

Conveyancing and Companies: The Single Director and the Company Seal (Part 1)

Although it is a basic principle of both corporate and conveyancing practice that the affixation of a company's seal to an instrument should generally be carried out in the presence of, and attested by, two directors of the company, in recent years there has been a series of reported cases in Hong Kong concerning the validity of an assignment attested by a single company director. In a three-part article, Philip Smart tackles this unsettled area of the law

Part 1 sets out the fundamental elements of the rule in *Turquand's Case* and introduces the operation of ss 20 and 23 of the Conveyancing and Property Ordinance (Cap 219) (CPO). Parts 2 and 3 critically discuss the key Hong Kong judgments and offer practical advice across a range of relevant issues.

Introduction

There have been at least seven reported cases in the last few years regarding the affixation of a company's seal by a single director. These cases have typically involved purchasers raising requisitions on title in relation to (much) earlier assignments by previous corporate owners. The cases have generally been decided, *inter alia*, by reference to a combination of the application of the rule in *Turquand's Case* (often called the 'indoor management rule') and especially the presumption of regularity contained in s 23 of the CPO. (The

fact that a vendor can insert a special condition, namely that the purchaser accept one attesting signature, has seemingly not prevented this spate of litigation. See Wilkinson and Sihombing, *Hong Kong Conveyancing: Law & Practice* (1993) Vol 1, VI [168].)

Interestingly, in nearly all of the reported cases (leaving to one side those cases now overruled) the vendor's reliance upon the rule in *Turquand's Case* and s 23 has not been successful – the most notable exception being perhaps *Tread East Ltd v Hillier Development Ltd*, IICA 907/91 (Godfrey J) and [1993] 1 HKC 285 (CA). The cases do not, however, present a completely coherent picture. In particular, it is submitted that not only has an element of confusion crept into some of the recent judgments (notably *Lim Sui Chun v Billion Light Investment Ltd* [2000] 2 HKC 621) but also that parts of the reasoning of the Court of Appeal in *Hillier* itself is wrong in principle and contrary

to authority. Fortunately, however, a most troubling recent line of first instance cases, dealing with the construction of 'deeming' language in a company's articles, has very recently been overruled by the Court of Appeal (see *Grand Trade Development Ltd v Bonance International Ltd*, CACV 1002/2000, 26 July 2001, below).

The purpose of this article, after reviewing the applicable common law rules and statutory provisions, is to offer a critical analysis of the key decided cases, with a view to arriving at a conceptual framework into which those cases can be placed.

Turquand's Case and the Company Seal

The rule in *Turquand's Case* initially arose some 150 years ago in the context of the doctrine of constructive notice. (The doctrine of constructive notice of a company's public documents was, of course, abolished prospectively in Hong Kong in February 1997.) A person

dealing with a company was deemed to know the contents of the company's memorandum and articles of association but, where the company's affairs were seemingly being conducted in accordance with its memorandum and articles, an outsider would not be affected by any defect in the internal management procedures of the company. Thus, as in *Royal British Bank v Turquand* (1856) 6 E & B 327 itself, where the articles stated that the board of directors could borrow such sums as were authorised by a resolution of the shareholders in general meeting, a lender was entitled to assume that such a resolution had indeed been regularly obtained. The absence of such a resolution was said to be a matter of the indoor management of the company and would not prevent the lender from enforcing its rights against the company.

The rule was partly dictated by practical necessity – persons contracting with a company were not expected to spend their time checking that any required resolutions had properly been passed, at meetings that had been correctly convened, by directors whose appointments had been duly made. But it may also be noted that outsiders have no general right to investigate every aspect of the internal procedures and management of a limited liability company. The following statement of Lord Hatherley in *Mahony v East Holyford Mining Co* (1875) LR 7 HL 869 at 894 is a classic formulation of the rule:

[W]hen there are persons conducting the affairs of the company in a manner which

appears to be perfectly consonant with the articles of association, then those so dealing with them, externally, are not to be affected by any irregularities which may take place in the internal management of the company.

But the rule did not operate in a completely unrestricted manner. Firstly, it is inherent in the rule that if the transaction in question could not in the circumstances have been validly entered into by the company (eg the board purported to exercise a

exercised for purposes which were wholly unconnected with the company's business and of no benefit to the company. Fifth, it has often been said that the rule in *Turquand's Case* cannot apply in cases of forgery (see, eg, per Cheung J in *Hua Rong Finance Ltd v Mega Capital Enterprises Ltd* [1998] 4 HKC 532 at 534).

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The rule in *Turquand's Case* can operate in relation to any contractual obligation but has over the years frequently been raised in respect of a document to which the company's seal has been affixed

power which was specifically and exclusively reserved by the articles to the general meeting), then the third party could not enforce it. Second, the rule only protected 'outsiders', that is persons dealing 'externally' (as Lord Hatherley put it, above) with the company; directors, obviously, were the very people who would be expected to know if internal procedures had been duly followed. (This second point has apparently been overlooked in the Hong Kong jurisprudence: see *Tread East Ltd v Hillier Development Ltd*, below.) Third, actual notice of the failure to comply fully with internal procedures precluded reliance upon the rule. Fourth, an outsider could not rely upon *Turquand's Case* where the nature of the transaction was suspicious; for example, where the company's borrowing powers were

company's seal has been affixed. Thus in *County of Gloucester Bank v Rudry Merthyr Steam and House Coal Colliery Co* [1895] 1 Ch 629 a mortgage executed under seal was held to bind the borrowing company even though there was no proper quorum at the meeting of the directors which authorised the execution of the instrument. Professor Gower, summarising the common law position in 1969, stated:

[Where] the third party receives a document sealed in the presence of the appropriate individuals as stated in the articles of association, he is entitled to rely on its formal validity. Even if the board have never resolved that the document be sealed, he will be protected for he is not entitled

to see the minutes of the board meeting which relate to a matter of 'indoor management' and has no means of checking whether the internal regulations have been complied with.

(*Principles of Modern Company Law*, 3rd Ed (1969) at p 158, footnotes omitted, approved in *Re Cosco Supply (1979) Ltd* (1982) 135 DLR (3d) 557 at 560.)

The appropriate procedure for the affixation of a company's seal should always be provided for in the company's articles of association and, of course, different companies will have different procedures. But the articles will commonly (if not invariably) contain two distinct aspects. It will be stated that the seal may only be used with the authority of the board of directors (or a committee thereof); in addition, the articles will lay down the 'mechanics' of the physical affixation of the seal.

Traditionally, every instrument to which the seal is affixed shall be signed by two directors, or one director and the company secretary (see, eg, Companies Ordinance (Cap 32), Table A, reg 114). It is this latter aspect which has been at the heart of the recent Hong Kong case law, in particular where the articles have departed from the traditional requirement of two signatures and contemplate, or appear possibly to contemplate, attestation by one individual. Moreover, additional uncertainty was introduced because, where the attestation provision in the articles was couched in 'deeming' language, there were a number of recent cases where the court effectively treated

the provision as non-binding. These cases have now been overruled (see *Grand Trade Development Ltd v Bonance International Ltd*, CACV 1002/2000, 26 July 2001).

At this stage a couple of general, but significant, points concerning the rule in *Turquand's Case* may be highlighted. First, the rule does not seek to operate merely as a rebuttable presumption: once the outsider can satisfy the requirements of the rule, even an actual defect in the procedures for the affixation of the seal (for example, the failure to hold a board meeting to authorise the affixation of the seal or the non-appointment of the officers who signed) will be cured. Secondly, an outsider could never at common law safely rely upon the rule in *Turquand's Case* without first checking the articles of association. The articles might conceivably say that the seal could only properly be affixed in the presence of all of the company's directors, or that the chairman and one director or the secretary (rather than simply any two directors, or one director and the secretary) had to be present. Hence, at common law, conveyancers would always have to check the company's articles with particular care.

Section 20 of the CPO: Two Signatures

In England, s 74(1) of the Law of Property Act 1925 fundamentally altered the common law position where two officers attested the affixation of the seal. Section 74(1) provides:

In favour of a purchaser a deed shall be deemed to have been duly executed by a corporation

aggregate if its seal be affixed thereto in the presence of and attested by its clerk, secretary or other permanent officer or his deputy, and a member of the board of directors, council or other governing body of the corporation, and where a seal purporting to be the seal of the corporation has been affixed to a deed, attested by persons purporting to be persons holding such offices as aforesaid, the deed shall be deemed to have been executed in accordance with the requirements of this section, and to have taken effect accordingly.

The actual draftsman of the Law of Property Act 1925 (Sir Benjamin Cherry) stated in *Wolstenholm & Cherry's Conveyancing Statutes* (12th Ed, (1932) Vol 1, at 344) that the section 'removes the necessity for enquiry as to the formalities required under the memorandum, articles, charter, etc of the corporation'. His opinion was expressly endorsed by Nourse LJ in *Longman v Viscount Chelsea* [1989] 2 EGLR 242 at 246.

This explanation of s 74(1) of the 1925 Act is significant in Hong Kong in light of s 20(1) of the CPO, as amended (which first came into operation on 1 November 1984):

In favour of a person dealing with a corporation aggregate in good faith, his successors in title and persons deriving title under or through him or them, a deed shall be deemed to have been duly executed by the corporation if the deed purports to bear the seal of the corporation affixed in the

presence of and attested by its secretary or other permanent officer of the corporation and a member of the corporation's board of directors or other governing body or by 2 members of that board or body.

(It will be noted that the Court of Appeal in *Excelling Profit Investments Ltd v Sera Ltd* [1992] 2 HKC 262 at 269 held that the term 'corporation aggregate' in s 20(1) included a foreign company.)

A slight doubt has at times been raised in Hong Kong as to whether, despite s 20(1), a solicitor who has any suspicions must check the articles to ensure that the mode of execution complies therewith, as well as check that the signatories were in fact directors (and so on). Although this question has not yet been specifically addressed in the Hong Kong courts, this commentator would suggest that the English authorities make it clear that the provision was intended to do away with the need for checking for full compliance with a company's articles. Section 20(1) is not merely a rebuttable presumption. Unless the person dealing with the company has acted in bad faith, s 20(1) operates fully to protect the purchaser and his/her successors in title, provided of course two officers have attested the affixation. The one exception set out in the English books is where the deed is a forgery. (As to what is meant by a 'deed' in this context, see *South London Greyhound Racecourses Ltd v Wake* [1931] 1 Ch 496.)

Section 20(1) does not apply to a deed executed prior to November 1984. Nevertheless, attestation by two directors, or one director and

the company secretary, has for so long been the customary practice (see, eg, Companies Ordinance, Table A, reg 114) that such signatures will give rise to a presumption of due execution by virtue of the maxim *omnia praesumuntur rite esse acta*, even in the absence of proof of the contents of the company's articles. Such a presumption may, of course, be rebutted, but it will be of importance where one is concerned with a pre-November 1984 assignment and relevant documentation no longer exists.

Section 23 of the CPO: One Signature

Section 23 of the CPO contains a well-known and generally applicable (rebuttable) presumption that 'An instrument appearing to be duly executed shall be presumed, until the contrary is proved, to have been duly executed'. The key question is whether the general presumption contained in s 23 may apply where there is only one signature attesting the affixation of the company's seal to an instrument. It is here that the somewhat technical case law must be tackled. But before doing so, this commentator would suggest that (unless the legislature intervenes) a clear solution will only appear once the courts have decided where as a matter of principle they stand. If the judges continue by and large to take the view that the signatures of two directors (or equivalent) is what is to be expected, then anything less than two signatures will be viewed cautiously and will be likely to encounter formidable obstacles.

On the other hand, should the judges take the more relaxed view

that, in certain circumstances, one signature has in itself become almost a customary practice (albeit less desirable than two signatures) then the tendency for obstacles to be put in the vendor's path would surely fall away. This in turn involves a question of the standard of care and competence that is to be expected from conveyancers. Undoubtedly, in the past, details were not checked, nor records kept, by solicitors as carefully as one might have expected. As Peter Lo recently put it in his article 'Reasonable Doubt in Conveyancing' (*Hong Kong Lawyer*, June 2001, p 42 at 44): 'In the "old days" few people scrutinised the sealing provisions in a company's articles. Perhaps this was not quite right, but it was a fact of life'.

But it should not be assumed that the 'old days' are gone forever. In *Grand Trade Development Ltd v Bonance International Ltd* [2000] 4 HKC 57, reversed, CACV 1002/2000, 26 July 2001, the assignments in question had been entered into as recently as 1995 and 1996.

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