CORPORATE LIABILITY FOR UNAUTHORIZED CONTRACTS — UNIFICATION OF THE RULES OF CORPORATE REPRESENTATION*

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* This Article is part of an ongoing study intended to develop the theoretical foundations for personal, as opposed to vicarious, liability of corporations for their representatives’ acts, and to examine the public policy implications and practical ramifications of such liability in various aspects of modern corporate law.

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1. Introduction

This Article discusses the case of a corporate representative who enters into a contract with a third party on the corporation's behalf, but in doing so exceeds the limitations imposed by the corporation on his authority. The unauthorized contract which results from his misbehavior later forms the basis of the third party's contract claim against the corporation. The corporation's liability depends in this case not on interpretation of the contract, but rather on the legal question of whether a contract exists. The court must decide whether the representative's conduct has bound the corporation to a contract, despite the fact that the representative acted outside of his authority and that the contract was made against the corporation's will. Expressed in the classical terms of agency law, the legal relationship between the corporate prin-

1 Two distinct questions arise in these cases. The first concerns the internal relationship between a corporation and its representative, i.e., the duties of the representative towards the corporation, and the rights of the representative against the corporation. The second deals with the external aspect of the representation, i.e., the power of the representative to conclude a legal transaction binding the corporation and third parties. This second relationship forms the focus of this Article.
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principal (P) and the third party (T), that results from the actions of the agent (A), is the subject of our discussion.

Corporations function in the world of commerce primarily by means of contracts signed by their representatives. It is no wonder, therefore, that the extent of corporate contractual liability to third parties is one of the most discussed issues in agency law.\(^2\) Courts and scholars\(^8\) have struggled long and hard to classify, define and rationalize the cases in which courts have ruled that the unauthorized act of a corporation's representative resulted in a binding contractual relationship between the corporation and the third party. This struggle has produced various solutions, none of them completely satisfactory.

This Article begins by arguing, on policy grounds, for broad corporate liability on contracts signed by corporate agents.\(^4\) It continues with a description of the approaches adopted by the common and civil laws, as represented by English and German law, respectively, and demonstrates their weaknesses.\(^8\) It then discusses the United States approach, concluding that it, too, is inadequate because it is ad hoc and fails to predict the outcome of future cases.\(^6\) The survey of these disparate legal systems does, however, reveal a common trend in modern legal thought that recognizes the unique relationship between principal and agent in the corporate context and therefore departs from traditional agency law. This trend, it is argued, is fueled by the urgent needs of the business community. The main body of this Article is devoted to the introduction of an original approach — the "organic theory" — that achieves the desired policy goals by explicitly acknowledging the uniqueness of corporate structure which unconsciously drives the modern trend.\(^7\) Moreover, this Article will suggest that the organic idea, if adopted, may play a crucial role in protecting commercial stability in the marketplace and in unifying the law governing interna-

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\(^2\) Powell concludes that "few subjects in the law of agency have created so much controversy on both sides of the Atlantic." R. Powell, The Law of the Agency 53 (1961).


\(^4\) See infra Section 2.

\(^5\) See infra Sections 3.1-3.2.

\(^6\) See infra Section 3.3.

\(^7\) See infra Sections 4-7.
2. **Drawing the Limits of a Principal's Liability**

The problem presented by unauthorized contracts of corporate representatives is that the representative, by his misconduct, has placed two innocent entities in a legal confrontation that frequently results in a loss to one of them. Because neither T nor P is responsible for the confrontation, a policy favoring one of them at the expense of the other is to some extent arbitrary. In the absence of clear fault the loss must be allocated to one side or the other in accordance with policy considerations.

2.1. **Policy Considerations Favoring a Narrow Scope of Liability**

Extension of a corporation's liability to the unauthorized contracts of its agents conflicts with basic legal principles. It is almost axiomatic that a legal entity is accountable only for its own acts or omissions, where it is itself at fault. As one commentator stated, "[t]hese principles are so deeply rooted in legal thinking that any departure from them seems at first sight impossibly unjust."

Likewise, the principle of collegiate management by the board of directors "was devised . . . as a means of protecting the shareholders against hasty, uninformed and ill-considered transactions being entered into by their company." Broad responsibility for agents' acts seems to run counter to this principle as well, because it renders the shareholders bound to, and unprotected against, not only the contracts of the board of directors, but also the contracts of individual directors and officers even when they act against the will of the board.

In addition, a corporation's ability to enter into contracts through representatives of limited authority is vital to the functioning of commerce and is central to the idea that a corporation may act only in accordance with the limitations contained in its charter. Without restraints on the scope of their liability for acts of agents, corporations

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8 See infra Section 7.3.
9 P. Atiyah, Vicarious Liability in the Law of Torts 12 (1967). Violation of these principles may at first appear to be appropriate in those legal systems that adopt the rule of vicarious liability in torts — e.g., by making a master liable even in the absence of a strict causal connection between his own acts and the servant's tort and where the master is not at fault. However, the scope of the torts rule is limited to cases in which the servant was acting within the scope of his employment, while a broad view of corporate responsibility for an agent's actions shifts the responsibility onto the corporation even for an agent's acts to which the corporation had explicitly expressed its objection. See infra notes 20 & 41 and accompanying text.
10 R. Pennington, supra note 3, at 136.
could become subject to unanticipated liabilities of such magnitude that
the institution of agency representation would become prohibitively ex-
pensive. Limitations on corporate liability for agents’ behavior help to
maintain the usefulness of agents and thereby make it possible for cor-
porations, which can only exist through their agents, to function
effectively.11

2.2. Policy Considerations Favoring a Broad Scope of Liability

Despite the concerns raised above, both courts and scholars have
tended to favor a broader scope of corporate liability for their agents’
contracts.12 Several related arguments provide support for this position.

The traditional answer to the question of who should bear the risk
of loss resulting from an agent’s unauthorized contracts has long been
the following: “wherever one of two innocent persons must suffer by
the acts of a third, he who has enabled such third person to occasion
the loss must sustain it.”13 The precise question, therefore, should be:
Who has “enabled” the agent to misuse his power?

It was once the rule that where the corporation (or any P) did not
communicate directly with T, so that T relied only on the agent’s repres-
entations with regard to the limits of his authority, “[i]t is he himself
[T], and not the principal, who trusts the agent beyond the expressed
limits of the power; and therefore, [the court follows] the maxim, that
where one of two innocent persons must suffer, he who reposed confi-
dence in the wrong-doer must bear the loss . . . .”14

This reasoning made some sense in the nineteenth century. At that
time there was justification for imposing the duty of inquiry on T, be-
cause the marketplace was smaller, the system of commerce more indi-
vidualized, and the use of the agency device more limited. T, who had a
real opportunity to check upon A’s authority, and who failed to do so,
neglected his duty, enabled A to misuse his power, and therefore was
made to bear the loss. Nowadays, however, T does not enjoy a real
opportunity to make inquiries in every case in which he deals with
agents. Business today is dominated by large organizations and the ma-

11 No one, of course, would favor limiting corporate liability to so great an extent
as to destroy corporate credibility, because this too would impair corporations’ ability to
function effectively by making third parties reluctant to contract with corporations at
all.
12 For a discussion of German, English, and United States law, see infra Section 3.
their principals. "[T]he complexity of the products and of the skills involved in services purchased by the consumer largely forecloses self-protection . . . . [T]he incidence of breach of warranty, error, or fraud by servants is so small relative to the volume of business that inquiry or any other delay or cost-creating factor is uneconomical." The present market is consumer-oriented and characterized by mass production. The legal system must reflect market realities by creating new rules to abolish the unrealistic duty of inquiry, and thus support an efficient market without unfairly penalizing the innocent individual customer.

While scholars agree that "there is a tendency to consider the principal who employs the erring agent to be primarily at fault since he hired and introduced the agent into the business transaction," they seem somewhat uncomfortable with this conclusion, adding that "[t]his idea persists despite the fact that there was nothing . . . that the principal could reasonably have been expected to do to prevent this particular occurrence." In fact, though, $P$ is in a position to exercise some control. $P$ can employ strict criteria for the selection and evaluation of agents and can limit an agent's contacts with third parties until the agent has demonstrated his reliability. The agent is a part of the principal's organization and as such is subject to the principal's discipline. Furthermore, $P$ is in a better position to discipline $A$ because of the fiduciary duty and duty of care that $A$ owes to his principal but does not owe to $T$, with whom $P$ is bargaining at arm's length.

$T$, on the other hand, is in a poor position to take precautions against $A$'s unauthorized contracts. $T$'s acquaintance with $A$ is typically limited to the single transaction at issue. If the duty to inquire into the scope of $A$'s authority is placed on $T$, $T$ is forced to go to great expense to investigate $A$, all for the sake of a single transaction. In contrast, $A$ will normally be representing $P$ in many transactions. Hence, $P$'s cost of control, on a per-transaction basis, is much lower than $T$'s. From an efficiency standpoint, therefore, the burden of inquiry is properly placed on $P$.

Furthermore, $P$'s transaction costs in enforcing his rights against $A$ in the event $A$ acts without authority may well be lower than $T$'s. Since $P$ and $A$ have a continuing relationship, $A$ might well reimburse $P$ for the costs of $A$'s malfeasance on $P$'s demand. $T$, on the other hand, would more likely be forced to take action in the courts.

In addition, the corporation has far greater ability to insure itself against its representatives' misconduct than does $T$. The corporation

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16 Id. at 115.
has the financial strength to procure insurance, and it can spread the cost of the insurance over the entire purchasing public by adjusting the prices of its products. The corporation can also absorb the associated transaction costs with relative ease. T, who is often a lay consumer, would have much greater difficulty insuring himself against losses he might incur in the course of his numerous daily transactions.

The fact that it is the corporation, rather than the third party, that requires the agent's services, also supports placement of the risk on P. "[T]he feeling that one who derives a benefit from an act should also bear the risk of loss from the same act is probably a deep-rooted one which has played its part in the formulation of the modern law." It seems unfair to allow a corporation to take advantage of the institution of agency without the corporation being bound to A's unauthorized contracts. Similarly, the position has been taken that "[i]f a man select[s] another to act for him with some discretion, he has by that fact vouched to some extent for his reliability." P, who made possible A's misrepresentation by selecting an unreliable agent, should, therefore, sustain the loss which results from his, P's, use of the agency device.

Finally, considerations of deterrence support imposing liability on P. In a case in which the loss inflicted on each T is minor, but the number of injured Ts is substantial, placing the burden on the Ts might result in A's never having to make whole the Ts for the injuries they suffered, because it would not be worthwhile for any individual T to sue. Consequently, A would not be deterred from misrepresentation. Were the burden placed on P, in contrast, he would more likely have adequate incentive to sue A, because the sum P would stand to recover would be the total of the losses suffered by all the Ts.

Taken together, the arguments in favor of a broad scope of corporate liability clearly appear to outweigh those supporting a narrower scope. As the survey of current law that follows will show, this is the direction in which the law has been moving.

3. Survey of Current Law

The conflict between the rights of the principal and those of the agent exists in every agency situation, regardless of whether or not the principal is a corporation. Different jurisdictions have balanced these conflicting interests in different ways; three approaches, those of Eng-

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17 P. Atiyah, supra note 9, at 18. The same argument is raised with varying degrees of persuasiveness in the Restatement (Second) of Agency § 8A comment a (1957) and in F. Mechern, Outlines of the Law of Agency § 100 (4th ed. 1952).
3.1. English Law

General English agency law declares that when an agent enters into a contract on behalf of his principal, the contract can be enforced against the principal if it was made within the bounds of A's actual, apparent or presumed authority from P. Even in regular agency relationships, therefore, in cases in which T could reasonably have assumed that A was authorized to sign a contract (based, for example, on A's holding a position which implies his authority, or on the custom of businesses of this type to authorize like agents to act in this way), English law has preferred to impose liability on P despite the fact that he never actually authorized these particular acts.

These basic rules extend the power of an agent to bind a principal beyond the authority expressly given the agent, and "are arguably market supporting on the assumption that the operation of the market is furthered by rules facilitating the creation of binding and enforceable bargains."

Adaptation of these principles to the special case of corporations has caused some complications which are reflected in the special doctrines of ultra vires, constructive notice and the indoor management rule.

The first two of these rules tend to narrow a corporation's scope of liability. The ultra vires doctrine restricts the capacity of the corporation's agent by allowing him to contract only in order to carry out the legal objectives of the corporation as they are specified in the corporation's charter. The constructive notice doctrine assumes that T has notice of the corporation's documents and thus prevents T from relying on the representative's apparent authority where the corporation's documents make it clear that such authority does not exist.

While the first two rules limit the liability of the corporation, the indoor management rule has the opposite effect. It was designed to pro-

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19 G. FRIDMAN, THE LAW OF AGENCY 189 (5th ed. 1983). For additional sources discussing the different types of authority see supra note 3.
20 These basic rules have also been adopted to some extent in the United States. See infra Section 3.3.1.
21 Hetherington, supra note 15, at 79.
tect third parties dealing with the corporation by allowing them to assume compliance of the corporation and its representatives with the procedures and rules dictated by the internal regulations of the corporation. According to the indoor management rule, T is not bound to make any inquiry into the authority of the agent if compliance with the corporation's documents would have given the agent such authority. The policy behind the indoor management rule is, again, to facilitate the smooth functioning of the market, "for business could not be carried on if everybody who had dealings with a company had meticulously to examine its internal machinery in order to ensure that the officers with whom he dealt had actual authority."

English scholars and courts have generally supported the indoor management rule, and have also repeatedly proposed the abolition of the doctrines of ultra vires and constructive notice. This demonstrates plainly the tendency of English law to favor T's interest over those of the corporation in cases where the representative acted without authority.

English law has contemplated providing even greater protection of third parties by extending the indoor management rule. The Jenkins Committee has suggested that a bona fide T dealing with any director or other representative of the corporation should be entitled to assume "that the board had power to delegate authority to him, and that the necessary power to enter into the transaction in question had been delegated to him." Under this proposal T would enjoy a high degree of

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24 L. GOWER, supra note 3, at 184. The House of Lords stated the rule this way: "persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to inquiry whether acts of internal management have been regular." Morris v. Kanssen, 1946 App. Cas. 459, 474.

25 Pennington concludes that the rule "has been one of the most efficacious rules of company law for ensuring that persons who deal with companies in good faith are treated fairly, and the essentially common-sense solutions it produces contrast notably with the injustices worked by the ultra vires rule." R. PENNINGTON, supra note 3, at 134.

26 In 1945, the Cohen Committee recommended to Parliament that the ultra vires doctrine be statutorily abolished. See REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT, 1945, CMND. No. 6659, at para. 12. In 1962, the Jenkins Committee recommended considerable mitigation of the ultra vires doctrine along with the abolition of the constructive notice doctrine. See REPORT OF THE COMPANY LAW COMMITTEE, 1962, CMND. No. 1749, at paras. 35-43 [hereinafter JENKINS COMMITTEE REPORT]. Analysis of the Committees' reports is provided by L. GOWER, supra note 3, at 177-80 and R. PENNINGTON, supra note 3, at 108, both of whom recommend total abolition of the rules of ultra vires and constructive notice.

27 R. PENNINGTON, supra note 3, at 135 (summarizing the recommendations of the JENKINS COMMITTEE REPORT, supra note 26). The Court of Appeals in Freeman
certainty in his transactions with corporate directors because he could safely assume that the director who represented the corporation had the authority to do so. The Committee believed that the commercial world should be provided with this degree of certainty even at the expense of diminishing the protection given to the shareholders' interest in not being bound by unauthorized acts of the directors.

The trend toward expanded liability also finds expression in section 9(1) of the European Communities Act of 1972, which became part of English law when England was admitted to the European Economic Community. Section 9(1) ensures that a T who deals in good faith with the corporate directors is "unaffected by the ultra vires rule or by the consequent absence of authority on the part of the board of directors . . . [or] by any absence of actual or apparent authority resulting from any provision in the memorandum or articles." Even if T is aware of the absence of authority through actual or constructive notice of the corporate documents, he may still enforce against the corporation the contract signed by the unauthorized board, provided, of

& Lockyer v. Buckhurst Park Properties (Mangal) Ltd., [1964] 2 Q.B. 480, adopted the Jenkins Committee's proposal as law with one distinction. For a discussion of this case, see R. Pennington, supra note 3, at 135.

European Communities Act, 1972, ch. 68. Section 9(1) of this Act reads:

In favour of a person dealing with a company in good faith, any transaction decided on by the directors shall be deemed to be one which it is within the capacity of the company to enter into, and the power of the directors to bind the company shall be deemed to be free of any limitation under the memorandum of articles of association; and a party to a transaction so decided on shall not be bound to enquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and shall be presumed to have acted in good faith unless the contrary is proved.

For further discussion of § 9, see Davies, Alteration of a Company's Objects Clause and the Ultra Vires Rule, 90 Law Q. Rev. 79 (1974); Farrar & Powles, The Effect of Section 9 of the European Communities Act 1972 on English Company Law, 36 Mod. L. Rev. 270 (1973); Prentice, Section 9 of the European Communities Act, 89 Law Q. Rev. 518 (1973).

Although the European Communities Act has been superseded, essentially identical language carries over into § 35 of the Companies Act, 1985, ch. 6.

The section is formulated to apply only to transactions that are executed by "the directors." It fails to apply to the more frequent occasions where the representative of the corporation is not the board but rather another officer in the corporate hierarchy. L. Gower, supra note 3, at 187.

The memorandum is the British equivalent of a United States corporation's by-laws.

L. Gower, supra note 3, at 188-89 (summarizing the effect of section 9(1)).

Section 9(1) abolishes the notion of constructive notice only with regard to the memorandum and the articles of association. It fails to do so with regard to all the other public documents of the corporation such as special resolutions. For a discussion of the undesirable consequences of this aspect of the provision, see L. Gower, supra note 3, at 189-90.
course, that his knowledge of the documents is not evidence of bad faith.

It is unnecessary here to elaborate further upon the intricacies of English law regarding a corporation's liability for the acts of its unauthorized representatives. For the purposes of this Article the preceding abridged description of English law is sufficient to demonstrate that English courts, scholars and committee reporters agree that in the case of conflict between two innocent parties, T and the corporation, the law ought to tilt the balance against the corporation. Their assumption, reflected in nearly every discussion of the issue in the context of agency law, is that efficient market operation, which is facilitated by favoring T's interests against the corporation, is more important than the interest of the law in protecting the corporation's property.

3.2. German Law

The German Civil Code distinguishes between two kinds of agency cases. T may enforce the contract against P if P informs T directly, by public notification or by written instrument that A has been given authority. However, where A's authorization is represented to T only by A, T cannot rely on A's representation; even if A is dealing in good faith, he cannot bind P if he is acting outside of his actual authority.

Because German law is aware of the importance of certainty in commercial matters, it has devised a special legal instrument, the Procura, to provide T with assurance that P will be bound by A's conduct. The Procura grants the agent a new type of authority whose extent is objective, legally fixed, and not subject to alteration by agreement between P and A. A's authority to represent P in commercial transactions commences upon the Procura's registration in the Register of Commerce, and empowers A to "bind the principal against his actual instructions not only in usual and customary acts but even in somewhat extraordinary acts, provided that they are within the scope of the commercial enterprise." By providing that the "restriction of the scope of

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33 Gower has formulated eight rules which restate the present law in England. See id. at 190-205.
34 See BÜRGERLICHES GESETZBUCH [BGB] §§ 170-172. This rule may be compared to the common law's doctrine of apparent authority. See Müller-Freienfels, The Law of Agency, in CIVIL LAW IN THE MODERN WORLD 85 (A. Yiannopoulos ed. 1965).
35 BGB § 167.
36 HANDELSGESETZBUCH [HGB] § 49.
the Procura has no legal effects toward third persons,” the law makes the external aspect of agency (P-T and A-T) independent of any internal agreement (P-A) concerning A’s authority; the authority A gains by registration of the Procura cannot be restricted either by an express declaration of P to T limiting A’s authority or by registration of such a limitation.

The purpose of granting such unlimited power to A, as expressed by the German legislative commission that proposed creation of the Procura in 1857, was to encourage commerce by dispensing with T’s need to inquire into and obtain evidence of A’s authority. When T makes a contract with a procurist, he gains the same degree of assurance that the contract will be enforceable as if he were negotiating directly with P himself. The Procura allows T the use of a convenient legal tool — representation — while avoiding its risks. It forces P to pay for his misjudgment of A’s honesty, thereby inducing P to exercise care before appointing another to be his representative under a registered Procura. Many other European codes, responding to the need to promote fluidity in business life, have adopted similar statutory measures granting A unrestricted power to represent P despite P’s instructions.

The general tendency of German agency law, then, is to protect T. This tendency is especially pronounced in the more specific situation where the corporation and its executives stand in the place of P and A, respectively. The German Stock Corporation Law (Aktiengesetz) grants the board of directors (BM) practically unlimited power to represent the Stock Corporation (Aktiengesellschaft) in transactions with third parties, and provides that the BM’s authority to bind the

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38 HGB § 50.
39 Müller-Freienfels, supra note 37, at 209, indicates that there is only one exception to this rule, namely, the case of collusion, i.e., where A and T conspire to damage P.
40 Nürnberg Protokolle 74, 86 (1857).
41 For references to the Codes of Austria, Hungary, Bulgaria, Switzerland, Sweden, Finland, Norway and Denmark, see Müller-Freienfels, supra note 37, at 208 n.72.
42 Usually the corporate documents delegate to one or more board members the board’s ability to represent the corporation. Steefel & Falkenhausen, The New German Stock Corporation Law, 52 CORNELL L. REV. 518, 530 (1966).
43 The duties of the board are divided between the supervisory board (SB) and the board of management (BM). See id. at 526-27. We are interested in the BM because it alone holds the corporate representative power toward T.
44 German law also recognizes another kind of corporation: the corporation with limited liability (Gessellschaft mit beschränkter Haftung or GmbH). Such a corporation serves purposes similar to those of a close corporation in the United States, and its shares cannot be publicly traded. See id. at 518-19.
45 Section 82(1) of the German Stock Corporation Law provides that “[t]he repre-
corporation cannot be restricted by the corporate documents.\textsuperscript{46} Moreover, \( T \) is not only protected against the actions of the representative outside of his authority, but he is also protected against the actions of the representative outside of the corporation’s powers; the ultra vires doctrine does not exist in German corporate law.\textsuperscript{47}

German law has no need for the common law’s doctrine of constructive notice because German law does not seek to limit corporate liability. It is the German view that, for the benefit of the market, corporations must be bound to their directors’ contracts even when the contracts are completely beyond the scope of corporate business. The few restrictions which do exist on a corporate executive’s power — for example, the requirement that the board secure shareholder approval before taking certain actions — only serve to restrict the executive; they do not limit \( T \)’s right to enforce the contract against the corporation, even if \( T \) knew of the restrictions.\textsuperscript{48}

It is apparent that German law\textsuperscript{49} generally seeks\textsuperscript{50} to secure ordinary business transactions by sharply preferring \( T \)’s interests to those of the corporation (or of any \( P \)). It adheres to the idea that, despite the inevitable losses to corporations, the market overall will benefit by enabling \( T \)’s to rely on actions of the corporation’s representatives.

3.3. United States Law

3.3.1. “Authority” as the Basis of a Principal’s Liability

Traditional United States agency law provides that the key to \( P \)’s liability to \( T \) arising from a contract signed by \( A \) is \( A \)’s authority to representational authority of the directors cannot be limited.” Aktiengesetz § 82(1), 1965 Bundesgesetzblatt, Teil I 1106. Similarly, with respect to limited liability corporations, “[a] limitation of the manager’s authority to act on the corporation’s behalf is null and void with regard to third persons.” Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Limited Liability Corporation Act) § 37.

\textsuperscript{46} Steefel & Falkenhausen, supra note 42, at 529.

\textsuperscript{47} See Eckert, Shareholder and Management: A Comparative View on Some Problems in the United States and Germany, 46 IOWA L. REV. 12, 13 n.5 (1960); Steefel & Falkenhausen, supra note 42, at 520 n.10, 529.

\textsuperscript{48} Eckert, supra note 47, at 18.

\textsuperscript{49} The German approach is followed by other nations. For example, Japanese law provides that “[n]o restriction placed on the power of representation of any director can be set up against a bona fide third person.” Minpo (Civil Code), Law No. 89 of 1896 and Law No. 9 of 1898, § 54 (1975 English language version produced under authorization of the Japanese Ministry of Justice and Codes Translation Committee).

\textsuperscript{50} Some slight erosion of the corporate representative’s unlimited authority is described in Müller-Freienfels, supra note 37, at 211-15, 341-46. He concludes that the basic principle distinguishing between the representative’s authority and his actual power to bind a principal has “held good even though it has been modified in detailed applications . . . .” Id. at 346.
bind P to such a contract.\textsuperscript{51} Although in torts the master-servant relationship and behavior within the "scope of employment" are enough to impose vicarious liability on the master for his servant's tortious acts,\textsuperscript{52} in agency an additional element is needed: P must authorize A to sign the contract.\textsuperscript{53}

Although this doctrinal requirement is compatible with most of the reported cases, it is clear that the courts are no longer willing to impose it blindly. In a variety of situations courts now hold P liable for contracts that undoubtedly were beyond A's authority.\textsuperscript{54} Intent on reaching the reasonable result that P is bound by A's contract, but unwilling to depart from the traditional agency rule that P is liable only for authorized contracts, courts creatively expanded the concept of "authority" to include cases where A lacked "authority" in its classic, factual sense.\textsuperscript{55}

The notion of "apparent authority" was developed to bind P in all cases in which A does not have real authority, but in which P has somehow led T to believe otherwise, by telling T that A has authority, by supplying A with documents attesting to A's authority, or by consenting to A's serving P in a position that, in this corporation, customarily comes with such authority. Courts have extended P's liability to A in such cases, despite P's not having granted A authority to contract, on the functional grounds that "[t]he free flow of commerce, large and small, would be shackled if the burden of ascertaining the agent's real authority were put upon the multitude of individuals dealing, every day, with agents whose principals seem to have clothed them with adequate authority to do business."\textsuperscript{56} Compelled by commercial needs to go beyond traditional agency rules, courts have camouflaged the departure by redefining "authority" to include "apparent authority." Thus refurbished, agency law recognizes A's authority not only where it was

\textsuperscript{51} See, e.g., W. Seavey, Studies in Agency 181 \& n.7 (1939) (stating traditional rule and giving additional authorities); Hetherington, supra note 15, at 103.

\textsuperscript{52} See, e.g., W. Keeton, Prosser and Keeton on the Law of Torts, ch. 12, \S 70 (5th ed. 1984).

\textsuperscript{53} Mears, Vicarious Liability for Agency Contracts, 48 Va. L. Rev. 50, 51 (1962).

\textsuperscript{54} W. Seavey, supra note 51, at 181.

\textsuperscript{55} Mears, supra note 53, at 54, says that courts took this course:

\textsuperscript{56} American Anchor & Chain Corp. v. United States, 331 F.2d 860, 862 (Ct. Cl. 1964).
in fact conferred on him (real authority), but also where the law con-
fers the power because $P$ represented to $T$, directly or indirectly, his
assent to $A$'s acts (apparent authority). Authority thus becomes not
only a question of fact, but also a question of law, i.e., "whether an
apparent agent has the legal power to bind his principal, entirely apart
from the question whether he is actually authorized or not."

Courts have also found $P$ liable in many cases in which $T$ had
no contact with $P$ and therefore could not have relied on apparent au-
thority created by $P$'s behavior. Another type of authority — "usual
authority" — was invented to explain these cases. $A$, who has neither
real nor apparent authority, may subject $P$ to liability "for acts done on
his [P's] account which usually accompany or are incidental to transac-
tions which the agent is authorized to conduct," so long as $T$ has no
notice that $A$ is acting outside of his authority. The motivation for ex-
tending $P$'s liability is, again, public policy: "[c]ommercial convenience
requires that the principal should not escape liability where there have
been deviations from the usually granted authority by persons who are
such essential parts of his business enterprise."

The "undisclosed principal" cases demonstrate how far United
States law has departed from traditional agency rules. In these cases, $T$
believes that $A$ is the principal, and is unaware of the existence and
identity of $P$. Nonetheless, courts have held $P$ liable for $A$'s contract,
even if $P$ has explicitly forbidden $A$ to enter into it. Under such circum-
cstances, apparent and usual authority cannot exist, because $T$ does not
even know of $P$'s existence and therefore cannot rely on $P$'s behavior or
communications. Nevertheless, the Restatement (Second) of Agency (Re-
statement) has concluded that because the transaction arose in the or-
dinary course of business, $P$ should be made a party to the contract.

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67 The Restatement explains that:

apparent authority to do an act is created as to a third person by written
or spoken words or any other conduct of the principal which, reasonably
interpreted, causes the third person to believe that the principal consents
to have the act done on his behalf by the person purporting to act for him.

Restatement (Second) of Agency § 27.

68 S. Stoljar, supra note 23, at 22; see also Montrose, The Basis of the Power of
an Agent in Cases of Actual and Apparent Authority, 16 CAN. B. REV. 757, 761
(1938).

69 E.g., Kidd v. Thomas A. Edison, Inc., 239 F. 405 (S.D.N.Y. 1917); Thurber &
Co. v. Anderson, 88 Ill. 167 (1878); Moreschini v. Regional Broadcasters of Mich.,
Inc., 373 Mich. 496, 129 N.W.2d 859 (1964); Dewey T. Ross Eng'g Corp. v. Son-

60 Restatement (Second) of Agency § 161.

61 Id. § 161 comment a.

62 Id. § 194.
3.3.2. "Authority" Versus "Power"

The authors of the Restatement knew that many court decisions were inconsistent with the traditional requirement of actual authority, and were unwilling to explain these cases by stretching the term "authority" beyond its reasonable bounds. They therefore concluded that "authority" is not the only basis for P's liability. Instead, the Restatement recognizes that A can bind P, whether or not A is authorized to do so, whenever A possesses the legal attribute that the Restatement calls "power."63 Correcting the courts' confusing use of the term "authority" to explain two different situations,44 the Restatement's definition limits the term to its natural use, that of describing A's ability "to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him."65 "Power," however, has a much broader scope. It is the ability of a person, A, "to produce a change in a given legal relation,"66 P-T, even if A is not authorized by P to do so.

The Restatement's distinction between "power" and "authority" has been adopted by both courts87 and scholars,68 because it helps to rationalize otherwise obscure court decisions. P will be liable not only when A had authority to bind him, but also when A had the unauthorized power to do so. While the extent of A's authority is a factual question regarding P's intent to confer such authority upon A, A's power beyond his authority is a legal question to be decided by the

44 Professor Seavey distinguishes between "the power held by the agent, and the power coupled with the privilege of exercising it." W. SEAVEY, supra note 51, at 67. He adds:

Thus we have the qualifying and confusing words "real" and "apparent" added to it to explain that the principal may be bound by an act in excess of the agent's real authority if the act was within the scope of his apparent authority. This double use leads to inaccuracy and is unnecessary.

65 RESTATEMENT (SECOND) OF AGENCY § 7 (emphasis added).
66 Id. § 6.
47 See, e.g., Butler v. Maples, 76 U.S. (9 Wall.) 766 (1870) (agent had general power to buy cotton although specifically authorized to purchase only at certain prices and under certain circumstances); Thurber & Co. v. Anderson, 88 Ill. 167 (1878) (store manager possessed power to purchase goods even where principal expressly did not authorize purchases); Lewis v. Chapin, 263 Mass. 168, 160 N.E. 786 (1928) (insurance agent could bind principal to all claims settlements even though granted authority only to settle claims below a certain size); Watteau v. Fenwick, [1893] 1 Q.B. 346; see also W. SEAVEY, supra note 51, at 181.
68 R. POWELL, supra note 2, at 54.
legislature and the courts in accord with public policy considerations. 69

3.3.3. Inherent Agency Power as the Basis of a Principal's Liability

The Restatement associates different kinds of agency power with different legal sources. Rules of contract, tort, and restitution law are seen as providing A with power to impose liability on P for authorized acts or for unauthorized acts that are within A's apparent authority. The Restatement also suggests that the agent may possess power that does not stem from these sources, but is rather a distinctive creation of agency law derived solely from the agency relation. The Restatement uses the term "inherent agency power" to indicate "the power of an agent which is derived not from authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons . . . dealing with [the] agent." 70

We need not catalogue here all the situations in which the Restatement offers inherent agency power as the basis for P's liability. Professor Seavey has devoted an entire article 71 to exploring a few of these instances. The Restatement itself includes as examples of inherent power: (1) cases in which A acts in the way that similar agents customarily act, but in violation of P's actual orders; 72 (2) cases in which A acts with an improper purpose or for his own purpose, but the contract, had it been made for P's account, would have been authorized; 73 and (3) cases in which A is given title to chattels with authorization to do something with them, but departs from the authorized method of dealing with them. 74

No common denominator unifies the above cases and they are, therefore, not amenable to analysis as a group. The Restatement's method was to collect all agency cases which could not be explained on the basis of authority, and then state that in these cases the agency relation itself is the source of A's power to impose liability on P. Such ex post facto reasoning can be compared to circling the target around the arrow. The Restatement is aware of the problem and admits that inherent agency powers are so designated "since there is no other common designation which adequately describes them." 75 The "power aris-

69 See supra Section 2.
70 RESTATEMENT (SECOND) OF AGENCY § 8A.
71 Seavey, Agency Powers, 1 OKLA. L. REV. 3 (1948).
72 RESTATEMENT (SECOND) OF AGENCY § 161.
73 Id. §§ 165, 202.
74 Id. §§ 172, 201.
75 Id. § 161 comment a.
ing from the agency relation” cannot be characterized as existing when certain objective criteria are met, but rather exists where “policy requires that the agent should have power to bind the principal.” Professor Seavey also knew that any attempt at a principled, analytical explanation of the rule of inherent agency powers would fail, and therefore preferred to emphasize the public policy need for this new kind of power.

The approach can be summarized as follows: P is liable for A's unauthorized contracts when A has “power” to affect P's legal relations with T. A derives such power not from the agency relationship — because we have no rule that indicates where the agency relationship creates “inherent agency power” — but from the exigencies of business convenience, i.e., policy. While the need to impose liability on P for A's unauthorized contracts is evident, the Restatement's solution — namely, to collect all the unexplained cases under a new name — is inadequate. Since “inherent agency power” is a catch-all classification used to explain the result of assorted cases, rather than a single, unitary concept that comes into play when objective criteria are met, it has little predictive value and is quite unhelpful once one ventures beyond the enumerated cases. As one scholar put it, “inherent power is a label you stick on a decision once you've decided against the employer. It is like X, the algebraic unknown quantity. How you are to reach a decision remains somewhat of a mystery.”

Mysteries in this area of the law, however, are not conducive to commercial certainty. In Professor Powell's words:

we still have to find out when business convenience does demand his [P's] liability. If the question were left entirely to the discretion of the court it is arguable that there would be no certainty for men in commerce; for they would not know how each judge might decide any particular case.

Business convenience cannot serve as a final legal principle, because it is too broad, too unpredictable, and too likely to create confusion in the law.

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27 Id. § 140. “The liability of the principal to a third person upon a transaction conducted by an agent . . . may be based upon the fact that: . . . (c) the agent had a power arising from the agency relation and not dependent upon authority or apparent authority.” Id.

28 Id. § 140 comment a.

29 W. Seavey, supra note 51, at 95-96.

30 For a complete discussion of the policy considerations involved in this question, see supra Section 2.

31 Mearns, supra note 53, at 56.

32 R. Powell, supra note 2, at 95.
The following sections of this Article will present the theory of organs, which provides a principled approach for resolving the conflict between \( P \) and \( T \) in the special but very common case where \( P \) and \( A \) are a corporation and its organs, respectively.\(^{52}\) First, the general theory itself will be sketched out. Then, the theory will be applied to produce a satisfactory theoretical basis for achieving the policy goals and resolving the problems that were described in our survey of English, German and United States law.

4. **Overview of the Theory of Organs**

It is part of the common culture of Western civilization that corporations are capable of assuming legal responsibility. Jurists, philosophers, sociologists and laymen not only accept the legal validity of obligations made by corporations, but also recognize that a corporation may be held responsible for criminal acts or for harm that it causes.

Because, however, the corporation has no physical existence, neither body nor mind, it has always been understood that the corporation can only act through the agency of humans. The traditional scholarly position has been to view the corporation as a legal abstraction, a pure fiction of the law; an alternative view would consider the corporation to be a real, distinct entity.\(^{8}\) Advocates of both positions, however, would agree that in the absence of human beings, corporations can do nothing; they can neither incur legal liabilities nor accrue legal rights. Many legal systems, therefore, believe that corporate liability can be understood logically and legally only via the law of agency. "[I]t is clear," explains a noted modern authority on common law, "that the company must be treated as a principal, or as a master, and those through whom it acts as agents or servants . . . ."\(^{84}\)

The legal capacity of the corporation is thus limited when compared with the capacity of an ordinary individual: while the individual creates rights and duties both by his own deeds and by acts of his representatives, the corporation, as a collective body is believed to be able to act only through its representatives. An individual human being may assume both personal and vicarious liability, but corporate liability is necessarily vicarious. Corporate personal liability has been described as "a residue of anthropomorphic imagination"\(^{85}\) and claims of corporate

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\(^{52}\) The term "organ" refers to some of the representatives of the corporation and will be further defined in Sections 5 and 6.

\(^{55}\) See infra note 111.

\(^{8}\) G. FRIDMAN, supra note 19, at 313.

\(^{84}\) F. POLLOCK, Has the Common Law Received the Fiction Theory of Corporations?, in ESSAYS IN THE LAW 151, 179 (1922); see also G. HENDERSON, THE POSI-
personal intent have been described as "metaphysical subtleties which are needless and fallacious." 86

The law governing the relationships between a corporation and other legal entities, therefore, has been agency law, 87 and all corporate rights and duties have been molded to fit into the substance and rationale of that law. This has led to two unfortunate results. First, because people dealing with corporations deal only with agents and never principals, an increased sense of anonymity and impersonality is created in the world of commerce. More importantly, unjustified corporate immunity may result in cases where the principle of vicarious liability cannot be applied. Criminal law, for example, does not hold a principal answerable for his agents' crimes, because criminal guilt is essentially personal; hence, corporations are rarely found criminally liable. 88 Similarly, where the law of torts insists on personal fault as a necessary condition of liability, corporations are seldom subject to any such responsibility. 89 Finally, as we have seen, a corporation's contracts are

87 F. MECHEM, supra note 17, §§ 2-5.
88 Many early decisions refused to apply criminal liability to corporations because they were fictional rather than natural persons. See, e.g., People v. Duncan, 363 Ill. 495, 497, 2 N.E.2d 705, 706 (1936) ("There are certain crimes which a corporation, on account of its very nature, cannot commit."); Benson v. Monson & Brimfield Mfg. Co., 50 Mass. (9 Met.) 562, 563 (1845) (holding that a corporation lacked sufficient will to "knowingly" violate child labor laws). Other decisions found that a specific legislative intent was required to extend criminal liability to corporations. See, e.g., State ex rel. Voyles v. French Lick Springs Hotel Co., 42 Ind. App. 282, 85 N.E. 724 (1908) (holding indictment of corporation valid only where legislation specifically provides that corporation may be proceeded against); State v. Cincinnati Fertilizer Co., 24 Ohio St. 611, 614 (1874) (legislative failure to use word "corporation" in statute evinced intent to punish only natural persons).

More recent decisions, however, have shown less hesitation to impose criminal liability on corporations, particularly with respect to commercial or regulatory crimes. See, e.g., United States v. Cincotta, 689 F.2d 238 (1st Cir.) (upholding conviction of corporation for defrauding the United States where its agents acted within the scope of their employment and with intent to benefit the corporation), cert. denied, 459 U.S. 991 (1982); United States v. Carter, 311 F.2d 934, 941-43 (6th Cir.) (corporation convicted of willfully making improper payments to labor union representative), cert. denied, 373 U.S. 915 (1963).

89 The classic case is Lennard's Carrying Co. v. Asiatic Petroleum Co., 1915 App. Cas. 705. For a discussion of this case, see infra notes 90-92 and accompanying text. In some United States jurisdictions, exemplary damages are imposed on corporations only where a grossly negligent act has been the act of the corporation itself and not an act of its employees. See Hildebrand, Corporate Liability for Torts and Crimes, 13 Tex. L. Rev. 253, 257 (1935). Some Texas courts have, therefore, used language of the organic theory in concluding that a corporation can be held liable for exemplary damages for the torts of its alter ego who is a "superior officer representing it in its corporate capacity . . . ." Western Union Tel. Co. v. Brown, 58 Tex. 170 (1882). Other cases evince
binding on the corporation only according to the principles of agency; corporate contractual liability under the common law is only vicarious and is therefore conditional on the full authority of the agent. The unfortunate result is that corporations are sometimes able to free themselves from responsibility for their representatives' contracts.

The original objective of the organic theory was to broaden corporate accountability beyond the confines of vicarious liability and permit personal liability to be applied to corporations. The organic theory assumes that nothing in the nature or legal structure of corporations prevents the rules of personal liability from being applied just as they are applied to individuals. Any legal theory which attempts to apply personal liability to corporations, however, must provide suitable answers to several basic questions:

—Is a corporation capable of malice or mens rea? Can a corporation have an independent will or intent?

—Can physical acts be ascribed to an abstract body, and if so, how?

—Most importantly: who is the corporation? Can an individual or group of individuals be the corporation itself and not merely its representatives? And if so, what criteria can be used to identify those individuals who are the corporation?

The organic theory's answer to the first two questions is clearly "yes." Although will is, strictly speaking, a psychological result of the operation in an individual person of a single center of consciousness, the will of some individuals, who will be called the corporation's "organs," can be ascribed to the corporation. Similarly, the theory maintains that physical acts executed by organs may also be imputed to the corporation.

The answer to the third question touches upon the essence of the theory: although a corporation is a collective body, it functions through individuals who are not its representatives but who are the corporation itself. These individuals are considered to be the corporation only if they are located high in its hierarchy and are fulfilling a function of the corporation.

In Lennard's Case,90 the first case in which the organic theory appeared in the common law, a shipping company attempted to escape tort liability for damage caused by the acts of its managing director, a slightly different view. See, e.g., Fort Worth Elevators Co. v. Russell, 123 Tex. 128, 146, 70 S.W.2d 397, 407 (1934) (finding corporate liability for exemplary damages where tortious act is either one "of the corporation itself" or committed by an employee sufficiently high in its hierarchy).

Mr. Lennard. The company argued that damage could be caused by corporations only vicariously and not by "actual fault or privity" of the corporation itself, as the relevant act required.91

The court, aware of the growth and increasing importance of the early twentieth-century corporation, was apparently intent on finding corporate personal liability. It therefore proclaimed:

[A] corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, and very ego and centre of the personality of the corporation . . . . If Mr. Lennard was the directing mind of the company, then his action must, unless a corporation is not to be liable at all, have been an action which was the action of the company itself within the meaning of [section] 502 . . . . It must be upon the true construction of that section in such a case as the present one that the fault or privity is the fault or privity of somebody who is not merely a servant or agent for whom the company is liable upon the footing respondeat superior, but somebody for whom the company is liable because his action is the very action of the company itself.92

Later descriptions of the theory have stressed the comparison of a corporation to a human being in imposing tort liability on corporations. Lord Denning stated:

A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. So you will find in cases where the law requires personal fault as a condition of liability in tort, the fault of

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91 Merchant Shipping Act, 1894, 57 & 58 Vict., ch. 60, § 502.
the manager will be the personal fault of the company.\textsuperscript{93}

It should be stressed that the organic theory does not attribute the will or acts of every employee to the corporation. The theory suggests corporate personal liability only for policies which are adopted by those who are the "responsible officer(s) for the action in question"\textsuperscript{94} and who control the corporation — the organs. The theory's application, therefore, depends upon resolution of the preliminary question (not discussed in this Article) of identification of an organ.\textsuperscript{95} One must decide whether, in light of the facts of the case under discussion, the actor "is to be regarded as the company or merely as the company's servant or agent."\textsuperscript{96}

In summary, the organic theory states that, even in the absence of vicarious liability, corporations can be liable in the world of law, for the corporation itself is capable of acting, by signing a contract using its own business judgment or by committing a tortious or criminal act. The theory's device of identification of the organ with the corporation, and the imputation of the organ's acts, knowledge and will to the collective body, are the marks of this new theory in corporate law.

\textsuperscript{93} H.L. Bolton (Eng'g) Co. v. T.J. Graham & Sons, [1957] 1 Q.B. 159, 172 (C.A.).
\textsuperscript{94} L. GOWER, supra note 3, at 209.
\textsuperscript{95} The question of identification of an organ deserves separate and detailed discussion because of its paramount importance and because of the basic difficulty in finding a general definition of an "organ" which will produce the proper results regardless of any peculiarities in the division of powers in any given corporation. Courts and scholars have attempted to define organs through the use of both vague descriptions and formal criteria. A pragmatic approach based on both an analysis of corporate hierarchy and on analysis of the functional aspects of the representative's behavior seems proper.

In each case the court should first apply the function test: Is the act a function of the corporation? A function for the corporation, which is not a function of the corporation, is not sufficient. The distinction is illustrated by this hypothetical situation: "Suppose, for instance, that the managing director of a company in Oxford is suddenly summoned to a board meeting in London and, in his anxiety to be there in time, drives recklessly through a crowded street and kills an innocent pedestrian . . . ." Welsh, \textit{The Criminal Liability of Corporations}, 62 Law Q. Rev. 345, 360 (1946). In this case it seems obvious that, even though the director's driving was a function for the corporation within the scope of the director's authority, the corporation should not be criminally liable because the act was not a function of the corporation. \textit{See also} Barak, \textit{The Status of the Entity in Torts}, 22 HAPRAKLIK 198, 204-07 (1966).


5. THE UNDERLYING PRINCIPLES OF THE ORGANIC THEORY

To fully appreciate the organic theory, it is necessary to examine closely the object of the theory — the organ. What is the legal reasoning that justifies declarations that the mind of the organ is the mind of the corporation? And how can the organ's will, intention and acts be ascribed to the corporation? The theory seems problematic because it conflicts with the basic notion of the corporation as a separate legal entity which is distinct from its individual components.

This section will demonstrate that the organic theory does not contradict traditional principles of corporate law, and is not merely a play on words. This will be done by exploring two questions. First, does the organ enjoy a legal personality distinct from that of the corporation and from the individual's own legal personality? Second, what is the nature of the factual and legal relationship between the organ and the corporation?

5.1. The Organ as a Legal Personality

5.1.1. Introduction

The unit of social reality with which the legal system deals is the "legal person." This is the entity to which the legal rules are applied, and to which legal classifications are addressed.

Different entities may be characterized as "legal persons" through ad hoc examination of the facts of each case to ascertain whether the necessary qualifications for classification as a legal person are present. Alternatively, the characterization may be accomplished by application of general rules of law adopted by the legal system for this purpose; modern law prefers the latter approach. This subsection discusses the criteria of legal personhood and applies them to organs to determine whether by their "nature," as determined by legal rules, they are properly possessed of legal personality. In other words, we will examine whether all, or at least most, of the legal propositions that are true for individuals or corporations are true for organs as well.

5.1.2. Criteria for Identification of a Legal Personality and Their Application to the Organ

Maitland coined the famous phrase that a legal personality (a corporation in his case) is a "right-and-duty-bearing-unit." He ex-

plained that "in a vast number of cases you can make a legal statement about X and Y which will hold good whether these symbols stand for two men or for two corporations, or for a corporation and a man." This subsection argues that X or Y in Maitland's proposition can stand equally well for a corporate organ.

The accepted interpretation of Maitland's phrase is that being a right-and-duty-bearing-unit is the sole criterion for possessing legal personality. Legal individuality is not endowed by nature, but rather owes its existence to the recognition by the legal system of a group of legal relationships. The individual and the collective are realities that precede the law. A human being is alive whether or not the law recognizes this fact, and a group of people assembled for some mutual purpose is a collective even if the law will not acknowledge them as such. It is up to the law, however, to decide which individuals or collectives will possess personality in the legal sense. The personality of the individual is described by the law in a list of rights and duties which are brought into effect only under the circumstances and conditions described by the law. Similarly, for a group of individuals acting toward a mutual goal, the rights and duties created by the law which relate to the group and regulate its activities are a legal declaration of the "personality" of the group. The legal personality is not a fiction; it is a term that describes a normative arrangement. By subjecting the collective body (or the individual) to duties and rights, the law declares that the normative arrangement exists, and that the collective is therefore a legal personality.

It follows, as Derham suggests, "that any 'thing' which is treated by the appropriate legal system as capable of entering legal relationships 'is' a legal person, whether it can act and will for itself or must be represented by some designated human being(s)."

It must be emphasized that no automatic correlation exists between the fact of "real" personality and the notion of legal personality. The translation from fact to law does not necessarily follow. It is for each legal system to decide whether or not it is advisable to endow specific bodies, human or nonhuman, with personality. The question then becomes: what do legal systems consider in determining whether or not to grant a given body legal personality?

Review of relevant precedents reveals that pragmatism (political, social or economic) and practical necessity, rather than pure, systematic legal and logical considerations, provide the driving force in legislative,

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88 F. Maitland, Selected Essays 225-26 (1936).
89 Derham, Theories of Legal Personality, in Legal Personality and Political Pluralism 1, 13-14 (L. Webb ed. 1958).
if not judicial, decision-making in this area. While this statement is generally true of any kind of legal decision-making by the legislature, its truth becomes especially evident when observing the degree of legal personality historically attributed to corporate bodies.

In 1900, a strike broke out at the Taff Vale Railway Company. The company sued the trade union rather than the individual strikers for damages.\textsuperscript{100} It was awarded damages by the House of Lords which decided that, although the trade union was not a corporation, it could nonetheless be sued in its collective capacity. In Lord Macnaghten's words, "for this purpose it seems to me that it cannot matter in the least whether the persons acting in concert be combined together in a trade union, or collected and united under any other form of association."\textsuperscript{101} The court's view is in complete accord with the basic principles of the reality theory which was presented to the common law by Maitland at approximately the same time.\textsuperscript{102} Despite its scholarly correctness, the decision's practical impact was to put an end to any serious attempt at striking in the United Kingdom. "As is well known, the case awakened the most intense excitement and agitation that the country had seen since 1832. The laborites for the most part could very well feel (what theorists could hardly be expected to feel) that theories . . . may sometimes be different from what they seem."\textsuperscript{103}

The workers suspected that the court's decision would put an end to trade unionism, and therefore pressed the Labour Party to take a preliminary action — the Trade Disputes Act of 1906\textsuperscript{104} — which reversed the \textit{Taff Vale} decision. This legislation was described by Sir Pollock as "violent empirical operation on the body politic" with which "[l]egal science has evidently nothing to do."\textsuperscript{105}

The reverse process was occurring at the same time with regard to the question of the legal personality of the Free Church of Scotland. The House of Lords refused to ascribe legal personality to the church,\textsuperscript{106} and thereby deprived it of its property, which was to be given to another body. This decision, it was said, "could have been executed only at the cost of something like civil war, and did as a mat-

\textsuperscript{101} Id. at 438.
\textsuperscript{102} Maitland, \textit{Introduction} to O. Gierke, \textit{Political Theories of the Middle Age} (F. Maitland trans. 1958). For a discussion of the reality theory, see infra note 111.
\textsuperscript{103} Freyd, \textit{Gierke and the Corporate Myth}, 4 J. Soc'y Phil. 138, 140 (1939).
\textsuperscript{104} Trade Disputes Act, 1906, 6 Edw. 7, ch. 47.
\textsuperscript{105} F. POLLOCK, LAW OF TORTS v (8th ed. 1908).
\textsuperscript{106} General Assembly of Free Church of Scot. v. Overtoun, 1904 App. Cas. 515.
ter of fact produce rioting in several places before the settlement was made which abrogated it." The "settlement" was, as a matter of fact, a reversal of the judicial decision by political intervention of Parliament in the Churches (Scotland) Act of 1905.

The obvious lesson to be learned from this history is that even the best theory, if it results in unacceptable results, will be replaced by practicable law. The contradiction between the statutes of the Parliament from 1905 and 1906 cannot be resolved on any juristic basis. Yet this dissonance did not prevent the political system — the legislature — from passing these statutes. The legislature was, and always will be influenced by the material interests of its constituents. These interests may be socio-economic (as in the case of trade unions), political, religious (as in the case of the Scottish Church) or purely economic, involving the day-to-day activity of the commercial world.

Given that (a) the criterion for characterization as a legal personality is that the body is treated by the appropriate legal system as competent to enter legal relationships, and that (b) the law cannot attempt the impossible, and must operate in accordance with material interests and practical needs of the citizenry, it follows that the law does in fact deem the organ to be a legal personality. (Hereinafter, we will refer to this conclusion as "the first principle.")

As we have seen, the existing rules of our legal system establish that the organ is a duties-and-rights-bearing-unit. An organ's legal relationships with the corporation and with third parties are characterized by personal contractual, tort and criminal liability to the corporation and to the third parties. This holds true whenever the organ acts in its capacity as an organ. Furthermore, for practical reasons, as has been shown above and will be further commented on below, an organ must be recognized as a legal personality in order to satisfy the material interests of the commercial world.

A number of objections might be raised against granting legal personality to an organ. Some of these concerns are based on corporate theory and will not be discussed here, while others involve the

108 Churches (Scotland) Act, 1905, 5 Edw. 7, ch. 12.
109 "The simple fact is that no large and powerful body of men can in the long run be expected to sacrifice its material interests and submit it to be enslaved by a scholastic theory of jurists . . . ." Freyd, supra note 103, at 143.
110 See supra notes 97-99 and accompanying text.
111 The fiction theory of corporations recognizes the power of any legal system to deny personality to some "natural persons," and to attribute personality to "juristic persons" such as corporations. However, the "juristic persons" are abstract and artificial creatures, existing only in the abstract. Their judicial life depends entirely on the consent of the state, which, by its statutes, gives them legal capacity. While it is true
actual duties and capacities of corporate organs.

In the absence of a clear judicial declaration that the organ is a legal personality, its characterization as such must be examined in light of its capacities, rights and duties. Some have argued that the organ does not have separate rights and duties distinct from those of the corporation. Like the organs of the human body, which do not have separate existences outside the body, the corporation's organs do not exist outside the corporation. These commentors further argue that within the corporation only three legal personalities are recognized—that of the corporation itself, that of its stockholders and that of its directors in their personal capacities (but not as organs). While these personalities have rights and duties vis-a-vis one another, the organs per se, they argue, have no independent rights and duties vis-a-vis the corporation. They thus conclude that since the organ lacks the capacity to sue and to be sued, the functional criterion dictates that it is not a legal personality.

There is ample ground for disagreement. In many instances in tort, contract and criminal law, the organ—especially the individual director and the directorate as a whole—in its capacity as an organ, does possess duties and rights. The rights and duties of the organ derive from its status as an organ, as conferred upon it by operation of law or by the articles of incorporation or by resolutions of other organs of the corporation. For example, the organ owes to the corporation fiduciary duties and the duty of care because of his position as an organ.

While it is true, for example, that the organ cannot, in its capacity

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112 Although constraints of space preclude such a discussion in this Article, the author has written elsewhere about objections based on corporate theory. See Y. Stern, The Organic Theory, supra note 95, pt. 2, ch. I-A.


114 For a thorough discussion of the organ's legal status, see Y. Stern, The Organic Theory, supra note 95.
as an organ, have title to property, this does not necessarily destroy its ability to possess legal personality. In order to have a “legal personality,” an entity need not have all the rights and duties of a natural person. For example, the corporation was considered a legal personality even before it was considered capable of committing a crime or being sued personally in tort. Even today a corporation does not have all the legal rights of human individuals — it cannot, for example, be elected president. Yet no one questions its legal personality. Similarly, while organs do not possess all the rights and duties of either individuals or corporations, they do possess a sufficient abundance of legal obligations, responsibilities and rights to justify their classification as legal personalities.

5.2. The Unique Relationship Between the Corporation and its Organs

5.2.1. Introduction

From the point of view of legal theory, the world is composed of legal personalities which interact with each other in accordance with the dictates of legal rules. X exists in this world of legal theory, i.e., X possesses legal personality, if the law grants him legal rights and subjects him to legal duties. X relates to his legal environment, composed of other legal personalities, only through legal interactions.

It seems reasonable to assume that the law adjusts the rights and duties of each entity to ensure that they are appropriate in light of the nature of that entity’s factual relationships with other legal personalities. X may encounter various factual situations and be influenced by different kinds of factual relationships. The law, therefore, constantly revises and adjusts X’s legal status to enable him to respond appropriately to new factual situations.

The intensity, breadth, quality and intimacy of the factual relationship between the legal personalities X and Y may therefore produce far-reaching legal ramifications. The legal ramifications may be characterized as follows: (a) those that affect the independent legal status of X and Y; (b) those that affect the mutual legal relationship between X and Y; (c) those that affect third parties which have legal ties with either X or Y; and (d) those that affect the legal status of X through Y’s acts, or vice versa. For example, when X is a father and Y his juvenile son, the special factual relationship between them is reflected in all four categories: (a) X is sometimes entitled to social benefits which result from his connection to Y, and Y is entitled by the law, under certain circumstances, to collect debts owed to X after X’s death; (b) X may
compel \( Y \) to obey him, and \( Y \) has the legal right to get support from \( X \); (c) the state and the debtor in example (a) are third parties who have their legal duties changed because of the affiliation between \( X \) and \( Y \); and (d) if \( Y \) inflicts harm upon \( Z \), \( X \) may be obligated to compensate \( Z \).

Analysis of the unique factual and legal relationships between the organ and the corporation is, therefore, of great importance in understanding the legal rights and duties existing between them, the independent legal status of each and of third parties which deal with either, and the legal effects on the corporation of the organ's contracts with third parties.

5.2.2. Intimacy of Relationships

There is a strong correlation between the degree of intimacy of the relationship shared by two legal personalities and the extent to which the relationship shapes their rights and duties. In other words, the closer the relationship between \( Y \) and \( X \), the greater the possibility that \( Y \)'s acts will affect \( X \)'s rights.

The ultimate factual intimacy that can exist between legal personalities would be reflected in the sharing of a single legal personality. If \( X \) possesses a set of duties and rights identical to that possessed by \( Y \), then \( X \) and \( Y \) have identical legal personalities but they do not share the same legal personality. It is only when \( X \) and \( Y \) are responsible for all of each other's duties and are entitled to all of each other's rights that it can be said that, from a legal standpoint, these entities share a single personality. For example, the law might decide that a guardian and his ward possessed the maximum degree of intimacy because of the insufficiency of the ward's intellectual capacity. This intimacy would be reflected in the law's giving a guardian all the legal characteristics of his ward, i.e., the law would cease, under any circumstances, to differentiate between the legal acts of the guardian in the name of his ward, and those of the ward himself. The legal existence of the ward would then merge into that of the guardian in his capacity as guardian, so that the two could be considered as sharing the same legal personality. The discrete physical existence of the guardian and his ward would be irrelevant.\(^\text{115}\)

A lesser but still very high degree of intimacy exists between legal entities where each of them possesses a different set of rights and duties

\(^{115}\) Also irrelevant would be the fact that the guardian would continue to possess legal personalities other than the one that derives from his guardianship. For example, if the guardian had children, he would also possess the legal personality of a father. Nonetheless, with respect to his guardianship, he would be sharing his ward's legal personality.
vis-a-vis its environment, but both share the same center of consciousness, and therefore cannot assume separate wills. Such a situation can exist because the law may impose different legal obligations upon entities which share the same factual and emotional experiences and are served by one mind. Cooperative use by more than one entity of a single mind and will — especially when one of these entities is inherently unable to operate without these shared attributes — bespeaks a high degree of factual intimacy between them, which necessarily has a great effect on their legal status. This, as we will see in Section 5.2.3, characterizes the relationship between a corporation and its organ.

Another juristic relationship with a high level of intimacy is one in which each of the legal entities possesses a separate will and mind, but one entity is, as a factual matter, under the total domination of the other. For example, in a case of "undue influence" of X on Y, where Y is a testator or a donor, X's influence must be so great that he controls Y's mind. In these cases, the domination which causes the substitution of X's will for Y's has as its legal effect the invalidation of the legal rights declared by the will, contract or donation made by Y. Similarly, in every case of superiority of will or mind, whether brought about by inordinate flattery, moral coercion or mental defect, a reflection of real-world relationships must be felt in the world of legal relationships.

In each of the above examples, the intimacy of the relationship is so great that a significant influence is likely to be felt on all four categories of changes in the legal statuses and relationships described earlier in Section 5.2.1. It is clear, however, that lesser degrees of intimacy between legal personalities, which influence these categories to a much lesser extent, are possible. One important example for our purposes is the relationship between a principal and his agent. A enjoys a separate mind and will and is free of domination by P. His intimacy with P is entirely measured by the authority P gives to A to represent him for certain purposes, under certain circumstances, and according to rules which A and P agree upon. It is true, even in the case of agency, that one legal personality (P) is influenced by the acts of the other (A). But due to the reduced degree of their legal cooperation, some acts of A in his capacity as an agent, such as acts that lie outside of the authority conferred by P, will not be binding on P.116

116 In contrast, every action taken by an organ in his capacity as an organ will be binding on P, so long as it is a function of the corporation. See supra note 95 and infra Section 6.
5.2.3. Intimacy of the Organ-Corporation Relationship

The first principle, stated above in Section 5.1.2, makes it clear that the organ possesses a legal personality. The organ does not, however, share that personality with the corporation. The process of incorporation creates a separate set of corporate rights and duties that endow the newly created corporation with a personality. This personality must not be confused with the legal personalities of the incorporators or those of the corporation’s organs, each of which is defined by separate legal duties. The separation is one manifestation of the “corporate veil” which isolates the corporation from its components. The concept of the veil is helpful because it reminds us that the legal relationships between the corporation and its components (be they its owners — the shareholders, or its high officials — the organs) are not of the ultimate degree of intimacy, namely identity. However, the veil serves little advantage if it hides the fact that the corporation and its organs do enjoy a uniquely close relationship in which the veil parts to allow both sides to avail themselves of the same mind and will.

The corporation and the organ share the same will, the will of the organ. Will is the psychological result of the operation in a human being of a single center of consciousness. Obviously, therefore, it cannot be produced by the non-human corporation itself. Instead, the corporation necessarily uses the psychological attributes — mind, experience and consciousness — of its individual organs.

The organ-corporation relationship is highly intimate for other reasons as well. First, the corporation cannot function without the organ. The organ serves the corporation as a pair of hands serves a human being; the corporation is crippled in the absence of its organ. It is logical, then, to assume that just as a person bears the full responsibility for the acts of his hands (because of the high degree of intimacy), so, too, does the corporation for the deeds of its organs.

Second, the organ’s duties are not limited to its functions for the corporation and of the corporation. The organ is not only the executive body of the corporation, but is also its legislative authority. By the exercise of their powers, organs such as directors can alter the corporate functions. Thus, the corporate functions do not limit the organs’ power because the organs can expand the corporate functions. More importantly, the very existence of the corporation is in the hands of its organs who can, for example, use their authority to end the corporation’s existence by dissolving it.

117 See supra note 95.
Finally, the organ, in its capacity as an organ, does not exist outside the framework of the corporation. The organ's power originates from one of two sources — the general statutory law or the internal documents of the specific corporation. Whatever its source, the organ's power does not attribute to the organ any duties or rights outside its existence in the corporation's service. By the very definition of an organ, the organ's legal personality depends totally on the corporation. The criteria for identification of an organ are functional and hierarchical. The function criterion suggests that only one who fulfills a function of the corporation is an organ. The hierarchy criterion identifies the organ according to its position in the corporate hierarchy. Obviously, then, the organ cannot exist in the absence of the corporation. Combining this fact with our earlier findings, it follows that the intimate relationship between the corporation and its organs takes on a very special form: neither of them can survive or function without the other.

The findings of the above analysis may be summarized in the following principle (hereinafter called "the second principle"): The relationship between the corporation and its organs is of a highly intimate nature. The unique intimacy of the relationship is evident from the fact that (a) the corporation cannot function, or crystallize a will or consciousness, without the organ; (b) the organ possesses the executive and legislative authority of the corporation; and (c) the organ cannot exist in the absence of the corporation.

One would expect the high degree of intimacy between these two legal personalities to have an impact on the legal relationships existing between them, the legal status of each of them, the effect on one of them of the acts of the other, and most important, for our discussion of an organ's unauthorized contracts, the rights of third parties involved in legal relationships with either of them.

5.3. Conclusion

The finding that the organ possesses a legal personality separate from that of the corporation may seem to conflict with the basic idea of the organic theory that the organ is the very ego and center of the corporation and, as such, is identified with the company. There really is, however, no paradox.

The unique factual intimacy of the organ-corporation relationship (the second principle) allows us to ascribe the acts, will and mind of the organ to the corporation, which does not by itself possess these charac-

\footnote{See id.}
For this purpose the organ is identified with the corporation and is indeed its very ego. This is the essence of the organic theory as described above. In addition, however, the organ has an independent personality which is subject to legal rules, a fact recognized by our legal system when it subjects the organ to personal liability (the first principle).

The question of whether the organ or the corporation must take responsibility in any given situation must be determined by the legal system according to policy considerations. Sometimes it will be appropriate to find the organ responsible, while at other times it may be wiser to impose liability on the corporation alone, and yet in other cases the best solution might be, as the common law concluded in the criminal arena, to find both the corporation and the organ legitimate subjects for liability. While the issue is one of policy, the legal rules illustrated in this section make it clear that, from the point of view of legal structure, either one or both may be held liable in order to achieve the best results. In the following sections, corporate liability for the contracts of organs will be explored as one possible consequence of the unique organ-corporation relationship.

It is important to stress, however, that the organic theory's usefulness is not restricted to the issue of corporate contractual liability. The theory provides a general legal tool by which the corporation can be deemed personally responsible for the acts of its organs or vice-versa. Application of the organic theory can solve many traditional corporate questions such as: (1) corporate residence; (2) corporate liability when an individual actor is personally immune from liability or individual liability when a corporation is immune; (3) which admissions or confessions against the corporate interest are to be considered the corporation's admissions and admissible as evidence; (4) which individuals must be given notice in order for the notice to be deemed given to the corporation itself; (5) whether an individual's knowledge of certain facts can be imputed to the corporation, thus triggering corpo-

118 See supra note 88 and accompanying text.
119 See L. Gower, supra note 3, at 210 ("[T]hose controlling the management of the company . . . are treated as the company's 'brains,' and wherever the brain functions, there resides the company.").
120 Outside the context controlled by the organic theory, the general rules of vicarious immunity would apply. See, e.g., Restatement (Second) of Agency § 347; P. Atiyah, supra note 9, at 401-05; G. Fridman, supra note 19, at 287-90.
121 See Restatement (Second) of Agency §§ 284-289; Morgan, Rationale of Vicarious Admissions, 42 Harv. L. Rev. 461 (1929).
122 See Restatement (Second) of Agency §§ 268-271; R. Powell, supra note 2, at 236-37; S. Stoljar, supra note 23, at 83 n.81.
rate liability;\textsuperscript{124} and (6) which corporate employees are considered to be the "client" for the purpose of determining the scope of the attorney-client privilege.\textsuperscript{125}

The organic theory is of general use in deciding whether and how laws that make reference to particular attributes of an individual, such as "fault" or "knowledge," are applicable to corporations. The organic theory can also be used in any of the numerous situations in which it is unclear whether a law regulating a corporation also applies to the corporation's employees.

6. THE ORGANIC THEORY AS A BASIS FOR A CORPORATION'S LIABILITY FOR UNAUTHORIZED CONTRACTS OF ITS ORGS

In a routine case of agency, in which $A$ is authorized to act as he does, "authority" provides an acceptable theoretical basis for $P$'s liability because it leads to legal results which satisfy the reasonable expectations of both parties. $P$ and $T$ are bound to a contract on the terms for which they bargained, and $A$ is not a party. However, when $A$ acts outside of his authority and $T$ relies on $A$'s misleading representation of $P$'s wishes, some of the parties' expectations cannot be fulfilled. If the law allows $P$ to repudiate the contract because he never agreed to be a party to it, $T$'s reasonable expectations for execution of the contract will not be satisfied. On the other hand, if the law sympathizes with $T$'s reliance on $A$'s promises, $P$ will be bound to a transaction which is against his business judgment, and the principle of freedom of contract will be violated.

Acceptance of "authority" as the basis for liability results in placing the loss, often unjustly, on $T$. It has often been claimed that this loss is only preliminary, and therefore not "real"; $T$ can be indemnified for his loss by $A$, who created the conflict and who will ultimately bear the risk.\textsuperscript{126} Practically speaking, however, the possibility of shifting the

\textsuperscript{124} See Restatement (Second) of Agency §§ 272-282; Müller-Freienfels, Law of Agency, 6 AM. J. COMP. L. 165, 183-84 (1957); Seavey, Notice Through an Agent, 65 U. PA. L. REV. 1 (1916). Some insurance policies provide that the policy is invalid if the insured corporation is aware of certain facts. The question arises as to which corporate employee need know of these facts for the condition to be satisfied.

\textsuperscript{125} One could argue that according to the organic theory, only the organs should be considered the "client," and communications of other employees should be privileged only if some other privilege is applicable. This view was suggested in City of Philadelphia v. Westinghouse Elec. Corp., 210 F. Supp. 483, 485 (E.D. Pa.), petition for mandamus and prohibition denied, 312 F.2d 742 (3d Cir. 1962), cert. denied, 372 U.S. 943 (1963), and rejected in Upjohn Co. v. United States, 449 U.S. 383 (1981). For a discussion of the application of the organic theory to various other corporate questions, see Y. Stern, The Organic Theory, supra note 95, pt. 1, chs. I-A to I-D.

\textsuperscript{126} For an illustration, see Mearns, supra note 53, at 52-53.
risk to A will frequently fail to improve T's situation. In many cases, especially in modern commercial transactions involving huge corporations, the avoidance of the contract between T and P produces losses of such magnitude that A, who is typically an individual, cannot realistically be relied upon to make good the loss.\textsuperscript{127} In these cases, or where A is bankrupt or insolvent or possesses some sort of defense against T, T's preliminary risk becomes final and real. In these cases, the actual consequence of the doctrine of "authority" is to impose on T a duty of inquiry about A's authority and, where he fails to do so, to subject him to the risk of loss.\textsuperscript{128}

The doctrine of "authority" does not attempt to reconcile the conflicting interests of P and T or to satisfy, to the extent possible, their mutual expectations. It is, rather, a somewhat arbitrary basis which directs us to prefer one of the interests involved to the expense of the other. As such, it may be challenged by other proposals for allocating the loss which are also unable to satisfy both P's and T's expectations, but which prefer a different resolution of the conflict based on their different assessment of the policy considerations at stake.\textsuperscript{129}

Because of the shortcomings of the doctrine of authority in its pure form, both the civil and common law systems, as was shown above,\textsuperscript{130} have developed rules which resolve the conflict between P and T by

\textsuperscript{127} Where A is adequately insured for such a loss, his insurance company will ultimately be responsible for the loss. In that case, our discussion is important only for deciding where to place the loss in the first instance.

\textsuperscript{128} See A. BARAK, AGENCY LAW 1965 at 34, 516 (1975) (emphasizing that it is A, not T, who is in the better position to inquire into the limits of A's authority).

\textsuperscript{129} The torts doctrine of vicarious liability, for example, "appears to be more widely based and has for many years had little difficulty with unauthorised acts," and therefore "[s]uggestions are . . . from time to time made that the idea of authorisation in agency should be abandoned in favour of wider reasoning more akin to that found in tort cases." Reynolds, Agency: Theory and Practice, 94 LAW Q. REV. 224, 226 (1978). Reynolds mentions some recent English opinions favoring this idea, but it is always the dissenting view, and the doctrine has never been applied in England. See id. at 226-27. Some voices in the United States also favor a new rule of "vicarious contract liability" which would be in perfect analogy to the master-servant rule of torts, and would bind P on A's unauthorized promises where such promises are within the scope of A's power. See Mears, supra note 53, at 56-57.

A theory of representation that falls between the agency and torts theories is suggested by Ferson. He suggests that an agent has a double status. Where he executes juristic acts, such as consenting to a contract, the legal basis of P's liability must be A's authority. However, where A performs nonjuristic acts, such as representations or promises on behalf of P without juristic results, he acquires the status of a servant, and thus P is liable according to the criterion of "course of employment." M. FERSON, PRINCIPLES OF AGENCY § 80 (1954). Munro supports this view enthusiastically: "That this rationale tends to hybridize most agents into servant-agents is all to the good. It simply recognizes the true situation." Munro, The Agent's Status: The Kidd Case, 20 U. PITT. L. REV. 33, 38 (1958).

\textsuperscript{130} See supra Section 3.
finding $P$ liable for $A$'s unauthorized contracts in an increasing number of situations. This shift toward placing liability on $P$ is particularly dramatic in the context of corporate accountability. Both the common law, as demonstrated by England's indoor management rule and doctrine of constructive notice, and the civil law, as represented by the Procura and other unique rules of German law, have developed special rules different from those of regular agency law to address the unique situation of the corporation. The organic theory provides an elegant theoretical basis for this trend, producing legal effects that accurately reflect the parties' expectations and closely correspond to market needs.

Direct application of regular authority-based agency rules in the special case of the corporate-organ relationship does not make sense when viewed in light of the two basic principles of the organic theory. While the first principle, which states that the organ and the corporation have separate legal personalities, applies also in regular principal-agent relationships, the second principle, which states that the corporate-organ relationship is highly intimate, does not. The fact that the intimacy between principal and agent cannot be compared to that between the corporation and its organ is improperly ignored by simple application of the traditional authority rule to promises made by organs to third parties. This Article has argued that the rights and duties of each legal personality are shaped by its interactions with other legal personalities. The corporation's legal status with regard to its contracts with $T$ must be influenced, therefore, by the fact that the contract was negotiated by the alter ego of the corporation, the organ. The organic theory recognizes this fact, since, by definition, it is based on the assumption that the quality of the legal relationship between the corporation and its organ is different from that of a regular $P$ and $A$, and that this difference must be reflected in the laws regulating corporate activity through the use of its organs.\(^{133}\)

\(^{131}\) See supra Section 3.1. United States law, in contrast, does not generally accept the indoor management rule. Pennington is able to report on only three United States cases which accepted this rule as a means of protecting $T$ when $A$ exceeded his authority. R. Pennington, supra note 3, at 134.

\(^{133}\) See supra Section 3.2.

\(^{133}\) The Model Penal Code, for example, recognizes the distinction by imposing criminal liability on the corporation for its organ's crimes, where mens rea is needed, while absolving a non-corporate $P$ for the actions of its agent in similar circumstances. Model Penal Code § 2.07 (1962).

One might have expected that contract law would similarly reflect the exceptional factual and judicial ties between a corporation and its organs. However, as our examination of various legal systems has shown, this is simply not the case. Even commentators who subscribe to the organic theory are not in agreement on this question. Procaccia, Agency Law 5725-1965 and Corporate Directors, 1 IYUNEI MISHPAT 234 (1971),
The organic theory argues that an organ, to use the House of Lords’ classic description, “is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.” The corporate-organ relationship is thus one of unique closeness. Neither the organ nor the corporation can function as such without the other; indeed, the existence of the organ depends totally on the corporation. The organ controls the corporate business not only as the executive body of the corporation but also in some cases as its legislative body. Moreover, the organ’s intimate relationship with the enterprise is characterized by the fact that only the organ itself produces the corporation’s psychological attributes, such as will and intent. How, then, can an organ express simultaneously, through the use of the same consciousness, both the intention to sign a contract and oblige the corporation to its terms, on the one hand, and an innocent business judgment, on behalf of the corporation, to negate the execution of the contract, on the other? How can the corporation, which cannot crystallize any separate will, not be responsible for every contract of an organ?

These strong mutual influences between the organ and the corporation do not exist between a regular $P$ and $A$. Because of these influences, the organ’s contract is not simply a contract entered into by $A$ for $P$, but is a contract of the corporation itself. Consequently, “authority” becomes irrelevant to the question of the corporation’s liability on the contract.

describes the principles of the organic theory and its applications to various issues, but seems unaware of its usefulness in rationalizing the law of contracts between corporations and third parties. He concludes that, with some linguistic corrections, the rules given in L. Gower, supra note 3, at 190-205, which are based on the fundamental principles of agency law, accurately describe the legal situation, even as it would be after adoption of the organic theory. Procaccia, supra, at 254-56. In contrast, Barak expresses the view that the theory may support corporate liability, because $T$, who transacts business with the organ, reasonably assumes that he is involved in a legal relationship with the corporation itself. Barak, Agency Law and the Organic Theory, 2 Iyunei Mishpat 302, 319-20 (1972). The fact that the organ acted outside of its authority is not the concern of $T$, but is merely part of the inner relationship between the corporation and its organs. Id.

The Restatement’s failure to reach a unique solution responsive to the special factual and legal relations between the corporation and its organs is striking in light of Professor Seavey’s basic acceptance of the principle that one’s degree of intimacy with another should find expression in the law. He wrote:

\[\text{The persons included within the generic term “agent” operate under widely differing circumstances and the closeness of their relation to the principal varies from those authorized merely to conduct one transaction to those who are in complete control of a business. No blanket rule will or should cover all situations. The line of liability must be pricked out as cases arise.}\]

W. Seavey, supra note 51, at 201 (emphasis added).

\[13^4\] Lennard’s Case, 1915 App. Cas. at 713.
Holding the corporation liable for its organs' contracts is justified from T's point of view as well. When T communicates with the board of directors, he sees the board as the corporation itself. Frequently, the board is the only body allowed to represent the corporation and to negotiate the terms of the contract. This high degree of intimacy between the corporation and its organs causes T to assume that the other party to the contract is the corporation itself rather than the board or the individual director representing the corporation.\(^{135}\)

In summary, the analytical approach of the organic theory achieves fair results.\(^{136}\) Viewing the organ as the real possessor of the attributes of the corporation empties all meaning from the requirement for corporate consent to its organ's contract; the organ's consent to the contract is, to the outsider, the corporate consent. Any disagreement between the corporation (by its use of other organs) and the organ must be viewed as an internal issue to be dealt with inside the corporation, and as having no effects on T.

The approach of the organic theory can also be understood through a comparison of the different criteria used by the organic theory and by traditional United States agency and tort law to restrict the corporation's liability for its representatives' acts. In traditional United States agency law, the agent's ability to represent the corporation was limited solely by a narrow function test—the authority granted to him to execute the specific function. His position as an agent was totally dependent on the functions he was designated to fulfill; therefore, when A acted beyond his authority, he was no longer an agent and his acts could not bind the corporation.\(^{137}\)

In tort law, a master is liable for his employee's tort where (a) the

\(^{135}\) Although they believe that broadening the scope of liability is a practical necessity, advocates of the organic theory are aware of the moral difficulties in overexpansion of P's responsibility. See Williams, Vicarious Liability and the Master's Indemnity, 20 Mod. L. Rev. 220, 230 (1957) ("In a society based on the division of labor we are all constantly receiving benefit from the work of others, but this does not, and cannot, make us legally liable for their wickedness and mistakes.").

To avoid overbroad liability, the theory distinguishes between two classes of corporate representatives, agents and organs. The function and hierarchy tests that distinguish between an agent and an organ are strict and clear enough to prevent overbroad liability. They guarantee that only contracts which have been agreed to by those officers who are likely to be perceived by T as the corporation, and which thus arouse unjustified expectations on T's part, will actually be imposed on the corporation without its consent.

\(^{136}\) Judged from a result-oriented viewpoint, the organic theory is superior to the Procura (discussed supra notes 36-41 and accompanying text), because the organic theory operates in all cases by force of law, while a Procura protects a third party only if P wishes to provide protection and has therefore executed and registered the required documentation.

\(^{137}\) See supra notes 51-53 and accompanying text.
employee is a servant, and (b) he was acting within the scope of his employment. This is a two-part test: the first part is inclusive, looking only to the status of the harm-doer (i.e., that he is a "servant"), while the second is restrictive, limiting the master's liability according to a function test. This function test is much broader than the one used in agency law because it requires only that the nature of the harm-producing act be within the scope of employment, the rationale being that vicarious liability is unjustified only if the servant's act was different in nature from those he was employed to execute. The breadth of this test causes the master to be responsible in a great number of cases. Though tort law's function test is broader than the analogous test used in agency law, it is similar to its agency counterpart insofar as it focuses on the nature of the specific harm-producing act at issue.

The organic theory, it was suggested earlier, also uses a two-part test that focuses on hierarchy and function. Like the agency and torts tests, it looks at the functional aspects of the behavior in question. The theory is unique, however, in that it does not limit corporate liability to a representative's specific authorized functions (as agency law does), nor to acts similar to those the representative was employed to execute (as tort law does), but rather defines every function of the corporation to be a function that satisfies the functional aspect of the test. The limited purpose of the function criterion is to eliminate corporate liability for an organ's act that does not exercise the powers of the corporation. But if the organ enters into a contract on a subject matter related to a function of the corporation, the corporation is rendered liable for the organ's promise even if it was made outside of his authority or in furtherance of his own interest at the corporation's expense. The organic theory's rationale is that corporate accountability is created by the corporation's relationship with the organ. The intimacy of the corpora-

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188 W. Keeton, supra note 52, ch. 12, § 70.

189 See supra note 95. Professor Barak disagrees, suggesting that the primary criterion for defining an organ should be purely hierarchical. This easily explains why the legal solution suggested by the organic theory must differ from the solution suggested by agency law, which is based only on a function test. See Barak, supra note 133, at 320 n.71. Because the criteria suggested by this Article do include a function test, a more detailed examination of the different solutions is needed. Therefore, the textual discussion below focuses on the differences between the criteria used in agency law, tort law and the organic theory, by analyzing the different scope of the function test used by each. The uniqueness of the organic theory lies not only in its hierarchical aspect, but also, more importantly, in its restructuring of the function test used by agency and torts.

140 This idea is implicit in Professor Seavey's discussion of the rationale of agency: "The [agent's] power must be created by the relationship of principal and agent, and the principal is not bound upon a theory that he assented or manifested any assent; he is bound because he is a principal." W. Seavey, supra note 51, at 92.
tion's relationship with the organ, not the corporation's consent, is the legal source and justification for the corporation's responsibility for contracts entered into against its will.\textsuperscript{141}


7.1. The Doctrine of Separation — The Civil Law's Solution, the Common Law's Confusion

The comparative law survey early in this Article\textsuperscript{142} showed that the civil law and the common law have taken very different approaches to the general question of the extent of an agent's power to bind his principal. Underlying the split between the civil and common laws is disagreement about the "doctrine of separation"; the civil law has adopted this doctrine, while the common law, for the most part, has not.

The doctrine of separation has been developed by French,\textsuperscript{148} German\textsuperscript{144} and Scandinavian\textsuperscript{145} scholars over the last two centuries, and was first stated in definitive form by Paul Laband in 1866.\textsuperscript{146} Since that time, the doctrine has become widely accepted in the world of civil

\textsuperscript{141} An additional limitation on corporate liability is that \( T \) must be unaware that the organ is ignoring limits on his authority. Where \( T \) knows that the organ is acting beyond his authority, the policy considerations which justify corporate liability do not exist.

\textsuperscript{142} See supra Section 3.

\textsuperscript{145} Pothier explained:

\textquotedblleft[T]he contract made by my agent in my name would be obligatory upon me if he did not exceed the power with which he was ostensibly invested; and I could not avail myself of having given him any secret instructions which he had not pursued. His deviation from these instructions might give me a right of action against himself, but could not exonerate me in respect of the third person with whom he had contracted conformably to his apparent authority; otherwise no one could be safe in contracting with the agent of an absent person.

\textsuperscript{144} M. Pothier, Law of Obligations 37 (Evans trans. 1839) (emphasis added).

\textsuperscript{146} In the case of agency based on mandate, the contract between mandator and mandator determines the respective relation between these two persons, the \textit{internal} side of the respective relation; whereas "principal and agent" determines its quality towards third persons, the exterior side of the relation. The one side is completely without influence on the other one; their coincidence is purely accidental.

Müller-Freienfels, supra note 37, at 198 (quoting 1 Ihering, Yearbook 312-13 (1857)).

\textsuperscript{146} See id. at 198 n.23.

\textsuperscript{148} P. Laband, Die Stellvertretung bei dem Abschluss von Rechtsgeschäften nach dem Allgemeinen Deutschen Handelsgesetzbuch (Representation in the Conclusion of Legal Transactions Under the Common German Commercial Code) (1866), cited in Müller-Freienfels, supra note 37, at 197.
law, and has “achieved singular success in convincing both the academic world and modern legislators.”

Laband’s contribution to the theory of agency was his distinction between the two separate relationships that exist in every agency situation. The conferral of authority by P on A, usually by a bilateral contract, is the internal side of agency — the mandate (Auftrag). The ability of A to execute the contract with T — his power (Vollmacht) is another aspect of agency which is totally independent of the mandate. In many cases these two relationships will coincide and A’s power to execute contracts will not exceed his authority under the mandate. In other cases, however, it will be possible for A to act within his power while violating P’s explicit instructions under the mandate. The mandate defines A’s obligations and rights toward P, that is, what A ought to do, but it does not limit what A may do; therefore the mandate does not affect T’s legal rights as agreed upon in a contract signed by A in the name of P.

The doctrine of separation was advocated by many scholars in the second half of the nineteenth century, and was adopted by a variety of legal systems. Most codes in the world of civil law consider the mandate a routine contractual relationship which is governed by the regular law of obligations, while the relationship between P and T is considered a special one which must be controlled separately, by agency law. This dichotomy in the statutory frameworks demonstrates the independence from each other of the two relationships.

The grant of agency power to A is a one-sided instrument, not a contract, because A’s consent is not needed for the creation of his

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147 Müller-Freienfels, supra note 37, at 199.
148 The German term “Vollmacht” has often been translated, unfortunately, as “authority.” Even before their introduction to the German term, common law scholars had struggled to distinguish between “authority” and “power.” See Comment, The “Authority” of an Agent — Definition, 34 YALE L.J. 788 (1925) (authored by Arthur Corbin), and the discussion above in Section 3. “Authority” in the common law is based on the intent of the principal and it “denotes merely the factual relationship between Principal and Agent.” Id. at 794. “Vollmacht,” on the other hand, is more akin to the common law’s “power,” i.e., it is not a factual but a legal relationship and it “expresses the concept of possible future changes in the legal relations of the principal with third persons.” Id. This Article, therefore, defines “Vollmacht” as “power,” instead of as Müller-Freienfels’ translation “authority.” See Müller-Freienfels, supra note 37, at 198.
149 Germany, Switzerland, Turkey, Greece, Sweden, Denmark, Norway, Finland, Italy, Japan, Thailand, Formosa, Ethiopia, Russia, Poland, Czechoslovakia and Hungary all follow Laband’s distinction to a greater or lesser extent. For references, see Müller-Freienfels, supra note 37, at 199-200.
150 For examples of such statutory treatment, see Hay & Müller-Freienfels, Agency in the Conflict of Laws and the 1978 Hague Convention, 27 AM. J. COMP. L. 1, 5-6 (1979); Müller-Freienfels, supra note 124, at 171-73.
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power;\textsuperscript{151} A's power is effective upon a unilateral act on the part of \( P \) regardless of \( P \)'s motive, even if neither \( T \) nor \( A \) agreed to it or knew about it. This distinction has important practical ramifications. One of these, for example, is that a minor may acquire the power to bind his \( P \), if the latter takes the risk and authorizes the minor to represent him, despite the minor's incompetence to oblige himself to the fiduciary duties and other obligations specified in the mandate.\textsuperscript{152}

It seems likely that the overwhelming triumph of Laband's idea cannot be explained merely by its analytical soundness. Rather, the doctrine's spread ought to be understood, in the context of the demands of the world of commerce, as strong evidence that it answered an urgent need in the business community for stability by guaranteeing the validity of contracts that were executed by agents. The doctrine's distinction between power and mandate promotes stability by allowing the third party to rely safely on A's promises. A's power is not measured by the scope of his employment and is not affected by mistakes in the mandate or even by the mandate's invalidity. Termination of the internal side of the agency (\( P-A \)) does not affect \( T \) if he is not aware of the termination. Most important, \( T \) is not bound to investigate whether A's promises are within his authority as established by the mandate.\textsuperscript{153} In sum, the doctrine of separation enabled the civil law to generate rules allowing \( T \) to rely on A's representations, a sensible response to the increased need of modern commerce for security in ordinary transactions.\textsuperscript{154} The resulting broader liability of \( P \) is, as was shown earlier,\textsuperscript{155} a desirable result.

The common law's traditional theoretical approach to the agency relationship differed sharply from that of civil law. Anglo-American law did not distinguish between A's power and his mandate; rather, they were viewed as a single entity. In other words, A's power to bind \( P \) was prescribed by the terms of the underlying contract between the two. Agency was viewed not as a separate concept, but as a species of contractual relationship.\textsuperscript{156} Thus, the existence of an agency relation-

\textsuperscript{151} Müller-Freienfels, supra note 34, at 95.

\textsuperscript{152} This is the law even in many legal systems where the doctrine of separation is not accepted. See Restatement (Second) of Agency § 21; R. Powell, supra note 2, at 299; Müller-Freienfels, supra note 34, at 94; Müller-Freienfels, supra note 124, at 179-80.

\textsuperscript{153} He "is not bound to inquire for secret qualifications or limitations to the (actual or apparent) powers of an agent once he has ascertained the general character or scope of the agency." Müller-Freienfels, supra note 34, at 97.

\textsuperscript{154} According to Müller-Freienfels, Laband himself stated that his distinction "is called for by the modern requirements of ordinary business life." Müller-Freienfels, supra note 37, at 207-08.

\textsuperscript{155} See supra Section 2.2.

ship and the scope of A's power both depended on P's and sometimes on A's consent. Only acts which P expressly or implicitly asked A to do were within A's authority, and this authority constituted A's power to affect the legal relationship between P and T.

The same commercial reality that accounts for the flourishing of the civil law's doctrine of separation also exerted a strain on the common law orthodoxy which limited A's power to bind P. In response to the increased need to facilitate market functioning by better protecting T's rights, the common law evolved; the notion of authority was extended and the concept of inherent agency power was developed as a basis for P's liability. By recognizing that an agent's power could exceed his authority, the common law in effect accepted Laband's distinction, albeit in an altered, concealed form.

The classic pragmatic argument for extending P's liability was explained by Judge Learned Hand in Kidd v. Thomas A. Edison, Inc. A, who was authorized to hire singers, promised, in violation of P's instructions, that P would pay for the singers' services. The court held P bound to A's promises in an opinion that touched "upon the basic consideration of the existence of the agency power: business convenience." Judge Hand stated:

It makes no difference that the agent may be disregarding his principal's directions, secret or otherwise, so long as he continues in that larger field measured by the general scope of the business intrusted to his care.

... If a man select another to act for him with some discretion, he has by that fact vouched to some extent for his reliability. While it may not be fair to impose upon him the results of a total departure from the general subject of his confidence, the detailed execution of his mandate stands on a different footing. The very purpose of delegated authority is to avoid constant recourse by third persons to the principal, which would be a corollary of denying the agent any latitude

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157 See supra Section 3, and notes 51-53.
158 Bowstead opens his book with the following definition of agency: "Agency is the relationship that exists between two persons, one of whom expressly or impliedly consents that the other should represent him or act on his behalf, and the other of whom similarly consents to represent the former or so to act." W. Bowstead, Bowstead on Agency 1 (14th ed. 1976).
159 See R. Powell, supra note 2, at 35-38 (discussing ways to determine the extent of an agent's authority).
160 See supra Section 3.3.
162 Munro, supra note 129, at 34.
beyond his exact instructions. Once a third person has assured himself widely of the character of the agent's mandate, the very purpose of the relation demands the possibility of the principal's being bound through the agent's minor deviations.\(^\text{163}\)

The common law, in *Kidd* and later cases, was never fully ready to accept and apply Laband's distinction. In *Kidd*, P's liability was limited to those acts which appeared to T to be within A's general authority. Therefore, P would be liable only for "the agent's minor deviations," but not for "the results of a total departure from the general subject of his [P's] confidence."\(^\text{164}\) That is to say that the common law, unlike the civil law's Procura, does not fully protect T from the details of P's instructions to A, and therefore achieves a lesser degree of security in commercial transactions.

Nevertheless, comparison between the practical results of the civil and common law rules of agency shows that although "starting from opposed principles, [the two systems admit] so many exceptions that [they are extensively in] accord in practical results,"\(^\text{165}\) This resemblance in practice despite disagreement in theory can be illustrated by the following example. Unlike the civil law, the *Restatement* provides that "the agency relation exists only if the agent consents to it."\(^\text{166}\) But this statement refers only to the underlying mandate, not to the existence of agency power. The contract imposes fiduciary duties on A and therefore can exist only if A agrees to it. But the grant of power may be effective even if it is P's unilateral act, of which neither A nor T were aware.\(^\text{167}\)

The independence of agency power from the mandate as a practical matter may also be seen in the common law's rules providing that an agency relationship can be created although neither party receives

\(^\text{163}\) *Kidd*, 239 F. at 407-08 (citations omitted).

\(^\text{164}\) *Id.* at 408. In *Lewis v. Chapin*, 263 Mass. 168, 160 N.E. 786 (1928), P's liability was extended even to a case where T made no effort to ascertain A's authority; the court reasoned that business safety justified protection of T where a subjective appearance of authority existed. This finding was, however, dictum because the court held that no contract existed in this instance for lack of consideration. *Id.* at 172, 160 N.E. at 787.

\(^\text{165}\) Müller-Freienfels, *Comparative Aspects of Undisclosed Agency*, 18 Mod. L. Rev. 33, 41 (1955); see also Müller-Freienfels, *The Undisclosed Principal*, 16 Mod. L. Rev. 299 (1953).

\(^\text{166}\) Restatement (Second) of Agency § 17 comment b.

\(^\text{167}\) See Müller-Freienfels, *supra* note 37, at 203 n.48 (citing Ruggles v. American Cent. Ins. Co., 114 N.Y. 415, 21 N.E. 1000 (1889)). M. Persön, *supra* note 129, at 410, points out that conferral of power on A may be executed without a contract. W. Bowstead, *supra* note 158, at 2, notes that "there is no conceptual reason which requires an actual contract between principal and agent."
consideration;\textsuperscript{168} that mistakes in the underlying contract do not affect A's power;\textsuperscript{169} and that P is subject to liability on a contract made in violation of secret instructions of which T has no notice.\textsuperscript{170} United States law also distinguishes between the two aspects of agency with regard to the question of conflict of laws; the internal relationship between P and A may be subject to different law than the external relationship between P and T.\textsuperscript{171}

The most obvious example of the implicit recognition by the common law of Laband's distinction is the Restatement's doctrine of inherent agency power. A's inherent power is not conditioned on the mandate or on any other manifestation of P's consent. It is an independent power "which is derived not from authority, apparent authority or es-toppel, but solely from the agency relation."\textsuperscript{172} This new power, which seems strange to the student of common law and inconsistent with the law's basic doctrines, is, when viewed from the perspective of comparative law, only an obvious additional step in the long process by which the common law has recognized the need to advance commercial security by the separation of "authority" from "power."

In addition to its implicit acceptance of Laband's theory, the common law has also responded in some cases by showing a willingness to accept, more explicitly, a moderate version of Laband's doctrine of separation. The results of some United States and English cases from the eighteenth century suggest that courts had noticed the difference between the external legal powers of an agent and the internal agreement underlying them.\textsuperscript{173} For example, cases drew a distinction between general and special agents: a special agent's acts bind P only if they are within the scope of A's authority, while a general agent's acts bind P even if A exceeds his authority.\textsuperscript{174} For the most part, though, courts in the eighteenth century "reached the right results in the concrete cases, with a minimum of systematic and conceptual implements — without feeling the need of such a working hypothesis as was to be propounded

\textsuperscript{168} See Restatement (Second) of Agency § 16.

\textsuperscript{169} Müller-Freienfels, supra note 37, at 205.

\textsuperscript{170} Restatement (Second) of Agency § 160.


\textsuperscript{172} Restatement (Second) of Agency § 8A.

\textsuperscript{173} See Nickson v. Brohan, 10 Mod. 109, 88 Eng. Rep. 649 (Q.B. 1713), and other cases analyzed by Müller-Freienfels, supra note 37, at 349 n.152. The description of the implicit recognition of Laband's theory in United States law which follows in text is based on the detailed discussion in Müller-Freienfels.

by Laband."

An early nineteenth century writer recognized the difference more clearly: "There may be many cases . . . in which the acts of an agent, though not in conformity to his authority, may yet be binding upon his employer, who is left in such cases to seek his remedy against his own agent." In Hatch v. Taylor, a nineteenth century court, in characterizing the differences between "limitations" on A's power and private "instructions" given to him, noted that instructions "are matters between the principal and agent, so that a disregard of them, by the [agent], although it may make him liable to the principal, will not vitiate the act, if it be done within the scope of the authority itself." Limitations, on the other hand, defined as restrictions imposed by P on A's powers and known to T, would free P from being bound by A's acts if the acts exceeded those limitations.

The difficulty of reconciling these decisions with traditional common law concepts of agency is reflected in the confusion that they caused. Professor Mechem commented that "it seems impossible to say that an act can be a violation of instructions and still [be] within the scope of the authority." He therefore concluded that "[c]learly . . . the language quoted from Hatch v. Taylor (and typical of the language of many cases) cannot mean precisely what it says." One can understand Mechem's argument either as misunderstanding the distinction between A's authority and A's power or as supporting that distinction but merely objecting to the court's imprecise language.

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176 Müller-Freienfels, supra note 37, at 351.
177 W. Paley, A TREATISE ON THE LAW OF PRINCIPAL AND AGENT, CHIEFLY WITH REFERENCE TO MERCANTILE TRANSACTIONS 162 (2d ed. 1822); see also J. Story, Commentaries on the Law of Agency as a Branch of Commercial and Maritime Jurisprudence with Occasional Illustrations from the Civil and Foreign Law 70 (1839).
178 10 N.H. 538 (1840).
179 Id. at 543. The term "authority," as used by the court, should be translated as "power" in our terminology. This example helps to show the justice of Hohfeld's complaint that "the term 'authority,' so frequently used in agency cases, is very ambiguous and slippery in its connotation." Hohfeld, Some Fundamental Legal Conceptions as Applied in Judicial Reasoning, 23 YALE L.J. 16, 46 (1913).
180 F. Mechem, supra note 17, § 98.
181 Id.
182 Müller-Freienfels believes that F. Mechem, supra note 17, confuses the external and internal aspects of agency and thus "passes over the core of Laband's separation." Müller-Freienfels, supra note 37, at 355-56.
183 Mechem's language is not clear and may be interpreted not as denying the distinction but as attacking the court's use of the term "authority." If Mechem understands "authority" to be synonymous with the privileges conferred on A by P in the mandate, then he is right in his contention that it is impossible to accept that the violations of instruction are still within the scope of the authority. Mechem himself points
ever interpretation one prefers, the very fact that Mechem saw the need to comment testifies to the difficulties of accepting Laband’s idea within the framework of the common law.

In sum, the civil law’s clear understanding of the independence of the two aspects of agency has not yet been fully adopted by the common law. Yet the need to create certainty and commercial stability has generated a gradual movement toward recognition of Laband’s distinction and has led the common law toward greater protection of innocent third parties from losses caused by agents’ unauthorized contracts.

7.2. Powers of Position — A Suggestion for Unification of Agency Law

The Rome Institute for the Unification of Private Law (UNIDROIT), faced with the divergent conceptual approaches of the civil and common laws, has suggested an intermediate approach which bases A’s power on the position he occupies while representing P. In other words, the scope of A’s power to bind P is made directly dependent on the position A holds. The fact that an employee of a transportation company, for example, has the job of bus driver, both gives him certain power to bind the corporation and also defines the limits of that power.

In pertinent part, UNIDROIT’s draft Act on Agency reads:

Article 4. Implied Authorization. The authority of a person to act in the name of another may arise from some position which that person occupies with the consent of the other, and from which the power to act in the name of that other arises according to the law and usages applicable.

Article 8. Scope of Authorization Implied from a Position. In the case of authorization implied from a position, the agent shall be authorized to perform in the name of his principal all those acts normally implied by his position.

If a person shall be entrusted by another with the management of a business, then by that fact he shall be author-

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out that his remarks are not valid if the court “is talking of power rather than authority,” F. MECHEM, supra note 17, § 96, and recognizes that contracts executed in violation of his instructions “may be within A’s power but not within his authority.” Id. § 98.

ized to perform all acts required by the normal running of
the business.\footnote{185}

This proposal, which uses the term “authority” where we would
say “power,” is based on the Uniform Scandinavian Contracts Act.\footnote{186}
Section 10(2) of the Swedish version of that Act states:

If a person, by virtue of being employed by another or
otherwise by virtue of a contract with the other, holds a posi-
tion from which, according to the law or usages, there fol-
lows an authority to act for the other, he shall be considered
to have power to perform all acts falling within the scope of
such authority.\footnote{187}

In the tradition of the civil law, the power granted to \( A \) by section
10(2) exists independently of the mandate, and not surprising is in-
tended, according to the Legislative Committee’s Report, to enable \( T \) to
rely on the “mere appearance of the situation” in order to secure “the
interest of business convenience.”\footnote{188}

Under the Swedish rule, \( T \) will be protected if the following three
prerequisites are met:

(1) \( A \)'s authority is coupled with a position which “appears as the
outward and visible sign of an authority to act for the principal.”\footnote{189}

“Position” describes the “circumstances which according to the law app-
licable produce legal consequences that do not completely depend on
the intention of the parties.”\footnote{190} These circumstances may be, for ex-
ample, \( A \)'s linkage to a corporate organization, his professional title, his
managerial status, or his relation to another person’s property.\footnote{191}

(2) \( A \)'s occupation of the position is “by virtue of a contract.” This

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\footnote{185} Id. arts. 4, 8.
\footnote{187} Uniform Scandinavian Contracts Act (Swedish version 1915), § 10(2), translated in Grönfors, supra note 186, at 98.
\footnote{188} Report of the Swedish Legislative Committee on the Uniform Scandinavian Contracts Act 73 (1914), translated in Grönfors, supra note 186, at 102. The “situa-
tion” which justifies \( T \)'s reliance is, in the Committee's words, \( A \)'s occupation of a position which “according to a widespread opinion gives power to make contracts or to
undertake legal transactions of the kind in question.” \textit{Id.}
\footnote{189} Grönfors, supra note 186, at 103. Even where \( T \) is not aware of \( A \)'s position
at the time of the transaction, he is secured if the position is apparent. \textit{Id.} at 102.
\footnote{190} \textit{Id.} at 106 n.1 (quoting in translation Bergandal, \textit{Om Ötvalsbrott Sason För-
brytelse mot Tredje Man}, in \textit{Skrifter Tillägnade Johan C.W. Thyrén} 170, 214 (1926)).
\footnote{191} \textit{Id.} at 103-06.
prerequisite guarantees that P will be liable only when he intended to appoint A to his position. P's consent to A's position is the Swedish equivalent of the civil law's mandate. Of course, A's actual power, once granted by P's consent, is not limited to P's original intention, and the two are unrelated in accord with Laband's doctrine. P's consent is usually expressed in an employment contract but may be found in another kind of contract.

(3) A's action is within the scope of the powers that follow from the position "according to the law or usage." This criterion is problematic because it "can never attain such a detailed sharpness that it can offer clear-cut boundaries of the agent's power in the same way as an instrument of authority, a document manifesting the principal's intention to authorize."192

The doctrine of "powers of position" is not completely unknown in the common law,193 but its importance in the Anglo-American legal system is negligible.194 Although the UNIDROIT proposal is considered an "intermediate" approach, it is influenced less by the common law than by Laband's distinction.195 The doctrine follows Laband's approach because it does not confine A's actual power to represent P to P's expectations at the time of A's appointment to the position. However, "[t]he sharp theoretical separation of authority from underlying contract . . . is mitigated in practice," by the third prerequisite of powers of position, "by implying a 'normal' scope of authority from the grant of a special task or position."196 The doctrine may therefore be viewed as a civil law doctrine which in practice softens the consequences of its applications.197

192 Id. at 124.
193 While Grönfors states that the common law does not recognize this institution, id. at 98-99, Müller-Freienfels disagrees. See Müller-Freienfels, Book Review, 12 AM. J. COMP. L. 272, 274 (1963) (reviewing K. GRÖNFORS, STÄLLNINGSFULLMAKT OCH BULVANSKAP (1961)); see also id. at 274 n.10 (giving additional references).
194 Müller-Freienfels admits that "English and American laws seem to attach relatively little practical or theoretical importance to the implication of legal consequences, as, for instance, to the authority of an agent, from the position or profession held by the agent." Müller-Freienfels, supra note 193, at 273-74.
195 More proof that the doctrine of powers of position is essentially a civil law idea is provided by the fact that the doctrine is found even in the German Commercial Code. See HGB §§ 54, 56.
196 Müller-Freienfels, supra note 34, at 98.
197 Müller-Freienfels adds: "This special counter-balancing effect vis-a-vis the strong theoretical distinction between authorization and underlying contract has attracted the attention of modern legislators in civil-law countries and of writers seeking to rationalize these cases." Id. at 99.
7.3. The Organic Theory's Role in Unification of the Law Governing International Trade

To a certain extent, the doctrine of powers of position and the theory of organs are similar. Under both theories the existence of the representative's power is based on P's intent to appoint him, either to his particular position or to his status as an organ. Therefore T must sometimes still bear the risk — under Swedish law, when the position is held without an underlying contract, and under the organic theory, when the representative does not satisfy the criteria for being an organ. In addition, the organic theory, like the doctrine of powers of position, is consistent with the civil law's doctrine of separation. Once it is established that the representative is an organ, his power to bind the corporation is independent of the corporation's original intent, and one need no longer ask about the scope of the authority conferred on the organ.

One might argue, therefore, that the organic theory is only a specific application of the broader doctrine of powers of position, in which A's "position" is that of an organ of the corporation. This contention is strengthened by the Swedish definition of the term "position," which is based not only on the agent's status or job title but also on his "link in an organization" and on "the acting person's relationship to the organization of a company." Position, in other words, may be inferred from the legal relationship between P and A, just as the organ's power is based on his relationship with the corporation.

In fact, though, the organic theory has different practical consequences than the doctrine of powers of position. While the latter confines P's liability only to "all those acts normally implied by [A's] position," the organic theory recognizes the organ's power to bind the corporation to any contract which is part of the corporate function. This difference in impact is not incidental, but is rather the external, practical expression of an important inner, theoretical distinction between them.

While the doctrine of powers of position provides for a broad scope of liability, it continues to view the holder of the position as an agent of the principal. In contrast, the organic theory focuses on the high degree of intimacy between the organ and the corporation and views the organ as the alter ego of the corporation. The organic theory thus does not differentiate between the organ's power and the corporation's power. Although the organic theory accepts the doctrine of separation, it is otherwise unlike other civil law theories. Laband's distinc-

188 Grönfors, supra note 186, at 105.
189 Preliminary draft, supra note 184, art. 8.
tion, the German Procura and the Swedish powers of position are all designed to protect commercial certainty by using different solutions within the law of agency. The theory of organs, by contrast, stays outside of this field, and achieves the same results more simply by exploiting the idea of identification.

The purpose of the theory of organs is to restate the accumulated learning of the civil and common laws in terms appropriate to the special environment of corporate existence. The theory is designed to guarantee the commercial stability and certainty of contracts executed by a corporation’s organs. This use of the theory is consistent with its potential use in other areas of corporate law, many of which have already been accepted to some degree by both civil and common law.\textsuperscript{200}

Development of new means of international communication and transportation, the urgent needs of modern society for exchange of commodities and technology, and an increasing pace of technological innovation have all contributed to the worldwide expansion of international trade. This trade would benefit greatly from unification of the rules of representation regulating contracts that involve parties from more than one nation. But this goal is unlikely to be achieved through unification of agency law. “The divergencies of the law of agency and of the underlying principles and concepts make unification of substantive law exceedingly difficult.”\textsuperscript{201} Unification of the basic doctrines of agency is especially difficult because agency rules are applicable to so many areas of the law.\textsuperscript{202} These may be the reasons why the various efforts to adopt a uniform substantive law of agency have all failed.\textsuperscript{203} These are probably also the reasons for the relatively limited influence of La–band’s distinction on the common law.

As a means of creating a uniform law of corporate representation that will provide for a broad scope of liability, the organic theory has two broad advantages. First, the principle of identification between the organ and the corporation produces legal results which fully secure a third party in his good faith transactions with a corporation. It thus corresponds to the growing market need for certainty and confidence in

\textsuperscript{200} See supra text accompanying notes 120–25.
\textsuperscript{201} Hay & Müller-Freienfels, supra note 150, at 7. For an opposite view by Müller-Freienfels, see Müller Freienfels, supra note 124, at 187.
\textsuperscript{202} Müller-Freienfels adds that “agency or agency-like relationships exist in a number of contexts beyond commercial representation . . . and may be inextricably interwoven with other areas of law, such as labor, family or corporate law, procedural law, and public law generally.” Hay & Müller-Freienfels, supra note 150, at 7.
\textsuperscript{203} For a discussion of some of these efforts, see Eörsi, \textit{Two Problems of the Unification of the Law of Agency}, in \textit{Law and International Trade} 83 (F. Fabricius ed. 1973).
business. The scope of T’s protection under the doctrine of identification is broader than the protection offered by agency rules in the common law or by most civil law applications of Laband’s distinction. This comprehensive protection of T is justified by the special importance of the general policy considerations in the corporate arena, and it reflects the parties’ expectations when the corporation’s representative is an organ. It is also in accord with the tendency of other areas of modern law to place greater responsibility on the party more able to bear it efficiently, as exemplified by the replacement of the rule of caveat emptor with the law of products liability.

Second, the organic theory can be used as an intermediate approach between those of the common and civil laws. Since the theory is based on the idea of identification, not on agency doctrines, the adoption of the theory of organs to govern a corporation’s contracts with third parties would not force the civil and common laws to change their views about the basic concepts of agency law. The organic theory does not change agency rules, but instead supersedes them in the one specific area of the law — corporate representation — for which it was specifically tailored. Elsewhere, the common law’s principle of authority and the civil law’s doctrine of separation can continue to be the basic doctrines of agency law. Because the organic theory leaves agency law largely untouched, it is more likely to serve successfully as a basis for unification of the law governing international trade (which almost always involves only corporate organs) because it would not be susceptible to the objections raised against similar efforts to unify the substantive law of agency. The obstacles posed by the differences between the national laws of agency vanish through the use of the new idea of identification.

8. CONCLUSION

Acceptance of the organic theory in the context of corporate representation by both the civil and common laws does not ask too much from either of them, and thus is a reasonable compromise. Both systems are familiar with the concepts that underlie the theory, and as was shown earlier, various areas of the law already reflect the theory’s influence. The organic theory may ultimately help achieve uniformity in the entire area of law governing the internal and external aspects of corporate life. Adoption of the organic theory as applied to corporate representation would be only one move, immediately helpful because of its practical impact, important from the standpoint of policy and inevitable from the perspective of theory, towards further acceptance of the theory of organs.