durant* ("*Keighley, Maxsted*"), is the landmark case which established that undisclosed principals cannot ratify contracts. *Keighley, Maxsted* considered only whether an undisclosed principal could be held *liable* on a contract which, it was alleged, it had previously ratified; however, it is also the landmark case for denying undisclosed principals the *right* to *enforce* contracts based on ratification. It is interesting that a rule which is generally viewed as denying undisclosed principals a right enjoyed by other principals was developed in a case not involving rights of undisclosed principals, but their liabilities. This distinction between denying rights and denying liabilities was not made by the House of Lords in *Keighley, Maxsted*, and has not been made by any other court. This distinction should be important, however, as this article will suggest in its analysis of the issue.

To understand the historical background of the rule denying undisclosed principals the power to ratify, this section will present (1) a short discussion of the facts in *Keighley, Maxsted*, (2) a discussion of the decision by England's intermediate appellate court, the Court of Appeal, and (3) the decision of the House of Lords.

Keighley, Maxsted & Co. ("principal") authorized Roberts ("agent") to purchase wheat at a specified price. The agent was unable to obtain the wheat at the authorized price, but he contracted nevertheless with Durant & Co. ("third party") for wheat at a higher price. The agent did not disclose to the third party that he was representing a principal, and the contract was signed by the agent in his own name. When the agent informed his principal of the transaction, the principal agreed to the contract and instructed its agent to arrange for delivery. Before the time for delivery, the price of wheat dropped and the third party was told that the deal was off. The third party sued the principal seeking recovery for damages it suffered when it sold the wheat at a price lower than the price provided in the first contract with the agent. The third party's theory of recovery against the principal was that its instructions to the agent to arrange for delivery constituted the principal's ratification of the contract, thus making the principal liable for damages. After proof of these facts at trial, the trial judge directed a verdict for the principal based on the view that since the agent had not professed to act on behalf of a principal, ratification was not possible.[15]

[15]*Durant & Co.* v. *Roberts and Keighley, Maxsted & Co.*, [1900] 1 Q.B. 629 at 630 (C.A.).

On appeal to the Court of Appeal, the directed verdict was reversed and a new trial was ordered.[16] In reaching this decision, the Court of Appeal primarily relied upon two rules: (1) that ratification is "equivalent to a prior command",[17] and (2) that undisclosed principals can enforce and be held liable on contracts which the principal authorizes the agent to make when authority is given prior to the agent's signing the contract with the third party.[18] Lord Collins of the Court of Appeal reasoned that if there was prior authority, it would be of no consequence whether the agent disclosed the principal, and since ratification was equivalent to prior authority, it should be of no consequence for ratification if there was any disclosure by the agent of his principal.[19]

The Court of Appeal's ruling was reversed unanimously by the House of Lords.[20] Each of the eight Law Lords wrote separate opinions. The Earl of Halsbury wrote that there was no precedent for permitting ratification in this case. Nor did he find relevant that undisclosed principals can sue and be sued on authorized contracts. To permit ratification in this case would create a contract different than the one actually made.[21] Lord MacNaghten also relied on precedent writing that "there is a stream of authority all tending in one direction" against permitting ratification.[22] In regard to the argument that there was no case actually on point, he replied that "the clearer a thing is, the more difficult it is to find any express authority or any dictum exactly to the point."[23] He also viewed the Court of Appeal's decision as contrary to "common sense, whatever that expression means".[24] In general, only parties to a contract could sue or be sued on a contract. Ratification was an exception to this general rule, but since ratification was based on a fiction that the principal is deemed to be the other contracting party, the fiction would not cover the case of an agent who contracted on behalf of an undisclosed principal. Ratification, therefore, should not be extended to undisclosed principals because undisclosed intentions do not create civil obligations.[25]

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[16]*Ibid.* See also the annotations in (1900) 16 T.L.R. 244; 44 S.J. 291 (March 10, 1900); (1900) The Weekly Notes 54; and Recent Cases (1900) 14 Harv. L. Rev. 153.

[17]*Ibid.* at 651 *per* Parke B., citing *Foster* v. *Bates* (1843), 12 M. & W. 233.

[18]*Ibid.* at 659.

[19]*Ibid.*

[20]*Supra*, note 14.

[21]*Ibid.* at 43.

[22]*Ibid.*

[23]*Ibid.*, directly quoting *Panama & South Pacific Telegraph Co.* v. *India Rubber, Gutta-Percha, & Telegraph Works Co.* (1875), L.R. Ch. App. 515 at 526 *per* James L.J..

[24]*Ibid.* at 44.

[25]*Ibid.*

Lord Shand also agreed that the Court of Appeal should be reversed. The only contract actually made was between the agent and the third party. To allow ratification by an undisclosed principal "would be to give one of two contracting parties in his option, merely from what was passing in his own mind, and not disclosed, the power of saying that the contract was his alone, or a contract in which others were bound to him."[26]

Lord Davey first discussed earlier cases which he believed supported a view contrary to the Court of Appeal's decision. He then addressed the argument that because undisclosed principals can enforce authorized contracts, they should be able to ratify unauthorized ones. Lord Davey disagreed. He wrote that there is a "wide difference between an agency existing at the date of the contract, which is susceptible of proof", and "an intention locked up in the mind of the contractor, which he may either abandon or act on his own pleasure, and the ascertainment of which involves an inquiry into the state of his mind at the date of the contract."[27] That undisclosed principals can enforce authorized contracts is itself an anomaly, and to permit undisclosed principals to ratify would "be adding another anomaly to the law, and not correcting an anomaly".[28]

Lord James of Hereford was also concerned about relying upon the agent's undisclosed intentions. He disagreed that a man's thoughts, unexpressed and unrecorded, could form the basis of a contract.[29] Lord Brampton voted to reverse the Court of Appeal because an "essential element of a contract" was "concurrence of intention".[30] To give weight to a "reserved intention" would "open wide a doorway to fraud and deception; and it would necessitate the addition of the doubtful science of thought-reading to the requirements of a mercantile education."[31] A new contract would be required to create liability for the undisclosed principal in this case.[32] Lord Robertson's belief that the "whole hypothesis of ratification is that the ultimate ratifier is already in appearance the contractor", left no room for ratification unless the principal's credit had been pledged to the third party.[33]

Lord Lindley first addressed undisclosed principals and authorized contracts. Undisclosed principals are allowed to sue and be sued on authorized contracts because "effect is given... to what is true in fact, although that

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[26]*Ibid.* at 46.
[27]*Ibid.* at 48.
[28]*Ibid.*
[29]*Ibid.*
[30]*Ibid.* at 49.
[31]*Ibid.* at 50.
[32]*Ibid.*
[33]*Ibid.*

truth may not have been known to the other contracting party".[34] Although an anomaly exists in holding someone bound to someone of whom he knows nothing, agents are common and useful in business transactions and in most cases it would not have mattered to the third party that an undisclosed principal existed. Ratification aims to give effect to the real intentions of both contracting parties. However, to permit undisclosed principals to ratify would be extending this goal too far.

As can be seen by this summary of the eight opinions, there was no one reason common to the different opinions written by the judges.[35] Yet, four arguments do seem to characterize accurately the House of Lords decision. First, the House of Lords rejected the argument that because undisclosed principals can enforce authorized contracts, they should be allowed to ratify unauthorized ones. Allowing undisclosed principals to enforce authorized contracts would be "itself an anomaly",[36] and it would not be desirable to expand the rights of undisclosed principals any further. Second, the House of Lords expressed concern that to permit ratification by undisclosed principals would "open wide a doorway to fraud and deception",[37] because proof of ratification in part would be based on the agent's undisclosed intentions. Third, the House of Lords expressed the view that the "whole hypothesis of ratification is that the ultimate ratifier is already in appearance the contractor",[38] and therefore, there is "no room"[39] for someone who has not appeared previously to be granted a power of ratification. Fourth, the House of Lords relied on other cases it previously had decided, although none presented the precise issue involved in *Keighley, Maxsted*.[40] The final result of these opinions was that the third party was not able to collect any damages from the principal.

B. The Restatement

The *Restatement (Second) of Agency* has a few sections which conform to the House of Lords' decision in *Keighley, Maxsted*. Section 82 defines ratification as the affirmation by a person of a prior act which was "done or professedly done on his account". Section 84(1), in discussing what acts can be ratified, defines these acts as those which could have been authorized by a "purported principal". Section 85(1) provides that ratification does not

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[34]*Ibid.* at 51.

[35]Opinions were written by The Earl of Halsbury, Lord MacNaghten, Lord Shand, Lord James of Hereford, Lord Davey, Lord Brampton, Lord Robertson, and Lord Lindley.

[36]*Supra*, note 14 at 47.

[37]*Ibid.* at 50.

[38]*Ibid.*

[39]*Ibid.*

[40]*Ibid.* at 43.

result unless the agent "purported to be acting for the ratifier". One explanation for these rules, as provided in the comment to Section 85(1), is that ratification gives the third party what he expected when he made the contract with the agent. Since the third party does not expect a contract with any principal when the principal is undisclosed, there is no reason for ratification.

C. *Case Law*

The Reporter's Notes to Section 85 of the *Restatement (Second) of Agency* state that the requirement of ratification that an agent purport to act for another is "almost universally" followed. An examination of the case law supports this observation. The *Keighley, Maxsted* decision and *Restatement* position is the majority view in the United States,[41] although there

[41]See, *e.g.*: Alaska, *Pullen* v. *Dale*, 109 F.2d 538 (9th Cir. 1940); Arkansas, *Runyan* v. *Community Fund*, 182 Ark. 441, 31 S.W.2d 743 (1930); Arizona, *Fairway Builders, Inc.* v. *Malouf Towers Rental Co.*, 124 Ariz. 242, 603 P.2d 513 (1979); California, *Rakestraw* v. *Rodrigues*, 104 Cal. Rptr. 57, 8 Cal. 3d 67, 500 P.2d 1401 (1972); Colorado, *Nunnally* v. *Hilderman*, 150 Colo. 363, 373 P.2d 940 (1962); Connecticut, *Cyclone Fence Co.* v. *McAviney*, 121 Conn. 656, 186 A. 635 (1936); Delaware, *Hirzel Funeral Homes, Inc.* v. *Equitable Trust Co.*, 46 Del. 334, 83 A.2d 700 (1950); District of Columbia, *Lewis* v. *Washington Metro Area Transit Auth.*, 463 A.2d 666 (D.C. 1983); Georgia, *Healthdyne, Inc.* v. *Odom*, 173 Ga. App. 184, 325 S.E.2d 847 (1984); Kansas, *Schraft* v. *Leis*, 236 Kan. 28, 686 P.2d 865 (1984); Idaho, *Linn* v. *Alameda Mining and Mill, Co.*, 17 Idaho 45, 104 P. 668 (1909); Illinois, *Albin Karetzkis* v. *Cosmopolitan Nat'l Bank*, 37 Ill. App.2d 484, 186 N.E.2d 72 (1962); Indiana, *Bryan* v. *Pommert*, 110 Ind. App. 61, 37 N.E.2d 720 (1941); Iowa, *Anita Valley, Inc.* v. *Bingley*, 279 N.W.2d 37 (Iowa, 1979) Kentucky, *Capurso* v. *Johnson*, 248 S.W.2d 908 (Ky. 1952); Louisiana, *Bamber Contractors, Inc.* v. *Morrison Eng'g & Contracting Co.*, 385 So.2d 327 (La. 1980); Maryland, *Hammond* v. *Du Bois*, 131 Md. 116, 101 A. 612 (1917); Massachusetts, *Wedgwood* v. *Eastern Comm. Travelers Accident Ass'n*, 308 Mass. 463, 32 N.E.2d 687 (1941); Michigan, *Gandy* v. *Cole*, 35 Mich. App. 695, 193 N.W.2d 58 (1971); Minnesota, *Gran* v. *City of St. Paul Board of Education*, 274 Minn. 220, 143 N.W.2d 246 (1966); Mississippi, *Gulf Refining Co.* v. *Travis*, 201 Miss. 336, 30 So.2d 398 (1947); Missouri, *Fleming* v. *Anderson*, 232 S.W. 718 (Mo. 1921); Nebraska, *General Credit Corp.* v. *Moore*, 128 Neb. 881, 260 N.W. 368 (1935); Nevada, *Harrah* v. *Specialty Shops, Inc.*, 67 Nev. 493, 221 P.2d 398 (1950); New Hampshire, *Ernshaw* v. *Roberge*, 86 N.H. 451, 170 A. 7 (1934); New Jersey, *Goldfarb* v. *Reicher*, 112 N.J. 413, 171 A. 149, *aff'd*, 113 N.J. 399, 174 A. 507 (1934); New Mexico, *Ullibarri Landscaping Materials, Inc.* v. *Colony Material, Inc.*, 97 N.M. 266, 639 P.2d 75 (1981); New York, *O'Connor* v. *Bankers Trust Co.*, 159 Misc. 920, 289 N.Y.S. 252 (1936); North Carolina, *Wright* v. *County of Macon*, 64 N.C. App. 718, 308 S.E.2d 97 (1983); North Dakota, *Farmers Union Oil Co.* v. *Wood*, 301 N.W.2d 129 (N.D. 1980); Ohio, *Valaske* v. *Wirtz*, 106 F.2d 450 (6th Cir. 1939); Oklahoma, *Pettit* v. *Vogt*, 495 P.2d 395 (Okla. 1972); Oregon, *Southern Oregon Prod. Credit Ass'n* v. *Patridge*, 71 Or. App. 53, 691 P.2d 135 (1984); Pennsylvania, *DeSilvio* v. *Restauire*, 264 Pa. 528, 400 A.2d 211 (1979); Rhode Island, *Kesselman* v. *Mid-States Freight Lines*, 78 R.I. 518, 82 A.2d 881 (1951); South Carolina, *Brazell Bros. Contractors* v. *Hill*, 245 S.C. 69, 138 S.E.2d 835 (1964); South Dakota, *Minder & Jorgenson and Co.* v. *Brustuen*, 24 S.D. 537, 124 N.W. 723 (1910); Texas, *Rhodes, Inc.* v. *Duncan*, 623 S.W.2d 741 (Tex. Ct. App. 1981); Utah, *Bradshaw* v. *McBride*, 649 P.2d 74 (Utah 1982); Vermont, *Templeton Constr'n Co.* v. *Kelly*, 130 Vt. 420, 296 A.2d 242 (1972); Washington, *Atlas Bldg Supply Co.*, v. *First Independent Bank*, 15 Wash. App. 367, 550 P.2d 26 (1976); and Wisconsin, *Spivey* v. *Great Atl. & Pac. Tea Co.*, 79 Wis.2d 58, 255 N.W.2d 469 (1977).

are several decisions which do not follow it.[42] This rule is consistently followed in Canada[43] and in England.[44]

III. A Ratification Rule for Undisclosed Principals based on the Liability and Rights of Undisclosed Principals in Authorized Transactions

As discussed above, this article considers whether the rule denying undisclosed principals the power to ratify unauthorized contracts deserves continued acceptance in light of the consistency of the rule with other doctrines of agency law involving undisclosed principals. The first step in this analysis is to ascertain whether the rule denying undisclosed principals the power to ratify unauthorized contracts is consistent with the rules governing undisclosed principals' liability and rights on *authorized* contracts. This approach is not unprecedented. Both the Court of Appeal and House of Lords in *Keighley, Maxsted* discussed how the rules involving undisclosed principals and authorized contracts impacted on the rule involving undisclosed principals and ratification of unauthorized contracts. This section, therefore, will discuss the various theories which have been offered over the years to explain why undisclosed principals are liable on contracts which they authorize their agents to make with third parties, and why undisclosed principals are given the right to enforce such contracts against third parties. It is interesting to note that most of these theories were suggested by writers at the end of the nineteenth century or at the beginning of the twentieth century who were concerned with explaining agency law in terms consistent with other areas of the common law such as contracts, torts and trusts. These theorists were in part troubled by the "fictions" which they saw as the foundation of agency law.[45] They especially found troublesome the rules

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[42]The leading case expressing the contrary view is *Allen* v. *Liston Lumber Co.*, 281 Mass. 440, 183 N.E. 747 (1933). For additional support, see: *Moynough* v. *Empress Gold Mining Co.*, 6 Cal. App. 2d 674, 44 P.2d 659 (1935) (undisclosed principal held liable based on ratification). See also *Antar* v. *Trans World Airlines*, 320 N.Y.S. 2d 355 (1970).

[43]See, *e.g.*: *Begley* v. *Imperial Bank of Canada*, [1936] 2 W.W.R. 243 at 250, [1936] 2 All E.R. 367, [1936] 3 D.L.R. 1 (P.C.); *Eckroyd* v. *Rodgers*, [1913] 23 Man. R. 633; [1913] 4 W.W.R. 601, [1913] 24 W.L.R.318, 11 D.L.R. 626; *Eastern Construction Co.* v. *National Trust Co.*(1913), [1914] A.C. 197, 15 D.L.R. 755 (P.C.); *McCallum* v. *Cohoe*, [1918] 44 O.L.R. 497; *National Securities Ltd* v. *Darling*, [1927] 1 W.W.R. 413 (Alta. Dist. Ct.); and *Canadian Encyclopedic Digest (Ont. Ed.)*, Vol. 1, Title 4, Part III, Ratification of Agency §§34, 35 and 169.

[44]See, *e.g.*: *Baker* v. *Barclays Bank, Ltd*, [1955] 1 W.L.R. 822, 99 S.J. 491, [1955] 2 All E.R. 571; *A.L. Underwood, Ltd* v. *Bank of Liverpool*, [1924] 1 K.B. 775; *Greenwood* v. *Martins Bank, Ltd*, [1931] 1 K.B. 371; *Hepburn* v. *A. Tomlinson (Haulers), Ltd*, [1966] A.C. 451, [1966] 2 W.L.R. 453, 1 All E.R. 418 (H.L.); and *Woolett* v. *Minister of Agriculture* (1954), [1955] 1 Q.B. 103, [1954] 3 W.L.R. 776, [1954] 3 All E.R. 529.

[45]Holmes, *supra*, note 8 at 14 (agency law is the result of conflict between logic and good sense - one side striving to carry fictions out to consistent results, the other restraining that effort when the results become too manifestly unjust).

involving undisclosed principals. Today's view of agency law as an independent body of law not dependent on the law of contracts, torts or trusts resolves the tensions with which these theorists struggled. These older theories, however, still require our attention because they attempt to explain the "true" basis of agency law. Moreover, the *Keighley, Maxsted* decision was rendered during this period in which the great debates on agency law were being made by scholars such as Holmes, Ames, Lewis, Mechem, Huffcut and Wambaugh. Although the Law Lords did not rely on any of these commentaries, they were also attempting to understand the underlying foundation of all agency law. A brief analysis of these theories is therefore especially appropriate.

A. Theories Explaining the Liability of Undisclosed Principals on Authorized Contracts

An evaluation of the literature indicates there are seven theories which have been presented to explain why undisclosed principals are liable on contracts which they authorize their agents to make. These theories might be useful in reaching a rule concerning undisclosed principals and ratification of unauthorized contracts. These theories are (1) the benefit-burden theory, (2) the tort theory, (3) the indemnification theory, (4) the assignment theory, (5) the identity theory, (6) the change of position theory, and (7) the independent agency law theory. Because there is some overlap between the theories, and because some may even conflict, this section will evaluate each theory independently. Although most have been criticized, this article initially will assume their continued validity in order to understand their consequences on ratification. Subsequent analysis of their weaknesses, however, will enable us to evaluate their usefulness as a foundation for a new rule of ratification.

1. Benefit-Burden Theory

The benefit-burden theory was suggested by early theorists such as Huffcut,[46] Ames,[47] and Lewis,[48] as the basis of undisclosed principals' liability on authorized contracts. According to these scholars, undisclosed principals are liable on authorized contracts because as the party receiving the benefit of the contract, they should bear the burden of the obligations of the contract

[46]*Huffcut on Agency, supra*, at §162.

[47]Ames, *supra*, note 6 at 447.

[48]Lewis, *supra*, note 7 at 119. See also, E.J. Weinrib, "The Undisclosed Principle of Undisclosed Principals" (1975) 21 McGill L.J. 298 at 298 [hereinafter "Weinrib"]; *Comind, Companhia de Seguros* v. *Sikorsky Aircraft Div. of United Tech. Corp.*, 116 F.R.D. 397 (D. Conn. 1987); *Weitzman* v. *Stein*, 436 F. Supp. 895 (S.D.N.Y. 1977); and *First Nat'l Bank* v. *Federal Reserve Bank*, 6 F.2d 339 (8th Cir. 1925).

agreed to by the agent. As in any contractual situation, each bargaining side agrees that in return for a benefit which it desires to receive from the other party, it will suffer a burden. For example, the benefit to the buyer of wheat is the receipt of the wheat; the burden is the payment of money. This benefit and burden, of course, is reversed for the seller. In the agency situation, if the undisclosed principal is to receive the "benefit" (the wheat), he should be required to pay the "burden", and thus should be held liable to the seller for the fulfillment of the agreement.

If the benefit-burden theory is an accurate explanation of undisclosed principals' liability on authorized contracts, this tends to support a rule permitting undisclosed principals to be held liable on unauthorized contracts based on ratification. If the undisclosed principal, after learning of all the material facts of an unauthorized deal, decides to accept the benefits of the transaction, and instructs his agent to transmit the benefits to him, the undisclosed principal should be held liable, and this liability could be based on ratification.

It would be premature, however, to conclude that a rule permitting ratification by undisclosed principals must be adopted merely because it is consistent with the benefit-burden theory of an undisclosed principal's liability. The benefit-burden theory cannot by itself support a major change in the ratification doctrine due to a significant weakness: it does not explain the liability of undisclosed principals on authorized executory contracts where no benefit has been received.[49] For example, if the undisclosed principal breaches his agreement to pay for goods before delivery, he has received no benefit, yet he can be held liable for damages resulting from his breach. Ratification cases may also involve executory contracts. For example, in *Keighley, Maxsted*, the undisclosed principal had received no benefit from the wheat contract, but the basis of its liability was argued to be ratification based on the principal's instructions to the agent to arrange for delivery.

In summary, therefore, where ratification of an unauthorized contract is based on acceptance of benefits, the benefit-burden theory is more consistent with a rule contrary to *Keighley, Maxsted* and the *Restatement*. Its deficiency with regard to explaining executory contracts, however, limits its ability to be the sole support for a rule change.

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[49]See Lewis, *supra*, note 7 at 124.

2. Tort Theory

The "tort" theory was discussed by Lewis in his 1909 Columbia Law Review article.[50] Lewis explains the liability of undisclosed principals on authorized contracts as arising from the undisclosed principals' wrongful deceit of third parties. The third party has been deceived into believing that there is no one other than the agent. The person responsible for this misimpression, the undisclosed principal, should be held liable as a result of his deceit. If this tort theory is a proper explanation for the liability of undisclosed principals in authorized transactions, the ratification rule most consistent with it is that undisclosed principals be held liable on unauthorized contracts based on ratification. The reasoning is as follows. The undisclosed principal's "deceit" is his not disclosing his existence. The degree or type of deceit achieved by the undisclosed principal is not dependent on whether his agent acts with or without authority. As a consequence, in these situations where the agent has been instructed not to disclose his principal's existence, but the contract signed by the agent and the third party is beyond the authority previously granted to the agent, the "deceit" must necessarily be equal to the "deceit" involved in an authorized transaction; the "tort" of non-disclosure exists in both cases. Therefore, it should make no difference whether the agent acted with or without prior authority if liability is based on a deceit theory. The undisclosed principal should be held liable in both instances.

Again, however, simple reliance on a tort theory is too slim a reed to support a change in a doctrine with such wide acceptance as the present rule for undisclosed principals and ratification. The tort theory has a major drawback: it may not be deceitful for a principal to remain undisclosed. Undisclosed principals are very common, and thus no third party can reasonably argue that he was deceived into believing that none existed merely because the agent did not identify his principal.[51] The popularity of the practice of undisclosed principals weakens the argument that such actions constitute deceit which can then provide the basis for the liability of undisclosed principals on authorized contracts. Therefore, the tort-deceit theory cannot adequately justify undisclosed principals' liability on authorized contracts, and as a result, it cannot be relied upon as the sole foundation for a rule permitting undisclosed principals the power to ratify.

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[50]*Ibid.*

[51]See Goodhart & Hamson, *supra*, note 6 at 344; *Anchor Warehouse Co.* v. *Mead*, 181 S.W. 1057 at 1059 (Mo. Ct. App. 1916); and *Quick Erectors, Inc.* v. *Seattle Bronze Corp.*, *supra*, note 5 at 356.

3. Indemnification Theory

An indemnification theory has also been discussed by commentators[52] as the basis of undisclosed principals' liability on authorized contracts. This theory posits that by authorizing their agents to contract with third parties, undisclosed principals are in fact contracting with their agents that if there are any liabilities suffered by the agent, the principal will be liable. The indemnification theory maintains moreover that third parties gain the right to hold undisclosed principals liable on the contract because third parties become subrogated to the agents' rights against principals. According to this view, the liability of an undisclosed principal on an authorized contract is viewed as arising out of the principal's obligation to his agent, not out of any obligation of the principal to the third party. The right of the agent against his principal is in turn permitted to be enforced by the third party.

Acceptance of the indemnification theory as the proper basis of an undisclosed principal's liability to a third party on an authorized contract most likely supports a rule which permits undisclosed principals to ratify unauthorized contracts. This is the case because it is quite reasonable to view the act of ratification by the principal as an act of indemnification for the liability which the agent has incurred or will incur on account of the contract. If the agent has acted without authority, the principal would be under no obligation to indemnify his agent. In fact, the principal might have a cause of action against the agent for breach of the fiduciary duty to act only as authorized. But, by ratifying the unauthorized act, the principal is retroactively authorizing his agent, and thus the act of ratification constitutes a waiver of the principal's cause of action against the agent for breach of fiduciary duty.[53] A rule that permits undisclosed principals to ratify unauthorized contracts, therefore, would be consistent with the undisclosed principal's liability on authorized contracts as explained under the indemnification theory.

But, as in the cases of the benefit-burden and tort theories, the indemnification theory may be too limited in its explanation of an undisclosed principal's liability on authorized contracts for it to be the springboard for a new rule involving undisclosed principals and ratification. The limitation exists in that the indemnification theory is dependent upon the agent having suffered a burden from the contract. However, relying solely on the indemnification theory, if the agent has not suffered any burden, then the agent would have no rights against his principal to which the third party can be

[52]See Seavey, *supra*, note 6 at 879; and Ames, *supra*, note 6 at 449.

[53]*Restatement (Second) of Agency* §416. See also: *Brooks* v. *January*, 321 N.W.2d 823 at 829 (Mich. App. 1982); *Southwest Title Ins. Co.* v. *Northland Bldg Corp.*, 542 S.W.2d 436 at 450 (Tex. Civ. App. 1976); and *Rakestraw* v. *Rodrigues*, *supra*, note 41 at 1405.

subrogated. Thus, the third party would have no right to proceed against the principal, a right which would be present in the unauthorized case. This result, however, is probably not correct. If the agent, for example, becomes bankrupt after an authorized transaction, the third party still is able to hold the undisclosed principal liable even though the agent has no rights against the principal. The third party is given rights directly against the undisclosed principal without any need to go through the agent. This shows that the liability of an undisclosed principal on an authorized contract may be based on a direct right of the third party against the undisclosed principal. Such a direct, independent right is not recognized by the indemnification theory. For this reason, the indemnification theory does not fully explain the liability of undisclosed principals on authorized contracts. This deficiency limits its ability to support a ratification rule for undisclosed principals on unauthorized contracts.

4. Assignment Theory

Closely related to an indemnification theory of undisclosed principals' liability on authorized contracts is the assignment theory.[54] Like the indemnification theory, the assignment theory of an undisclosed principals' liability on authorized contracts treats third parties' rights to collect from undisclosed principals not as rights which run directly from undisclosed principals to third parties, but as rights which derive from the agent's rights against his principal. Unlike the indemnification theory, however, the assignment theory does not require that the agent suffer an actual loss in order to create liability for the undisclosed principal.

The assignment theory views the liability of undisclosed principals to third parties on contracts which they have authorized their agents to sign with third parties as based on the agent's assignment to the third party of the agent's rights against his principal. The best support for this assignment theory is found in the agency law rule that payment by the undisclosed principal to his agent of the amount due to the third party on an authorized contract before the third party is aware of the undisclosed principal's role in authorizing the transaction precludes the third party from suing the principal once he is disclosed.[55] This shows that the third party may not have

[54]*Hay* v. *Hollingsworth*, 42 Cal. App. 238, 183 P. 582 (1919). See also: *Restatement (Second) of Agency* §303; and *Cooper* v. *Epstein*, 308 A.2d 781 at 783 (App. D.C. 1973).

[55]*Poretta* v. *Superior Dowel Co.*, 153 Me. 308, 137 A.2d 361 (1957); *Railton* v. *Hodgson*, 4 Taunt. 576 (1804); *Thomson* v. *Davenport*, 9 B.C. 78 (1829); *Fradley* v. *Hyland*, 37 F. 49 (S.D.N.Y. Cir. Ct. 1888); Holmes, *supra*, note 8 at 19 and cases cited, *supra*, note 2; and Lewis, *supra*, note 7 at 117. The majority view is contrary to that expressed in the *Restatement (Second) of Agency* §208.

an original right against the principal, but that the third party's rights are derived from the agent.

If the assignment theory is the proper basis of undisclosed principals' liability on authorized contracts, the ratification rule for undisclosed principals which is most consistent with it is again one which permits undisclosed principals the power to ratify. As with the case of the indemnification theory, when the principal ratifies his agent's unauthorized contract, the principal agrees to be bound by his agent's act and thus creates rights in the agent against the principal. These rights could then be assigned to the third party who could proceed directly against the principal.

Again, however, because the assignment theory — like the indemnification theory — is founded on the idea that undisclosed principals are liable to third parties only because of the principal's obligations to his agent, and not because of any independent basis of liability of the undisclosed principal to the third party, it is limited in its ability to explain all of the rules involving undisclosed principals. Like the other theories discussed so far, to the extent it does lend support to a ratification rule for undisclosed principals, it supports one contrary to the present majority view.

5. Identity Theory

The identity theory was discussed by such early theorists as Holmes,[56] Huffcut,[57] and Lewis,[58] as a possible explanation for holding undisclosed principals liable on authorized contracts. They suggested that the legal fiction of equating the identity of the agent and the undisclosed principal shows that the contract with the third party, although apparently made with the agent, is actually made with the undisclosed principal. Since the undisclosed principal is actually the other contracting party, the undisclosed principal is liable to the third party. Acceptance of the identity theory as the appropriate basis of undisclosed principals' liability on authorized contracts should lead to the conclusion that undisclosed principals should be able to be held liable and to enforce unauthorized contracts by ratification. The explanation for this position would be that when an agent for an undisclosed principal enters an unauthorized contract, the agent is personally liable to the third party.[59] Moreover, even if the agent of an undisclosed principal is

[56]See *infra*, notes 71-73 and accompanying text.

[57]O.W. Holmes, *The Common Law* (Boston: Little, Brown, 1881) at 232.

[58]*Huffcut on Agency, supra*, note 8 at §161.

[59]Lewis, *supra*, note 7 at 119. See also: *Kayton* v. *Barnett*, 116 N.Y. 625, 23 N.E. 24 (1889); *Harris* v. *McKay*, 138 Va. 448, 122 S.E. 137 at 140 (1924); and *Geary St., P. & O.R. Co.* v. *Rolph*, 189 Cal. 59, 207 P. 539 at 543.

not authorized, the agent can enforce the contract against the third party.[60] Therefore, since according to the identity theory the undisclosed principal and the agent are legally the same person, the undisclosed principal has the same rights and liabilities of his agent. Because the agent of an undisclosed principal can enforce and be held liable on an unauthorized contract, this right and liability also belongs to the undisclosed principal. This fiction then allows the transfer of rights and liabilities on unauthorized contracts to be achieved by undisclosed principals through ratification.

But again, although a rule permitting undisclosed principals to ratify unauthorized contracts would be consistent with the identity theory, the identity theory cannot be relied upon as the sole basis for the law of undisclosed principals. This is true because there are instances in agency law where undisclosed principals and their agents are not treated as identical. There are transactions where agents can enforce a legal right against the third party, but undisclosed principals cannot. For example, undisclosed principals cannot enforce authorized contracts against the third party if the third party entered the contract because of the third party's special trust or confidence in the agent.[61] The agent, however, can enforce this contract. Nor can undisclosed principals enforce against the third party any rights created by agents on negotiable instruments.[62] If the identity theory explained fully the undisclosed principal's relationship with the agent, the rule for negotiable instruments could not exist or, if it did exist, remain coherent and consistent with the identity theory. Moreover, the invalidity of the contract between the third party and the agent such that the agent could not enforce the contract against the third party or be held liable to the third party, does not *per se* invalidate the rights and liabilities on that contract between the undisclosed principal and the third party.[63] If the agent lacked mental capacity, for example, the third party would still have rights against the undisclosed principal, and the undisclosed principal would have rights against the third party.[64] Again, the identity theory fails to account for this rule. Therefore, although the identity theory does support a rule which would permit undisclosed principals to ratify unauthorized contracts, because of

[60]See *Restatement (Second) of Agency* §§322 and 329; *In re Hawaiian Tel. Co.*, 61 Haw. 572, 608 P.2d 383 at 393 (1980); *United States* v. *Everett Monte Cristo Hotel, Inc.*, *supra*, note 4; and *Judith Garden, Inc.* v. *Mapel*, 73 Misc. 2d 810, 342 N.Y.S. 2d 486 at 488 (1973).

[61]See *Restatement (Second) of Agency* §322. See also: *Restatement (Second) of Agency* §369; *Mitsui & Co.* v. *Puerto Rico Water Resources Auth.*, 528 F. Supp. 768 at 776, 793 (D.P.R. 1981); and *Ritchie* v. *Mundon*, 268 Or. 283, 520 P.2d 445 at 447 (1974).

[62]See authorities cited at *supra*, note 6, involving personal trust or confidence in agent.

[63]See authorities cited at *supra*, note 6, involving negotiable instruments. See also, Seavey, *supra*, note 6 at 880 (inability of undisclosed principal to enforce contracts under seal shows that doctrine of undisclosed principal does not rest upon fiction of identity).

[64]Weinrib, *supra*, note 48 at 303.

the limitations of the identity theory in explaining all instances where undisclosed principals have liabilities and rights on authorized contracts,[65] the identity theory cannot fully be relied upon to resolve the issue. It in no way, however, supports the present rule.

6. Change of Position Theory

Lewis also proposed that undisclosed principals' liability on authorized contracts might be understood as resulting from the role of undisclosed principals in causing third parties to change their position.[66] Liability is imposed on the undisclosed principal not because of any deceit by the undisclosed principal, but because he is the "prime cause"[67] of the third party's change of position. The person responsible for someone's change of position should be held responsible for any damage created by such a change. For example, the person responsible for causing the seller of wheat to deliver it, should be held liable to pay for it.

Unlike the other theories discussed thus far, it is more difficult to decide which rule of ratification by undisclosed principals is consistent with Lewis' change of position theory. On the one hand, it could be argued that when the agent of an undisclosed principal contracts without prior authority from his principal, the third party's change of position is a result of the agent's actions, not the undisclosed principal's. Unlike authorized transactions, the agent may be viewed as the prime cause of the third party's actions. On the other hand, even though the agent has acted without authorization, the agent is still acting on behalf of his principal. Even in the unauthorized transaction, therefore, the prime cause of the third party's change of position is the person in control of the agency relationship — the principal. For example, even though the agent in *Keighley, Maxsted* agreed to pay more for the wheat than what he was authorized to pay, the principal should be viewed as the prime cause of the wheat seller's change of position because he can control his agent. The principal maintains control over his agent by his right to set a condition on the agent's employment. If we accept Lewis' change of position theory as a proper basis for the liability of undisclosed principals on

[65]If the fiction of identity between the principal and the agent were to be carried to the extreme, it could be argued that there would never be any "unauthorized" contracts because if the principal and the agent are identical, then the agent could never have acted contrary to the principal's instructions. This is extending the identity theory too far, however. The theory does not maintain that the principal and agent are actually the same person; it merely attempts to explain authorized contracts as resulting from the agent representing or standing in for the principal.

[66]See *Danziger* v. *Thompson*, [1944] K.B. 654, 101 S.J. 440, [1944] 2 All E.R. 151, discussed in Weinrib, *supra*, note 48 at 301-02. This is further support for the independent liability of the principal to the third party.

[67]Lewis, *supra*, note 7 at 135.

authorized contracts, either ratification rule for undisclosed principals — permitting or denying ratification — could be viewed as consistent with it. As such, this theory differs from the other theories previously discussed, since those theories are consistent only with a rule permitting undisclosed principals the power to ratify.

The change of position theory, however, may not provide a sufficient explanation of any agency law situation involving undisclosed principals — whether the issue involves authorized or unauthorized contracts. This argument flows from the concept of detrimental reliance. To create liability based on a change of position, reasonable detrimental reliance is required.[68] For example, under the doctrine of promissory estoppel as developed by the *Restatement (Second) of Contracts*, liability presupposes three factors: (1) a promise, (2) the promisor, by his promise, should have reasonably expected to induce action or forbearance by the promisee or third party, and (3) the promise induces action or forbearance.[69] In the authorized undisclosed principal situation, the undisclosed principal's promise is to the agent. The third party is induced to change his position by the agent; the third party is not induced to change his position by the undisclosed principal. An argument might be made that absent the promise by the undisclosed principal to his agent, there would be no change of position by the third party, but the better reasoning is that the change of position must be induced by the promise from the one to be held liable. Without knowledge of the promise between the principal and the agent, there can be no reliance on this promise; therefore, no liability should be imposed.

Consequently, there is a strong possibility that the change of position theory does not explain the liability of undisclosed principals on even authorized contracts, and is thus an invalid theory upon which to attempt to base any rules of agency law.[70] To the extent it is valid, it appears that a rule permitting ratification by undisclosed principals is consistent with it, although a contrary rule may also be consistent with it.

7. Independent Agency Law Theory

In 1920, Seavey wrote what today is considered the seminal article in agency law, "The Rationale of Agency".[71] In his article, Seavey argued that undisclosed principals' liability on authorized contracts is not dependent

[68]See *Drexel* v. *Union Prescription Centers, Inc.*, 582 F.2d 781 at 791 n.13 (3d Cir. 1978), and *Restatement (Second) of Agency* §8B.

[69]*Restatement (Second) of Contracts* §90.

[70]See, *e.g.*: Holmes, *supra*, note 8 at 19 (ratification has nothing to do with estoppel); *Restatement (Second) of Agency* §82 comment c (ratification not dependent on estoppel); and *Steffens* v. *Nelson*, 94 Minn. 365, 102 N.W. 871 (1905).

[71]Seavey, *supra*, note 6.

on any applications of contract, tort, or trust law, but is based on an obligation created by an autonomous body of law, the law of agency.[72] Undisclosed principals are liable for the contracts which they authorize their agents to make not because, for example, of any theories of assignment or deceit, but because principals in general are liable for the contracts which they authorize their agents to make. It is the principal's status as principal in the agency relationship which creates liability. This independent agency law theory of liability of undisclosed principals is widely accepted today.[73] This theory is particularly strong because unlike other theories based on contract or tort, this theory can resolve agency law issues within one consistent framework.[74]

The independent agency law theory of an undisclosed principal's liability on an authorized contract leads to a ratification rule permitting an undisclosed principal to ratify unauthorized contracts. Because the principal's liability is based on his status as principal, there is no justification for distinguishing between undisclosed principal liability in authorized or unauthorized situations followed by ratification. Undisclosed principals are just as much principals in unauthorized yet ratified agency relationships as they are in authorized agency relationships. Interestingly, although as Reporter of the *Restatement*, Seavey assented to the decision that the rule denying undisclosed principals the right to ratify be included in the *Restatement*, he later wrote that he believed undisclosed principals should be able to ratify unauthorized contracts.[75]

Unlike the other theories explaining the liability of undisclosed principals on authorized contracts, the independent agency law theory has no weaknesses. It provides a *sui generis* basis for liability not based on legal fictions, torts of deceit, or chains of subrogation. As a result, it is consistent with the expectations of common business practice. It can account for all areas of undisclosed principal liability and does not conflict with other agency law doctrines. As such, it is the best explanation of why undisclosed principals are liable on authorized contracts. The ratification rule which is consistent with the independent agency law theory is one which permits ratification by undisclosed principals. Because of its soundness, the inde-

[72]*Ibid.* at 878. See also: *Williamson* v. *O'Dwyer & Ahern Co.*, 127 Ark. 530, 192 S.W. 899 (1917).

[73]See, *e.g.*: *Grinder* v. *Bryans Rd. Bldg & Supply Co.*, 290 Md. 687 at 706, 432 A.2d 453 at 461 (1981); M.L. Ferson, "Undisclosed Principals" (1953) 22 U. Cin. L. Rev. 131 at 148; Weinrib, *supra*, note 48 at 299; and M.A. Sargent & A. Rochvarg, "A Reexamination of the Agency Doctrine of Election" (1982) 36 U. Miami L. Rev. 411 at 415-16.

[74]See *infra*, note 66.

[75]W.A. Seavey, "Ratification — Purporting To Act As Agent" (1954) 21 U. Chi. L. Rev. 248 at 248.

pendent agency law theory provides the strongest basis for the adoption of a new rule contrary to *Keighley, Maxsted* and to the *Restatement.*

8. Summary

This section has presented seven theories which have been offered by commentators seeking to understand why undisclosed principals are liable on authorized contracts. The purpose of this section was to find if any of these theories concerning authorized contracts leads to a conclusion about undisclosed principals and their ability to ratify unauthorized contracts. A ratification rule permitting undisclosed principals to ratify unauthorized contracts is more consistent with the theories explaining the liability of undisclosed principals on authorized contracts. Of the seven theories, only one, the change of position theory, can be seen as lending any support to the present rule denying ratification rights to undisclosed principals. Even this support, however, is critically wounded by two points about the change of position theory: it also supports permitting ratification by undisclosed principals, and it may be an inappropriate basis for any explanation about undisclosed principals. The other six theories strongly support a rule permitting undisclosed principals to ratify. These six offer no support for the present rule. Although some of these theories may be weak in their ability to account for all of agency law, their weaknesses in no way limit their usefulness in an analysis of ratification. These weaknesses were identified merely as a precaution against relying on that theory as the sole basis for a change in the law. When viewed as a whole, they strongly support the conclusion that the *Keighley, Maxsted* rule needs to be revised. Most importantly, the independent agency law theory suffers from none of the weaknesses identified with the other theories, and offers the strongest support for a rule permitting undisclosed principals to ratify.

The conclusion to this point, therefore, is that for a ratification rule for undisclosed principals to be consistent with the rules involving the liability of undisclosed principals on authorized contracts, undisclosed principals should have the power to ratify unauthorized contracts.

B. Theories Explaining the Right of Undisclosed Principals to Enforce Authorized Contracts

The previous section discussed those theories offered by various commentators to explain the liability of undisclosed principals on authorized contracts in order to determine whether these theories lead to a conclusion concerning ratification of unauthorized contracts by undisclosed principals. This section will present and analyze theories which have been offered by commentators and courts to explain why undisclosed principals can *enforce*

a contract against third parties which undisclosed principals authorize their agents to make. Again, the purpose of this discussion is to see if any of these theories involving undisclosed principals' ability to enforce *authorized* contracts leads to a conclusion concerning ratification of unauthorized contracts by undisclosed principals.

This section will discuss five theories which have been offered to explain why undisclosed principals can enforce authorized contracts. These theories are (1) the reciprocal rights theory, (2) the consideration theory, (3) the trust theory, (4) the circuitry of action theory, and (5) the assignment theory. This section, like the one preceding it, will conclude that a new rule which permits undisclosed principals to ratify unauthorized contracts is more theoretically sound than the present rule.

1. Reciprocal Rights Theory

This first theory of undisclosed principal enforcement rights is the corollary of all those theories discussed in Part III which create liability for undisclosed principals on authorized contracts. The reciprocal rights theory provides that undisclosed principals can enforce authorized contracts against third parties because undisclosed principals are liable on these contracts to third parties. The theory is based on notions of fairness and consistency. Justice requires one who is liable on a contract to be able to have enforcement rights on that contract.[76]

Whether this theory of enforcement rights of undisclosed principals leads to any conclusion regarding ratification for undisclosed principals is dependent on whether the theories which justify undisclosed principals' liability on authorized contracts lead to a conclusion about ratification for unauthorized contracts. As indicated by the previous section's discussion of the seven theories explaining undisclosed principals' liability on authorized contracts, these theories support permitting undisclosed principals the power to ratify. Therefore, the conclusion under the reciprocal rights theory of enforcement should be that undisclosed principals should be allowed to ratify unauthorized contracts as well.[77] Thus, the reciprocal rights theory supports a ratification rule permitting undisclosed principals to ratify.

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[76]Weinrib, *supra*, note 48 at 298; *Massachusetts Bonding & Ins. Co.* v. *Higgins*, *supra*, note 6 at 1151.

[77]See *supra*, notes 46-75 and accompanying text.

2. Consideration Theory

It has been suggested by one scholar that the ability of undisclosed principals to enforce authorized contracts is based on the concept of consideration.[78] Even though the third party thought he was dealing only with the agent, undisclosed principals can sue third parties because the consideration for the transaction comes from the principal. As the provider of the consideration, undisclosed principals are entitled to receive the benefit from the one who is the recipient of the consideration.

It is unclear how the consideration theory supports a rule permitting or denying ratification by undisclosed principals. The issue becomes whether the undisclosed principal is providing the consideration by ratifying the unauthorized contract in the same way that the undisclosed principal is seen as providing the consideration in an authorized transaction. An argument can be made that the act of ratification is an act by the principal providing on his part the necessary consideration enabling him to enforce the contract. If ratification serves this purpose, there seems no distinction between consideration in authorized and unauthorized transactions. On the other hand, two theories suggest that consideration may not play a role in ratification. The first is that if consideration is lacking in the original agent-third party transaction, ratification does not provide the needed consideration.[79] The second is that no new consideration is needed for a principal to ratify.[80] These two theories seem to suggest that the consideration could only have come from the agent.

It might be concluded that since consideration is the basis of the right of undisclosed principals to enforce authorized contracts, but is not the basis of ratification by partially and fully disclosed principals, denying undisclosed principals the right to ratify is more consistent with the consideration theory of undisclosed principal enforcement rights on authorized contracts than permitting ratification by undisclosed principals. The consideration theory thus perhaps supports the present rule denying undisclosed principals the power to ratify. It seems, however, that the consideration theory is actually no more than the reciprocal rights theory as applied to the benefit-burden theory of liability since consideration may be analogous to the burden as-

[78] *Borrowscale* v. *Royal Bosworth*, 99 Mass. 378 at 383 (1868); and Müller-Freienfels, *supra*, note 6 at 304, 306-08. Müller-Freienfels argues that the consideration theory is supported by the historical development of the undisclosed principal. The principle of consideration, he argues, was fully settled at the end of the 17th century, and there are no cases involving undisclosed principals before the 18th century: *ibid.* at 308.

[79] *Restatement (Second) of Agency* §82 comment c. See also: *Love 1979 Partners* v. *Public Service Comm.*, 715 S.W.2d 482 at 487 (Mo. 1986); *Texas Pac. Coal & Oil Co.* v. *Smith*, 130 S.W.2d 425 at 430 (Tex. Civ. App. 1939).

[80] *Ibid.*

sumed or the benefit given by the parties. In other words, undisclosed principals should be able to enforce contracts because they have provided a benefit (consideration) to the third party. To the extent that the consideration theory is based on the benefit-burden theory, it is not inconsistent with permitting ratification by undisclosed principals as discussed in Part III.

3. Circuitry of Action Theory

Another argument presented as a basis of an undisclosed principal's ability to enforce authorized contracts lies in the power of an undisclosed principal to compel the agent to sue the third party, and compel the agent to pass on the benefits of the transaction to him. It would follow that direct action by undisclosed principals against third parties should be allowed.[81] When the agent contracts with a third party without disclosing for whom he is contracting, the agent has the right to enforce the contract against the third party.[82] Because the agent is subject to the control of the principal,[83] the principal could order the agent to sue the third party. Rather than requiring this order, the principal should be allowed to sue the third party directly. Moreover, after the agent successfully sues the third party, the agent owes a duty to the principal to deliver the benefit of the transaction to the principal.[84] For example, in a suit for specific performance of delivery of wheat, the agent would be bound to deliver the wheat to the principal once the agent received the wheat from the third party. Rather than requiring the wheat to be delivered to the agent and then delivered to the principal (or requiring the principal to sue the agent to force the agent to deliver the wheat to the principal), undisclosed principals are given the right to proceed directly against third parties. Transaction costs such as attorneys' fees and court costs are reduced by permitting this direct action. Consequently, there may be strong efficiency reasons for allowing the principal to enforce rights.

This circuitry of action theory supports permitting undisclosed principals to ratify and thus enforce contracts which were originally unauthorized. This is true for the following reasons. The agent of an undisclosed principal who has acted without authorization has the right to enforce the contract against the third party.[85] By ratifying, the undisclosed principal is

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[81]Müller-Freienfels, *supra*, note 6 at 301; Wright, *supra*, note 6 at 189 (undisclosed principal's right to sue third party is a "short cut"); *Kelly Asphalt Block Co.* v. *Barber Asphalt Paving Co.*, 136 A.D. 22, 120 N.Y.S. 163 at 166 (1909).

[82]*Restatement (Second) of Agency* §322.

[83]*Restatement (Second) of Agency* §1(1). See also: *Brady* v. *Ralph Parsons Co.*, 308 Md. 486, 520 A.2d 717 at 729-30 (1987); and *Jones* v. *Reith*, 166 Cal. App. 2d 220, 333 P.2d 226 at 231 (1958).

[84]*Restatement (Second) of Agency* §§377, 385(1), 387, 402(1), and 404.

[85]See authorities cited at *supra*, note 61.

ordering the agent to enforce the contract. Moreover, because the agent acted without authorization, the agent may be held accountable to the principal for breach of duty to act only as authorized.[86] The agent will be relieved of this breach by the principal's ratification,[87] but only if the agent passes on the benefits to the principal.[88] Therefore, because undisclosed principals are able to obtain the benefit of the originally unauthorized contract by ordering their agents to sue the third party or by suing the agent for breach of fiduciary duty, undisclosed principals should be given the direct right against third parties by allowing them to ratify. The circuitry of action theory therefore supports a rule contrary to *Keighley, Maxsted* and the *Restatement.*

4. Trust Theory

A theory of enforcement of authorized contracts by undisclosed principals based on the law of trusts was presented by Ames in his 1909 Yale Law Journal article.[89] Under this trust theory, the undisclosed principal is the *cestui que trust* (beneficiary), the agent is the trustee, and the *res* is the claim against the third party. The agent-trustee holds legal title to the claim against the third party, but this claim is actually for the benefit of the undisclosed principal.[90] Application of the trust theory to a ratification rule for undisclosed principals would again most likely support a rule permitting undisclosed principals to ratify. Such is the case because the undisclosed principal is as much the beneficiary of his agent's actions whether the agent has acted with or without authority. It matters not whether the agent is acting in an authorized or unauthorized manner, provided that the agent is still acting as an agent and thus acting on behalf of the principal for the principal's benefit.

It is not appropriate, however, to evaluate what rule of ratification by undisclosed principals results from the trust theory because the trust theory incorrectly explains the relationship between the agent and principal and thus should be rejected.[91] A trust relationship is not necessarily an agency relationship.[92] For example, in an agency relationship, the agent is subject to the principal's control.[93] In a trust, the trustee is not subject to the control of the beneficiary.[94] Other differences distinguishing trust from agency in-

[86]*Restatement (Second) of Agency* §383.
[87]*Ibid.* §416.
[88]See *supra,* note 84.
[89]Ames, *supra,* note 6 at 444.
[90]*Ibid.* at 444. See also, Lewis, *supra,* note 7 at 126-30.
[91]Seavey, *supra,* note 6 at 868 n. 29. For further support, see, Müller-Freienfels, *supra,* note 6 at 308.
[92]*Restatement (Second) of Agency* §14B.
[93]*Ibid.* §1(1).
[94]*Ibid.* §14B comment f; and *Baron* v. *Bryant,* 556 F. Supp. 531 at 537 (D. Haw. 1983).

volve the consent of the parties,[95] the power to bind the principal,[96] and termination.[97] Therefore, since it is not proper to equate the trust relationship with the agency relationship, a trust theory tends to not be useful in understanding a ratification rule for undisclosed principals.

5. Assignment Theory

Another explanation why undisclosed principals can enforce authorized contracts against third parties is based on the agent's assignment of his claim against the third party to the principal.[98] In authorized transactions, the agent of an undisclosed principal has a claim against the third party,[99] and absent special language in the contract,[100] or special circumstances,[101] the agent can assign his claim to the principal. Proponents of the assignment theory emphasize the lack of prejudice to the third party in allowing undisclosed principals to sue the third party directly.[102] Although the third party may not be aware that the agent is acting on behalf of a principal, it does not matter because generally assignments of contracts to persons unknown to the third party at the time of the contract are permitted.[103] In fact, an undisclosed principal is less of a "stranger" to the transaction than assignees in general.[104] The rules of contract law which limit the ability of a contracting party to assign certain rights under the contract because performance by the assignee would vary materially from the bargained-for performance[105] — for example, a contract premised on the artistic skill or unique ability of the supposed assignor[106] — are also recognized in agency law which denies undisclosed principals any right to enforce certain contracts where the third party contracted with the agent because of a special trust or confidence in the agent.[107] The assignment theory, therefore, is a useful theory in understanding the enforcement rights of undisclosed prin-

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[95]*Ibid.* §14B comment e.

[96]*Ibid.* §14B comment g.

[97]*Ibid.* §14B comment h.

[98]Goodhart & Hamson, *supra*, note 6 at 352; *Hay* v. *Hollingsworth*, *supra*, note 54 at 584. But see, Müller-Freienfels, *supra*, note 6 at 314 (assignment theory not proper under English law although valid under Continental law).

[99]*Restatement (Second) of Agency* §322.

[100]*Ibid.* §189.

[101]See *supra*, note 6.

[102]Goodhart & Hamson, *supra*, note 6 at 352.

[103]*Ibid.* For support, see Seavey, *supra*, note 6 at 879.

[104]Müller-Freienfels, *supra*, note 6 at 300 (undisclosed principal not in position of complete stranger).

[105]*Restatement (Second) of Contracts* §317(2)(a).

[106]See *Taylor* v. *Palmer*, 31 Cal. 240 at 247-48 (1866).

[107]See authorities cited at *supra*, note 6 involving personal trust or confidence in agent.

cipals, and in turn towards understanding a rule involving ratification and undisclosed principals.

The assignment theory supports permitting undisclosed principals to ratify unauthorized contracts. Although the agent has acted in an unauthorized manner, the agent still has rights against the third party.[108] The agent could assign his rights to the undisclosed principal. There is no distinction between the agent assigning his rights resulting from the agent's authorized or unauthorized transactions. The agent has the same rights with regards to the third party. Therefore, the assignment theory of undisclosed principals' enforcement rights on authorized contracts supports a rule contrary to *Keighley, Maxsted* and the *Restatement.*

6. Summary

This section has presented five theories which attempt to explain why undisclosed principals can enforce against third parties contracts which they authorize their agents to make. The purpose was to find if these theories concerning authorized contracts would lead to a conclusion about undisclosed principals and their ability to ratify unauthorized contracts. The conclusion to be drawn from the above analysis is that the various theories which explain the ability of undisclosed principals to enforce authorized contracts lend more support to a rule permitting undisclosed principals to ratify than one denying them the power to ratify. The assignment theory, the circuitry of action theory, and a reciprocal rights theory, in particular when based on the independent agency law theory of an undisclosed principal's corresponding liability, all strongly support permitting undisclosed principals to ratify. The trust fund theory also supports such a ratification rule, but this theory is not appropriate to agency law and should not be counted as support for any ratification rule. Only the consideration theory does not clearly point to the adoption of a rule permitting ratification by undisclosed principals. To the extent that the consideration theory is merely a component of the benefit-burden theory of liability, however, it does support such a revised rule. This conclusion regarding the enforcement rights of undisclosed principals adds further strength to the conclusion reached in the preceding section that the rule established in *Keighley, Maxsted* and adopted by the *Restatement* is not supported by the theories underlying undisclosed principals' rights and liabilities on authorized contracts.

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[108]See *supra*, note 61.

IV. A Ratification Rule for Undisclosed Principals based on Ratification of Unauthorized Contracts by Disclosed and Partially Disclosed Principals

Another consideration in determining whether the *Keighley, Maxsted* decision and *Restatement* rule should continue to be followed is whether the rule denying undisclosed principals the power to ratify can be justified as being consistent with the theoretical underpinnings of ratification by disclosed and partially disclosed principals. Both the Court of Appeal[109] and House of Lords[110] in *Keighley, Maxsted* discussed ratification by disclosed and partially disclosed principals to determine whether permitting undisclosed principals to ratify would be contrary to the general ratification doctrine. The focus of this section will be on whether any of the theories which underlie ratification by disclosed and partially disclosed principals support any rule of ratification by undisclosed principals. Eight theories which attempt to explain ratification will be discussed. These eight theories concern (1) the relation-back concept, (2) the identity of principal and agent, (3) the principal as commander, (4) the agent-third party transaction as an offer, (5) the third party's conditional performance, (6) the ratifying principal as a party to the contract, (7) the agent's secret intentions, and (8) the third party's expectations. Although the theories involving ratification do not support uniformly one rule involving undisclosed principals and ratification, these theories do provide greater support for a rule permitting ratification by undisclosed principals than for one which denies this power to undisclosed principals.

A. Relation-Back Concept

It has been stated that because the principal's ratification relates back to the time of the agent-third party transaction, ratification is equivalent to original authorization.[111] If ratification is equivalent to original authorization, and undisclosed principals can enforce and be held liable on originally authorized contracts, this would be strong support for the position that undisclosed principals should be permitted to ratify unauthorized contracts. Lord Justice Collins, while sitting on the Court of Appeal in *Keighley, Maxsted*, relied on this reasoning in his opinion.[112] Support for the relation-back concept is found in the rule that the statute of limitations runs from the time of the agent-third party transaction, not from the time of the principal's ratification.[113] The relation-back concept also explains why the law governing a contract under the doctrine of *lex loci contractus* is the place where the agent and third party agreed to the contract, not the place of

[109]See *supra*, notes 15-16 and accompanying text.

[110]See *supra*, notes 36-40 and accompanying text.

[111]Wambaugh, *supra*, note 12 at 60; *Restatement (Second) of Agency* §100.

[112]*Supra*, note 15 at 645.

[113]*Owen* v. *King*, 130 Tex. 614, 111 S.W.2d 695 at 698 (1938). See *Restatement (Second) of Agency* §100A and §82 comment c. See also, Seavey, *supra*, note 6 at 888.

ratification.[114] Moreover, if the principal does not have the capacity to enter the contract at the time of the agent-third party transaction, the principal cannot ratify the contract after becoming competent.[115]

But again, we must be careful not to place too much emphasis on one theory. There are instances where the relation-back concept is not followed and ratification is not viewed as equivalent to original authorization.[116] For example, no ratification is permitted when there has been a material change of circumstances before the principal's attempted ratification.[117] If ratification were equivalent to original authorization, ratification would be permitted no matter what has transpired between the time of the agent-third party transaction and the principal's attempted ratification.

Therefore, although the relation-back concept in general does support permitting undisclosed principals to ratify, it must be recognized that this theory does have limits.[118] These limits, however, do not support a rule

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[114] *Ibid.*

[115] *Restatement (Second) of Agency* §84.

[116] Wambaugh, *supra*, note 12 at 61. If the original contract requires performance to be complete by a certain date, the contract cannot be ratified after that date. See *Restatement (Second) of Agency* §90. If a fourth party gains rights in the contract after the agent-third party transaction, but before the principal's purported ratification, ratification is not permitted. This is true whether the fourth party did or did not know of the original transaction: *Cook* v. *Tullis*, 18 Wall. (U.S.) 332 at 338 (1873); See also: Wambaugh, *ibid.*; Goddard, *supra*, note 11 at 40. Before ratification, most jurisdictions in the United States permit the third party to withdraw and terminate the principal's ability to ratify: *Restatement (Second) of Agency* §88. See also: Wambaugh, *ibid.*; Seavey, *supra*, note 6 at 891; Reporter's Notes to *Restatement (Second) of Agency* §88, and T.G. Pappas, 'Rescission by Third Party Prior To Principal's Ratification of Agent's Unauthorized Action" (1948) 2 Vand. L. Rev. 100. In contrast, the English cases do not permit withdrawal: *Bolton Partners* v. *Lambert* (1889), 41 Ch. D. 295, 58 L.J. Ch. 425, 60 L.T. 687. This case, however, is not uncontroversial. See, *e.g.*, *Fleming* v. *Bank of New Zealand*, [1900] A.C. 577 at 587, 69 L.J.P.L. 120, 83 L.T. 1 (P.C.) (questioned); *Dibbins* v. *Dibbins*, [1896] 2 Ch. 348 (distinguished); *Watson* v. *Davies* (1930), [1931] 1 Ch. 455, 100 L.J. Ch. 87 (distinguished); *Warehousing & Forwarding Co. of East Africa Ltd* v. *Jafferali & Sons Ltd* (1963),[1964] A.C. 1, [1963] 3 All E.R. 571 (distinguished); *Re Portugese Consolidated Copper Mines* (1890), 45 Ch. D. 16 (followed); G.H.L. Fridman, *The Law of Agency*, 5th ed. (London: Butterworths, 1983) at 86-90 (general support for the rule, but with the observation that its harsh effects are severely restricted by various limitations); and S.J. Stoljar, *The Law of Agency* (London: Sweet & Maxwell, 1961) at 189-93 (support for the rule). The *Bolton Partners* case has been followed in Canada. See *Farrell & Sons* v. *Poupore Lumber Co.*, [1935] 4 D.L.R. 783 (S.C.C.) (applied); and *Goodison Thresher Co.* v. *Doyle* (1925), 57 O.L.R. 300 (App. Div.) (distinguished).

[117] *Restatement (Second) of Agency* §89; *Guaranty Bank and Trust Co.* v. *Reyna*, 51 Ill. App. 2d 412, 201 N.E.2d 144 at 151 (1964). See also G.H. Robinson, "Ratification After Loss In Fire Insurance" (1933) 18 Cornell L.Q. 161.

[118] See also: A.L. Corbin, "Ratification in Agency Without Knowledge of Matcrial Facts" (1906) 15 Yale L.J. 331 at 332 (knowledge of agent not imputed to principal during ratification further proof that statement that ratification is equivalent to prior authority is too broad).

completely denying undisclosed principals the right to ratify; they merely suggest that other support for the rule permitting ratification is also desirable.

B. Identity Theory

The legal fiction of the identity of the principal and agent (discussed above in Part III) will also be considered here in deciding whether undisclosed principals should be permitted to ratify their agents' unauthorized contracts and thus be able to enforce and be held liable on them. Because under the identity theory, principals have the same rights and liabilities as their agents, it is important to understand the agent's rights and liabilities under unauthorized contracts.

1. Agent's Liability on Unauthorized Contracts

The agent of an undisclosed principal who makes an unauthorized contract is liable to the third party.[119] This liability is based either on the agent's status as a party to the contract,[120] or perhaps because of some breach of implied warranty of authority.[121] The agent of a disclosed principal who has made an unauthorized contract with a third party would also be liable to the third party unless the agent tells the third party that he is not authorized. The theory of liability, here, is either misrepresentation[122] (if the agent wrongly tells the third party that he is authorized), or breach of implied warranty of authority[123] (if there is no express misrepresentation but the agent's conduct reasonably leads the third party to assume that the agent is authorized). The agent of a partially disclosed principal is also liable on unauthorized contracts. This liability may be based on the agent's status as a party to the contract,[124] express misrepresentation,[125] or breach of implied warranty of authority.[126]

These rules concerning whether agents are liable on unauthorized contracts indicate that, in general, agents in unauthorized transactions are liable to third parties with whom they have dealt regardless of whether they act undisclosed, partially disclosed or disclosed. Absent special circumstances, when an agent makes a contract with a third party without prior authority from his principal, the agent will be liable to the third party whether the

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[119]See *supra*, note 60.

[120]*Restatement (Second) of Agency* §322.

[121]See, *e.g.*, *ibid.* §329. This section's requirement that the agent purport to contract on behalf of another seems to be needless.

[122]*Ibid.* §330.

[123]*Ibid.* §329.

[124]*Ibid.* §321.

[125]*Ibid.* §330.

[126]*Ibid.* §329.

third party was aware that the agent was acting on behalf of someone else or not, and whether that someone else had been identified or not.

Applying the identity theory of ratification, it therefore appears that there is no justification for treating undisclosed principals differently from disclosed and partially disclosed principals for liability purposes under a ratification theory. All principals should be able to ratify unauthorized contracts.

2. Agent's Ability to Enforce Unauthorized Contracts

Agents who make unauthorized contracts on behalf of disclosed and partially disclosed principals are not able to enforce these contracts against third parties.[127] The rationale for this rule is that the agent "cannot prove the existence of the contract which he purported to make".[128] Agents of undisclosed principals, however, do not fall within the ambit of this rule because the purported contract is one between the agent and the third party. Since the third party expected to be bound to the person who is in fact an agent of an undisclosed principal, the agent of an undisclosed principal can enforce unauthorized contracts against the third party.

Based on these rules of enforcement, the identity theory of ratification might lead to the conclusion that undisclosed principals be permitted to enforce unauthorized contracts through ratification, but that disclosed and partially disclosed principals should not be able to enforce unauthorized contracts by ratification. This of course is the very opposite of the present rule, but one which is consistent with the identity theory.

It should be reiterated, however, that there is a weakness in relying too heavily on an identity theory. Although there are times when the identity theory does hold up,[129] the ratifying principal is not always treated as identical to the agent. For example, if the agent has the power to perform a contract, but the principal does not, the principal cannot ratify the contract.[130] If a third party building contractor signs a contract with an agent who is a licensed electrician for services which the building code requires to be performed by only licensed electricians, a principal who is not a licensed electrician can not ratify this contract. If the agent and principal are identical, this would not be true. Because the identity theory cannot explain

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[127] *Ibid.* §369.

[128] *Ibid.* §369 comment a. This rule is also consistent with giving the third party the right to withdraw before the principal ratifies. See authorities cited at *supra*, note 99.

[129] *Dolvin* v. *American Harrow Co.*, 125 Ga. 699, 54 S.E. 706 at 710 (1906) (principal cannot ratify if agent induced third party into contract fraudulently).

[130] *Restatement (Second) of Agency* §86(1); *State* v. *Thompson*, 191 Conn. 360, 464 A.2d 799 at 811 (1983).

all the rules of ratification, it cannot by itself justify a rule permitting undisclosed principals to ratify. But to the extent it offers some help, it supports a rule permitting ratification by undisclosed principals.

C. Principal as Commander

It has also been suggested that ratifying principals' liability is based on control of the agent and that "liability follows control".[131] One court wrote that the "underlying principle upon which liability for ratification attaches is that he who has commanded is legally responsible for the direct results and for the natural and probable consequences of his conduct".[132] The fact that the agent acted without authority does not refute that the principal is the one in control of the agent. The same court also wrote that it is "immaterial" whether the command is given "before or after the conduct".[133] This "principal as commander" theory of liability of the ratifying principal does not depend on the principal being disclosed or partially disclosed. There is no difference between an undisclosed principal's ability to control and command the agent to operate on his behalf, and the ability of a disclosed or partially disclosed principal to control and command the agent. Therefore, since the basis of the liability of a ratifying principal under the "principal as commander" theory is the same for all principals, this theory is more consistent with a rule permitting undisclosed principals to ratify than one which denies undisclosed principals such a right.

D. Agent-Third Party Transaction As Offer

It was also suggested by Wambaugh in his 1895 Harvard Law Review article that when the agent acts without authority from his principal, the agent-third party transaction might be viewed as an offer by the third party to the principal.[134] This offer theory of ratification finds support in the rule followed in most American jurisdictions that the third party is permitted to withdraw from the transaction before the principal has ratified.[135]

It is not easy deciding whether this theory leads to any firm conclusion about ratification and undisclosed principals. It could be argued that the offer theory might support a ratification rule which treats undisclosed principals differently from disclosed and partially disclosed principals. This is true for three reasons. First, the third party's agreement with the agent could be construed only as an offer if the agent tells the third party that he is not

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[131]Seavey, *supra*, note 6 at 884.

[132]*Steffens* v. *Nelson*, *supra*, note 70 at 873.

[133]*Ibid.* at 873.

[134]Wambaugh, *supra*, note 12 at 67.

[135]See authorities cited at *supra*, note 116.

authorized but that he will be requesting ratification by his principal. This scenario is only relevant to disclosed and partially disclosed principals. It is not relevant to undisclosed principals because if the agent tells the third party that he must seek ratification from his principal, then the principal is at least partially disclosed. As a consequence, since an offer analysis can apply only to disclosed or partially disclosed principals, it might support a ratification rule which treats undisclosed principals differently. Second, under the offer theory, the third party is expecting that someone else other than the agent needs to respond to the contract. This can only be true if the principal has been disclosed either fully or partially. In the undisclosed principal situation, the third party is not aware of any other step needed for a complete contract. Third, under the offer theory, the agent has no enforcement rights against the third party because the third party has not agreed to a binding contract, but only has made an offer. This is true with agents of disclosed and partially disclosed principals who have no enforcement rights against the third party. But this is not true for agents of undisclosed principals who can enforce contracts against third parties.[136] Therefore, because the offer theory is consistent with the rules involving disclosed and partially disclosed principals, but contrary to the rules involving undisclosed principals, it might support denying undisclosed principals the right to ratify unauthorized contracts.

But the offer theory is limited in explaining ratification, and should not be relied upon too heavily. If the agent-third party transaction is only an offer, no contract would be formed until the principal communicated his ratification to the third party. A communication from the principal to the third party, however, is not required for a valid ratification even in cases where ratification is permitted.[137] The offer theory is also defeated by the rule which permits principals to ratify even if the principal has earlier repudiated the transaction.[138] Offers cannot be accepted once they have been repudiated.[139] If the original contract is only an offer, once repudiated by the principal it could not be subsequently ratified. Moreover, the relation-back concept weakens the argument that the third party has made only an offer.[140] If the agent-third party transaction is only an offer, the contract

[136]See *supra*, notes 119-30 and accompanying text.

[137]*Restatement (Second) of Agency* §95; Wambaugh, *supra*, note 12 at 67. There is a minority position which requires the principal to communicate his affirmance to the third party: *Dodge* v. *Hopkins*, 14 Wis. 686 at 697 (1861); See Wambaugh, *supra*, note 12 at 64-5; Mechem, *supra*, note 10 at 273; and B.R. Brown, "Agency — Ratification and Consent — Should Wisconsin Follow the Restatement?" (1947) Wis. L. Rev. 394 at 395.

[138]*Restatement (Second) of Agency* §92(b); *Stortroen* v. *Beneficial Finance Co.*, 736 P.2d 391 at 398 (Colo. 1987); Reporter's Notes to *Restatement (Second) of Agency* §88. See also, *Restatement (Second) of Agency* §82 comment c (fresh consent not needed).

[139]*Restatement (Second) of Contracts* §37.

[140]Seavey, *supra*, note 6 at 887.

would be created at the time of acceptance — when the principal ratifies. But under the relation-back concept (and independent of its ability to support ratification as described above), the contract is seen to be formed at the time of the agent-third party transaction.[141]

The offer theory, therefore, although it has some elements which argue for a differing treatment of undisclosed principals with regards to ratification, does not accurately describe ratification. It therefore should not be relied upon as support for a rule denying undisclosed principals the power to ratify.

E. Third Party's Conditional Performance

Another suggestion proposed by Wambaugh was that the third party from the time of the agent-third party transaction has a contract with the principal but that the third party's obligation to perform the contract is conditional on the principal ratifying.[142] This characterization of the third party's obligation to perform supports a rule treating disclosed and partially disclosed principals differently from undisclosed principals for ratification purposes. This is so because agents of disclosed and partially disclosed principals cannot enforce against the third party the unauthorized contract they have negotiated with the third party.[143] Because of the agent's inability to enforce, the third party's obligation to perform is conditional on the principal ratifying. This does not hold with respect to undisclosed principals because the agent of an undisclosed principal can enforce the unauthorized contract against the third party.[144] Therefore, the third party's performance is not dependent on the principal. Using this distinction, this conditional view of the third party's performance consequently may provide some support for denying undisclosed principals the power to ratify unauthorized contracts.

F. Ratifying Principal as a Party to the Contract

If a ratifying principal is construed as a party to the contract, this might support a rule denying undisclosed principals the power to ratify. This is true because undisclosed principals, unlike disclosed and partially disclosed principals, are not considered parties to authorized contracts.[145] Because undisclosed principals are treated differently in terms of whether they are parties to authorized contracts, it may make sense to treat undisclosed prin-

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[141]See *supra*, note 113.

[142]Wambaugh, *supra*, note 12 at 67.

[143]See *supra*, notes 127-28 and accompanying text.

[144]*Ibid.*

[145]*Restatement (Second) of Agency* §147. See *supra*, notes 71-3.

cipals differently if ratification also involves the principal becoming a party to the contract.

The only support for the view that a ratifying principal is a party to the original contract is that a ratification once made cannot be revoked.[146] But there are more and better arguments for the view that the ratifying principal does not become a party to the contract. First, the ratifying principal need not supply any consideration,[147] a requisite for a contract.[148] Nor does ratification provide consideration if consideration was lacking in the agent-third party transaction.[149] Second, mutual assent, another requisite for a contract,[150] is lacking in the ratification situation.[151] Third, ratification treats the transaction as complete at the time of the agent-third party transaction.[152] This is not the case with a contract which would be considered complete only at the time of ratification. For these reasons, the ratifying principal should not be considered a party to the original contract, and this view does not support a rule denying undisclosed principals the power to ratify.[153]

This analysis reiterates the position taken earlier in the article when discussing the liability of undisclosed principals on authorized contracts: the rules of agency law are best understood by recognizing and referring to an independent body of law of agency rather than attempting to fit the rules of agency law into the law of contracts. Although contract law is helpful in understanding some aspects of agency, the ratifying principal's liability is better viewed as based on a non-contractual basis — the law of agency.[154] Contract law cannot be used as an explanation for agency law because the agency relationship differs from a contractual relationship. An agency relationship is consensual, not contractual.[155] Because the agent in an agency relationship acts primarily for the benefit of the principal, the agency relationship is a fiduciary one.[156] In a contractual relationship, the parties are acting for their own benefit and are not fiduciaries of each other. Moreover,

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[146]*Haney School-Furniture Co.* v. *Hightower Baptist Inst.*, 113 Ga. 289, 38 S.E. 761 (1901).

[147]See *Restatement (Second) of Agency*, §82 comment c.

[148] S. Williston, *A Treatise on the Law of Contracts*, 3d ed., vol. 1 (Mount Kisco, N.Y.: Baker Vooris & Co., 1957-1978) §18 (consideration is one requisite of a contract).

[149]See *supra*, note 79.

[150]*Safeway Stores, Inc.* v. *Altman*, 296 Md. 486, 463 A.2d 829 at 831 (1983); *Forbes* v. *Wells Beach Casino, Inc*, 307 A.2d 210 at 216 (Me. 1973).

[151]*Fulton County Fiscal Court* v. *Southern Bell Telephone & Telegraph Co.*, 289 Ky. 159, 158 S.W.2d 437 at 439 (1942).

[152]See *Restatement (Second) of Agency* §82 comment c.

[153]*Ibid.*

[154]*Ibid.* §82 comment a (ratification is a legal concept in the law of agency).

[155]*Ibid.* §1.

[156]*Ibid.*

someone who lacks the capacity to enter into a contract may have the capacity to be an agent.[157] Liability is imposed on the principal because he is the one that controls the agent and is the one to whom fiduciary obligations are owed. The basis of the principal's liability is his consent to having someone act on his behalf. The principal's liability is not necessarily contractual.

The liability of the ratifying principal should be explained identically to the liability of undisclosed principals on authorized contracts — by the independent agency law theory. Ratifying principals are liable because they are principals in agency relationships. Their status as principals creates rights and liabilities. This status is what is important, not the degree of disclosure made known to third parties. Because disclosure is not a distinguishing feature in this analysis, all principals should have equal rights and liabilities under a ratification doctrine.[158]

G. Agent's Secret Intentions

The House of Lords in *Keighley, Maxsted* expressed the concern that ratification by undisclosed principals would permit the creation of legal rights and obligations based on the agent's secret intentions as to on whose behalf the contract is being made. Permitting the agent's secret intentions to create rights and obligations, it was argued, is undesirable because it promotes fraud.[159] If allowing undisclosed principals the right to ratify does increase the likelihood of fraud, this might be a good reason to deny them a ratification right. But this is not true. The potential for fraud because of reliance on the agent's secret intentions is not unique to undisclosed principals. The same possibility of fraud arising due to reliance on the agent's secret intentions exists even with partially disclosed and fully disclosed principals. For example, it is accepted that partially disclosed principals can ratify.[160] This means that although the agent must at the time of the transaction with the third party purport or profess to act on behalf of a principal, the agent is not required to identify the principal. When the agent makes a contract without prior authority on behalf of a partially disclosed principal, the rule is that only the person intended by the agent to be the principal can ratify.[161] Thus, in the partially disclosed principal situation, the "secret intention" of the agent, *i.e.*, the identity of the principal, is permitted to be the basis of legal rights. The potential for fraud is equally possible with the partially disclosed principal as the undisclosed principal. Because the con-

[157]*Ibid.* §21.

[158]See *supra*, notes 72-3.

[159]See *supra*, note 37. See also, Recent Cases (1900) 14 Harv. L. Rev. 153.

[160]*Restatement (Second) of Agency* §85 comment c.

[161]*Ibid.* §§85, 87.

cern about the agent's secret intentions does not deny partially disclosed principals the right to ratify, it should not be sufficient to deny undisclosed principals the right to ratify.[162] Moreover, the ratification rule which permits a contract to be ratified even if the "agent" is not acting on someone else's behalf at the time of the agent-third party transaction, but the agent tells the third party that he is acting on that person's behalf,[163] has just as much potential for fraud as permitting undisclosed principals to ratify. Yet this potential for fraud is not viewed as so hazardous as to justify denying a power to ratify.

The policy of reducing any possibility of fraud by denying the creation of contract rights based on the agent's secret intentions cannot justify treating undisclosed principals differently from partially disclosed or fully disclosed principals. No meaningful distinction can be drawn between undisclosed principals and partially or fully disclosed principals on this issue. This alleged policy, therefore, cannot support a rule which denies undisclosed principals the power to ratify unauthorized contracts.

H. Third Party's Expectations

One reason for allowing ratification, it has been argued, is to give the third party what he expects to get when he agrees to the transaction with the agent.[164] The third party believes that he is contracting with the agent's principal, not the agent. Ratification is aimed at correcting a defect in the agent's authority so that the bargain which the third party intends to make is the actual bargain he receives.[165] This reasoning supports the *Keighley, Maxsted* decision and *Restatement* position denying an undisclosed principal the right to ratify. If ratification exists solely to protect the third party's expectations, the appearance of an undisclosed principal as ratifier is contrary to these expectations and thus should not be permitted.[166]

There is support for viewing ratification as existing to protect the third party's expectations. For example, under present law, it is accepted that if a third party enters a contract with someone who is not the agent of anyone, if this someone (the alleged agent) purports to the third person to be acting on behalf of another person (the alleged principal), the contract can be

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[162]See Goddard, *supra*, note 11 at 44-5.

[163]*Restatement (Second) of Agency* §85 comment d. See also *Linn* v. *Kendall*, 213 Ia. 33, 238 N.W. 547 at 548 (1931).

[164]*Ibid.* §85 comment a. See also J.A.C. Hetherington, "Trends in Enterprise Liability: Law and the Unauthorized Agent" (1966) 19 Stan. L. Rev. 76 at 111.

[165]*Ibid.*

[166]See Seavey, *supra*, note 6 at 887 (law should seek to satisfy the reasonable expectations of persons).

ratified.[167] By ratifying the contract, the "principal" creates an agency relationship. Ratification is allowed under this circumstance in order to protect the expectations of the third party.

The problem with relying on this type of analysis in order to support denying undisclosed principals the power to ratify is that when dealing with *authorized* contracts, the expectations of the third party are not considered relevant. Although it must be conceded that the appearance of a ratifying undisclosed principal distorts the expectations of the third party, this distortion is not different following ratification of an unauthorized contract than the distortion experienced by the appearance of an undisclosed principal after an authorized transaction. When an undisclosed principal enforces an authorized contract, the third party's expectations are defeated since the third party never expected enforcement by anyone other than the agent. Yet, undisclosed principals can enforce authorized contracts. Therefore, although the policy of seeking to protect the third party's expectations does lend support to a rule denying undisclosed principals the power to ratify unauthorized contracts, this same policy is not considered significant when dealing with authorized contracts. There is no justification for protecting third party expectations in unauthorized transactions but not protecting them in authorized transaction. Whether the agent has been authorized is a matter between the principal and the agent. The third party has no role in the issue of the agent's actual (express or implied) authority. If the third party's expectations are to be a consideration for agency law doctrine, these expectations should be accorded equal dignity in all situations. The third party's expectations should not be seen, therefore, as a stumbling block to permitting ratification by undisclosed principals.

I. Summary

This section has discussed eight theories which attempt to explain ratification of unauthorized contracts by disclosed and partially disclosed principals. The purpose of this section was to find if the ratification theories concerning disclosed and partially disclosed principals lead to a conclusion about ratification and undisclosed principals. As the discussion has indicated, five theories favour permitting undisclosed principals to ratify: relation-back concept, identity of principal and agent, principal as commander, ratifying principal as a party to the contract, and the agent's secret intentions. Three theories lend support to denying undisclosed principals the right to ratify: agent-third party transaction as offer, third party's conditional performance, and third party's expectations.

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[167]See *supra*, note 163.

Although it is difficult to precisely and qualitatively assess which ratification rule for undisclosed principals is better supported by the theories explaining ratification of disclosed and partially disclosed principals — and it would be disingenuous to use merely a quantitative approach — the conclusion appears to be that a rule permitting undisclosed principals to ratify is more consistent with the theories explaining ratification by disclosed and partially disclosed principals than one denying undisclosed principals the right to ratify. Of the three theories which support denying undisclosed principals the right to ratify, two have significant weaknesses. As discussed above, the offer theory conflicts with three rules of ratification — that the principal need not communicate his ratification to the third party; that the principal can ratify even if he has repudiated earlier the contract; and that the date of formation of the contract, not ratification, is the time when the contract came into being (the relation-back concept).[168] Moreover, basing a ratification rule for undisclosed principals upon the third party's expectations conflicts with the lack of significance given to the third party's expectations in authorized undisclosed principal situations.[169] These two theories, therefore, are not strong bases to support the present ratification rule for undisclosed principals. The only theory which supports denying undisclosed principals the right to ratify which is not flawed is the one which views the third party's performance as conditional upon ratification. But this theory appears to be more of a deduction from the rule which denies undisclosed principals the right to ratify than a theoretical foundation for such a rule.

The ratification theories which support permitting undisclosed principals to ratify do not have the problems which their competing theories present. They also appear more consistent with those theories discussed earlier in this article concerning undisclosed principals and authorized contracts. Although the matter is not as clear as it was when discussing the theories involving undisclosed principals' rights and liabilities on authorized contracts (clearly supporting a rule permitting undisclosed principals the right to ratify), it nevertheless appears that the theories explaining ratification by disclosed and partially disclosed principals do not justify the differing treatment of undisclosed principals, but instead tend to support a rule permitting undisclosed principals the right to ratify.

V. Other Considerations in Determining a Rule of Ratification for Undisclosed Principals

This article has discussed the theories which explain (1) the liability of undisclosed principals on authorized contracts, (2) the right of undisclosed principals to enforce authorized contracts against third parties, and (3) rat-

[168]See *supra*, notes 137-41 and accompanying discussion.

[169]See *supra*, discussion in text following note 167.

ification by disclosed and partially disclosed principals. Analysis of these theories indicate that they better support a rule which permits undisclosed principals to ratify unauthorized contracts made on their behalf by their agents than the rule established in *Keighley, Maxsted* and adopted by the *Restatement*. Denying undisclosed principals the power to ratify unauthorized contracts is inconsistent with the well-established rules that permit undisclosed principals to enforce and be held liable on authorized contracts. Moreover, the theories which attempt to explain ratification do not support treating undisclosed principals differently from disclosed or partially disclosed principals with regards to the ability of principals to ratify. Therefore, if the rule which denies undisclosed principals the power to ratify is supportable and deserves continued acceptance, it must be on some other basis than the theoretical underpinnings of the law involving undisclosed principals and the law of ratification.

This section will discuss three possible bases of support for the rule denying undisclosed principals the right to ratify unauthorized contracts. These three bases are (1) a policy that undisclosed principals should be discouraged, (2) a policy that ratification should be discouraged, and (3) the state of authority. Analysis of each argument again will show, however, that none justify the continued acceptance of the *Keighley, Maxsted* decision and *Restatement* position.

A. Undisclosed Principals should be Discouraged

One possible justification for denying undisclosed principals the right to ratify unauthorized contracts might be a desire to limit the use of the device of the undisclosed principal. If undisclosed principals are treated equally with disclosed and partially disclosed principals, principals have no incentive not to operate undisclosed. Only by treating undisclosed principals less favourably than other principals will persons agree to have their agents identify them to third parties in order to avoid the less favourable treatment. One area where undisclosed principals can be treated less favourably is the ability to ratify.

There is some justification for the position that undisclosed principals should be treated unfavourably. Commentators have described the undisclosed principal as a "device of dubious social utility",[170] "a cloak to perpetuate outright fraud"[171] and "inimical to market functioning and business planning".[172] Undisclosed principals have also been criticized for "signifi-

[170]M.H. Merrill, "Election Between Agent and Undisclosed Principal: Shall We Follow The Restatement?" (1933) 12 Neb. L. Bull. 100 at 129.

[171]*Ibid.*

[172]Hetherington, *supra*, note 164 at 112.

cantly infringing" on the rights of third parties to select those with whom they deal,[173] and for destroying third parties' reasonable expectations.[174] If these criticisms are accepted, one reason therefore for denying undisclosed principals the right to ratify and be able to enforce unauthorized contracts against third parties is to punish persons for being undisclosed principals.[175] By doing so, conducting business as an undisclosed principal will be discouraged.

A closer inspection of these arguments, however, indicates little or no harm results from allowing the existence of undisclosed principals. Therefore, principals should not be punished for acting undisclosed. This is true for at least four reasons. First, from the third party's perspective, in the vast majority of contracts, it makes no difference whether there is an undisclosed principal.[176] It makes no difference to the wheat farmer whether the wheat is sold to Roberts or to Keighley, Maxsted & Co.. Second, undisclosed principals are so commonly used that the third party must be considered to have contemplated at least the possibility that he is dealing with an agent of an undisclosed principal.[177] If it does make a difference to the third party whether the other contracting party is only an agent, the third party can easily protect himself against the existence of an undisclosed principal either by asking about the existence of any principal[178] or by drafting a clause which excludes undisclosed principals.[179] Because the third party can so easily protect himself against the existence of undisclosed principals, the third party's failure to do so is best explained by the absence of any prejudice to the third party.[180] Third, the third party is not in a worse position because of the appearance of an undisclosed principal. The third party is bound to perform the contract only once. Performance is owed either to the agent or the principal.[181] Moreover, the third party can raise any defenses that he has against the agent in an action brought by the principal.[182] The third party even may be in a better position because now not only does he have the right to enforce the contract against the agent, but he also has enforcement rights against the principal.[183]

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[173]*Ibid.*

[174]*Ibid.* at 111.

[175]*Ibid.*

[176]Wright, *supra*, note 6 at 185-86.

[177]Note, "Personal Prejudice and the Doctrine of the Undisclosed Principal", *supra*, note 6.

[178]See *Restatement (Second) of Agency* §§302, 304.

[179]See *ibid.* §§302, 303.

[180]See Wright, *supra*, note 6 at 185.

[181]See *Restatement (Second) of Agency* §310 comment c.

[182]Wright, *supra*, note 6 at 188; Goodhart & Hamson, *supra*, note 6 at 322; *Frazier* v. *Poindexter*, 78 Ark. 241, 95 S.W. 464 at 466 (1906).

[183]See Müller-Freienfels, *supra*, note 6 at 313 ("unexpected godsend").

Finally, there are reasons why undisclosed principals rather than being "inimical to market functioning" are in fact positive forces in achieving an efficient system of contract law. First, undisclosed principals may be more useful than other principals in facilitating transactions that lead to more efficient economic use of goods.[184] For example, if a real estate developer seeks to purchase ten small vacant lots from their owners in order to build a shopping centre, the transfer of the lots may be facilitated by the real estate developer remaining undisclosed. This is true because if the lot owners know that the buyer is a real estate developer, they may attempt to "hold out" for a price higher than that which they would have been satisfied to receive had they not known the identity of the buyer. If each lot owner stubbornly holds out and attempts to receive a disproportionate share of the increase in land value from the building of the shopping centre, it may become uneconomical to build the shopping centre and the entire deal will collapse. Second, knowledge of the identity of the buyer might also lead to more transaction costs. For example, appraisal and legal fees may increase in order for both sides to calculate and negotiate the value of the properties if the sellers know that it will be used for a shopping centre. If undisclosed principals do facilitate transactions at lower costs, there is no reason to adopt rules of law which discourage persons from acting undisclosed.[185]

The policy that principals should not be punished for remaining undisclosed, and treated more poorly than disclosed and partially disclosed principals, is evidenced in other areas of agency law. For the most part, the rules of agency law do not change depending on whether the principal is disclosed, partially disclosed or undisclosed.[186] Where there is a difference in the law depending upon whether the principal is undisclosed, the undisclosed principal, although sometimes denied certain rights granted to other principals,[187] sometimes receives more favourable treatment than other

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[184]See Wright, *supra*, note 6 at 184.

[185]An argument might be made that undisclosed principal transactions create uncertainty in the bargaining process, and that this uncertainty might lead third parties to be less willing to engage in transactions. In other words, even though the third party is not told by the agent that he is acting on behalf of a principal, the third party nevertheless knows that undisclosed principals are common and that one may exist. In order to protect himself against this possibility, the third party may increase the price for his bargain in order to cover any possible additional risk posed by a potential undisclosed principal. If the cost of this risk is too high or uncertain, the third party might not contract at all. The response to this argument is that the more likely behavior by the third party is not to drop out of the market, but to ask the agent whether he is acting on behalf of a principal, or to include in the contract a clause excluding enforcement by any undisclosed principal.

[186]See authorities cited at *supra*, note 5 (all principals regardless of amount of disclosure can enforce authorized contracts).

[187]See authorities cited at *supra*, note 6.

principals.[188] Therefore, denying undisclosed principals the right to ratify cannot be justified as necessary to sustain a consistent policy of unfavourable treatment of undisclosed principals. Quite simply, no such policy exists.[189]

Even if there was a justifiable policy of unfavourable treatment of undisclosed principals in agency law, ratification would not be the proper place to implement it. Ratification involves situations where the agent has acted in an *unauthorized* manner. Undisclosed principals gain no advantage when their agents act contrary to their instructions. Moreover, the blanket rule denying undisclosed principals any right to ratify can not support a policy of unfavourable treatment of undisclosed principals because it shields undisclosed principals from *liability* arising out of a purported ratification. While a rule imposing liability on undisclosed principals based on ratification, but denying any enforcement rights against third parties, might be used to support a policy of discouraging principals from acting undisclosed, the *Keighley, Maxsted* decision and *Restatement* position, by protecting undisclosed principals from liability, does not further such a policy. In fact, the rule does quite the opposite. By denying ratification to undisclosed principals, the rule at times will serve to protect the undisclosed principal from liability, and consequently works contrary to the policy by eliminating for the principal a disincentive to remaining undisclosed.

The important point is that the rule denying undisclosed principals the power to ratify unauthorized contracts made on their behalf by their agents cannot be justified by a policy of discouraging principals from acting undisclosed. No such policy exists, and even if it did, it would not be furthered by a rule denying undisclosed principals the right to ratify.

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[188]Under the agency doctrine of election, a third party suing an undisclosed principal and his agent must elect to take judgment against one. Judgment against the agent releases the undisclosed principal from liability: *Restatement (Second) of Agency* §210. On the other hand, entry of judgment against the agent of a partially disclosed principal does not discharge the principal: *Restatement (Second) of Agency* §184(1). See generally, M.A. Sargent & A. Rochvarg, "A Reexamination of the Agency Doctrine of Election", *supra*, note 73. Moreover, the rule followed in most jurisdictions is that if the undisclosed principal makes payment to his agent, the undisclosed principal is released from liability to the third party: *Poretta* v. *Superior Dowel Co.*, *supra*, note 55; Holmes, *supra*, note 8 at 19; Lewis, *supra*, note 7 at 117; and Müller-Freienfels, *supra*, note 6 at 313. But see, *Restatement (Second) of Agency* §208. Payment by a disclosed or partially disclosed principal to his agent does not discharge the principal's liability to the third party: *Restatement (Second) of Agency* §183.

[189]Müller-Freienfels writes that Continental jurisprudence "esteems the institution of undisclosed principal very highly": *supra*, note 6 at 300. He also points out that neo-Babylonian cuniform law and Jewish law according to the law of the Babylonian Talmud recognizes rights of undisclosed principals: *ibid.* at 312.

B. Ratification should Be Discouraged

Perhaps a rule denying undisclosed principals the right to ratify might be justified on the basis that ratification in general should be discouraged, because it is unfair to third parties and is contrary to commercial needs. A rule denying undisclosed principals the right to ratify might be viewed as one step in the direction of reducing the use of ratification. Ratification, however, is not unfair on third parties and is useful to commerce, and therefore should not be discouraged. Since there is no need to discourage ratification, this policy cannot support a rule denying undisclosed principals the right to ratify.

1. Unfairness to Third Parties

Comment d to Section 82 of the *Restatement (Second) of Agency* notes that ratification "at times" may operate unfairly because it gives the principal "an election to blow hot or cold upon a transaction".[190] If after learning of the transaction, the principal decides that the contract is good for him, he will ratify. If the contract is not to his advantage, the principal is not bound and will not ratify.

But this does not establish the unfairness of ratification. First, the principal's right to "blow hot or cold" is merely giving the principal the right which he would have had if the agent had discussed the contract with him before the agent contracted with the third party. The principal is not getting an additional right, but merely the same right at a later time. Any potential unfairness that might result because of the principal's ability to access the contract at this later time is accounted for and militated against by the rule which denies the principal the power to ratify if there has been a material change in circumstances between the time of the agent-third party transaction and the principal's purported ratification thereby making ratification inequitable.[191] Moreover, the third party is protected from unfairness, according to a majority of jurisdictions in the United States, because during the time before the principal ratifies, the third party is permitted to withdraw.[192] This American rule gives the third party an unexpected additional right which he would not have had if the contract had been authorized. The third party thought he was bound to a contract, but now the third party is given the right to back out without any liability. Even under the English and Canadian approach, which denies the right of withdrawal to the third

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[190]*Restatement (Second) of Agency* §82 comment d. See also: *Bradley* v. *John M. Brabham Agency, Inc.* 463 F. Supp. 27 (D.S.C. 1978); *Cooke* v. *Orsen*, 12 M.J. 335 (1982); and *Fulka* v. *Florida Commercial Banks, Inc.*, 371 So.2d 521 (Fla. 1979).

[191]See *supra*, note 117.

[192]See *supra*, note 116.

party pending ratification,[193] an approach called "wrong" by Seavey,[194] ratification should not be seen as unfair to the third party. The English rule merely denies the bonus which the American rule provides; it does not take away any right from the third party. The third party, therefore, is not in a worse position than if ratification did not exist. The lack of unfairness is underscored in the situation of an undisclosed principal's ratification because the third party, even if not allowed to withdraw, is being held only to the deal to which he originally agreed — a contract with the agent.[195]

The third party is not treated unfairly by ratification because if the third party does not withdraw, or does not have the power to withdraw, the third party has a cause of action against the agent.[196] The third party would only not have a claim against the agent if the agent tells the third party that he is not authorized, and plans to seek ratification from his principal. But this circumstance should not be seen as unfair to the third party because the third party knowingly has agreed to take the risk that the principal will ratify. Interestingly, this last situation would not involve undisclosed prin-

[193]*Bolton Partners* v. *Lambert*, *supra*, note 116.

[194]Seavey, *supra*, note 6 at 891:

> It creates an offer [by the third party] when none was intended and imposes upon a mistaken party [the third party] an obligation not imposed upon an offeror. The English court creates before ratification . . . a one-sided obligation created elsewhere only where it has been paid for, where protection is afforded to a dependent class, or where there is fraud.

[195]This is true even under the most extreme circumstances. For example, without the ability of the third party to withdraw pending ratification, under some scenarios there might be a strong argument that they are unfairly disadvantaged. The argument would be premised on the fact that the undisclosed principal is presented later with an option to accept or reject the contract on the terms of the deal which were negotiated sometime before. The third party, on the other hand, would be bound at the time the agent makes the deal. In the meantime, market fluctuations may have made the deal more attractive (in which case the principal will choose to ratify) or less attractive (in which case the principal will choose to reject). Assuming this market fluctuation was not tantamount to a material change in circumstances, since fluctuating markets are a business reality, if the principal were to reject the deal, then he could not be held liable on the contract. The third party would then have recourse against the agent: *supra*, notes 119-26. The "unfairness" would arise if the agent is unable to pay the price. The third party then would be able to recover from neither the principal nor the agent. Therefore, the third party is at a disadvantage because he runs the risk of losing under the contract and changed market conditions, but has no reciprocal opportunity to benefit from them: he can lose but never win. The weakness with this argument is clearly that the third party is in no worse a position than he originally (and ostensibly) contracted for, since by all indications he was contracting with the agent alone. Consequently, from the third party's perspective, if the agent is unable to pay, the situation would be no different than any other contractual situation where the other party may be insolvent. In other words, there is no link between the principal's "option" and the potential disadvantage to the third party because the potential benefit of the option does not come at the expense of "unfairness" to the third party. They are independent of each other.

[196]See *supra*, notes 119-26.

cipals (if they are allowed to ratify) because by disclosing his lack of authority, the agent is creating at the least a partially disclosed principal. It could be argued, therefore, that ratification by undisclosed principals has the least potential for unfairness in that the agent is always liable to the third party.

There is also the argument that ratification not only is not unfair to third parties, but that it gives the third party an advantage over the principal. A principal deciding whether to ratify a contract already agreed to by his agent may ratify a contract less advantageous to him than what he might have been able to bargain for earlier in order for the principal to protect his business reputation.[197] Rather than have it become known that the principal's agents are "loose cannons" and have acted unauthorized, the principal may ratify a contract which is less desirable than one which might have been negotiated earlier. Moreover, a principal may ratify a contract even though he could have earlier negotiated a better one in order to avoid defending a lawsuit.[198] The rule which requires that the contract be ratified in its entirety, exactly as agreed upon by the agent and third party,[199] also indicates that the principal may be forced to agree to a less advantageous contract by ratification than if the original transaction had been made with his full knowledge and authorization. For all these reasons, ratification does not treat the third party unfairly.[200]

2. Commercial Usefulness

There is also no justification for discouraging the use of ratification because it is contrary to the needs of commerce.[201] In fact, the opposite is true — ratification is beneficial to commerce. As written in comment d to Section 82 of the *Restatement (Second) of Agency*:

> [P]erhaps the best defense of ratification is pragmatic; that it is needed in the prosecution of business. It operates normally to cure minor defects in an agent's authority, minimizing technical defenses and preventing unnecessary lawsuits.

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[197]See *Restatement (Second) of Agency* §82 comment d.

[198]*Ibid.*

[199]*Ibid.* §96; See also: *United States ex. rel. Trane Co.* v. *Raymar Contracting Corp.*, 295 F. Supp. 234 at 237 (S.D.N.Y. 1968), aff'd, 406 F.2d 280 (2d Cir. 1968), *cert.* denied, 394 U.S. 975 (1969); *C.Q. Farms, Inc.* v. *Cargill, Inc.*, 363 So.2d 379 at 382 (Fl. 1978); and *Land Title Co. of Dallas* v. *F.M. Stigler, Inc.*, 609 S.W.2d 754 at 758 (Tex. 1980).

[200]See Wambaugh, *supra*, note 12 at 62; Seavey, *supra*, note 6 at 891; and Holmes, *supra*, note 8 at 19.

[201]See Goddard, *supra*, note 11 at 45 (ultimate limitation of ratification should be determined by the convenience and necessities of business). See also: Wright, *supra*, note 6 at 184 (test to be applied should be that of business man's reasonable needs); and Müller-Freienfels, *supra*, note 6 at 309 (agency law has commercial slant because of the reception of the Law Merchant by the Common Law).

> In this aspect, it is a beneficial doctrine, which has been adopted in most systems of law.[202]

Ratification's role in reducing litigation not only reduces the transaction costs of doing business, but also serves society's need for reducing the burden on the court system. In "The Rationale of Agency", Seavey wrote that although it was "difficult to assign a logical place"[203] to ratification, it "conforms to our needs"[204] and "serves our convenience".[205]

In conclusion, therefore, ratification is not unfair to third parties and is beneficial to commerce and society.[206] Its use need not be discouraged. Any argument that permitting undisclosed principals to ratify is unwise because it would be expanding an unfair and damaging ratification doctrine must be rejected.

C. State of Authority

One last possible justification for continuing to accept the rule that undisclosed principals do not have the power to ratify contracts is its widespread acceptance. Although there may have been room for debate as to what was the state of the authorities at the time of the *Keighley, Maxsted* decision,[207] it is clear that today the overwhelming authority[208] is that undisclosed principals cannot ratify unauthorized contracts even if their agents make the contract on their behalf. Because consistency in the law is important for predictability and the ability for business to assess risks, the widespread acceptance of a rule may justify its continued acceptance. But this may not be true with the rule involving undisclosed principals and ratification. Courts do not feel constrained to follow precedent, even if a question is long settled, when the case involves a matter where parties have not placed reliance.[209] The rule against permitting undisclosed principals the right to ratify is not one on which parties rely in structuring their business dealings. Ratification involves only unauthorized transactions, and while unauthorized behaviour is not beyond the foreseeable risks involved in doing business through agents, business does not rely on such behaviour. Moreover, because the current rule is inconsistent with the rules involving

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[202]*Restatement (Second) of Agency* §82 comment d.

[203]*Supra*, note 6 at 887.

[204]*Ibid.*

[205]*Ibid.* at 888.

[206]See Seavey, "Ratification — Purporting to Act as Agent", *supra*, note 75 at 250 (ratification is a beneficient doctrine); and *Strader* v. *Haley*, 216 Minn. 315, 12 N.W.2d 608 at 613 (1943) (ratification is based on universally accepted principles of justice).

[207]See Goddard, *supra*, note 11.

[208]See *supra*, notes 41-4.

[209]*Looman Realty Corp.* v. *Broad St. Nat'l Bank*, 32 N.J. 461,161 A.2d 247 at 254 (1960).

undisclosed principals and authorized contracts[210] and the rules involving ratification by disclosed and partially disclosed principals,[211] allowing ratification by undisclosed principals in fact might be more consistent with business' present reliance (if any reliance exists on such issues).[212]

VI. Conclusion

Seavey once wrote that the House of Lords in *Keighley, Maxsted* "added the 'anomaly' of undisclosed principals to the 'anomaly' of ratification and got zero".[213] The better characterization of the *Keighley, Maxsted* decision is that it created its own anomaly.[214] There is no reason to permit undisclosed principals the right to enforce and be held liable on authorized contracts, but not to be able to enforce and be held liable on unauthorized contracts through ratification. Nor is there any reason to permit disclosed and partially disclosed principals to enforce and be held liable on unauthorized contracts through ratification but not to allow undisclosed principals this power. Unless undisclosed principals are denied rights and liability on authorized contracts, and unless ratification is denied for all principals, a rule which denies undisclosed principals the power to ratify unauthorized contracts which their agents make on their behalf should not be followed. Although courts may be reluctant to change a rule which is widely accepted, in light of the arguments presented in this article, the courts as well as legislatures and *Restatement* drafters should consider adopting a rule permitting undisclosed principals the power to ratify.

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[210]See *supra*, discussion in Part III.

[211]See *supra*, discussion in Part IV.

[212]See *Looman Realty Corp.* v. *Broad St. Nat'l Bank*, *supra*, note 208 at 254 (rules which lead to enigmatic anomalies may well intrigue the scholar and adorn his treatises, but serve only to baffle businessmen).

[213]Seavey, "Ratification — Purporting to Act as Agent", *supra*, note 75 at 250 n.16.

[214]See Müller-Freienfels, *supra*, note 6 at 315; See also Goodhart & Hamson, *supra*, note 6 at 325-26.