The decision in Akai: the interaction of apparent authority and knowing receipt

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Apparent authority and knowing receipt: common elements

When a senior employee of a corporation has no actual authority to commit the corporation to a transaction, the corporation might still find that it is bound on the basis of the apparent or ostensible authority of the agent. The elements of apparent authority were set out in the well-known passage in Diplock LJ’s judgment in *Freeman & Lockyer v Buckhurst Properties (Mangal) Ltd* ([1964] 2 QB 480). Paraphrasing slightly:

1. a representation must have been made to the third party that the purported agent had authority to enter into that kind of contract on behalf of the company;
2. by someone with actual authority to commit the company to the transaction;
3. the third party entered into the contract in reliance on the representation; and
4. there is no limitation in the company’s constitution either preventing it from entering into the transaction or authorizing an agent to bind it to that transaction.

The fourth requirement has been written out of the law of the United Kingdom by section 40(1) of the Companies Act 2006 and is likewise irrelevant under Hong Kong’s system of Company Law.
Hong Kong’s Court of Final Appeal considered the third element in Thanakharn Kasikorn Chamkat (Mahachon) v Akai Holdings Ltd ([2010] HKEC 1692, CFA) (‘Akai’). When is the third party entitled to rely on the representation? In this case, Akai and Singer were members of the same group of companies. Singer had borrowed money from Thai Farmers Bank (‘the Bank’). Singer was in financial difficulty and the Bank agreed with Akai that Akai would borrow sufficient funds from the Bank to repay the outstanding Singer loan. Akai gave the Bank a pledge over shares in an Akai subsidiary (‘Akai Electric’). It then applied those funds to paying off the Singer loan. All of these transactions were arranged and carried into effect by Mr Ting, a director and majority shareholder of Akai. The bank insisted on proof that Mr Ting had the relevant authority. He produced minutes of a meeting of Akai’s Executive Committee conferring on Mr Ting the authority, acting alone, to enter into the transaction on Akai’s behalf. In fact, the meeting had never taken place and the minutes had been fabricated by Mr Ting. Akai proved unable to meet its commitments under the loan agreement. The Bank sold the shares for just over HK$22m; this left HK$8m outstanding.

Akai made two principal claims. First, that since it was not party to the transaction, the Bank had not been entitled to sell the shares. There was, thus, a claim in conversion to recover the proceeds of sale from the Bank. Second, that the Bank was liable in knowing receipt and that therefore it had to compensate Akai according to more liberal principles of equitable compensation.
Apparent authority

The first question was whether Akai was bound by the transaction entered into by Mr. Ting, its Chief Executive Officer, purportedly on its behalf. He had not been given actual authority to enter into the transaction. The question, therefore, was whether he had apparent or ostensible authority to do so. On this question, Lord Neuberger of Abbotsbury referred to the passage in *Freeman & Lockyer* already referred to.

Lord Neuberger considered the question in two stages. First he asked whether (in the absence of the minutes) Mr Ting had had apparent authority to commit Akai to the transaction (at paras. 79 – 111). Apparent authority relies on there being a holding out or representation by Akai that Mr Ting had authority to commit it to the transaction. Here the representation emanated from Mr Ting’s position as Executive Chairman and Chief Executive Officer of Akai. In the normal course of events this would have been enough to clothe Mr Ting with the necessary apparent authority. The facts in this case, however, were so unusual as to prevent the Bank from being able to rely on apparent authority. The transaction conferred a benefit on Singer but none on Akai. Mr Ting had a conflict of interest (as shareholder and officer of both Akai and Singer). As a result, the transaction should have been disclosed to the Hong Kong Stock Exchange. Further, Akai’s bye-laws prohibited someone with this conflict of interest from being involved in the decision.
Even worse, the transaction was to the obvious advantage of the Bank (a factor making it more likely that it turned a blind eye to the question of Mr Ting’s authority). To compound this problem, the Bank departed from its normal procedure of requiring a resolution of Akai’s Board to enter into the transaction. The Bank also departed from its usual practice of requiring an opinion from a Hong Kong lawyer that Akai was bound by the transaction. Again, these factors suggested that the Bank was shying away from asking awkward questions. On the first question, then, there had been no holding out by Akai: it had not clothed Mr Ting with authority and it was irrational for the Bank to have relied on Mr Ting’s apparent authority (at para. 94).

Mr Ting’s production of the fraudulent minutes of Akai’s Executive Committee amounted to a representation by Mr Ting himself that he had authority to act as Akai’s agent. Lord Neuberger asked whether an agent can clothe himself with apparent authority in this way. Lord Neuberger referred to the House of Lords decisions in *Armagas Ltd v Mundogas SA* ([1986] AC 717) and *First Energy (UK) Ltd v Hungarian International Bank Ltd* ([1993] 2 Lloyds Rep 194). These decisions made it clear that it would be very unlikely that a third party could rely on apparent authority on the basis of the agent’s own unauthorised statement (at para. 68).
Lord Neuberger then went on to ask whether the Executive Committee minutes made any difference to the main conclusion that Mr Ting lacked apparent authority. Lord Neuberger held that the minutes (even taken at face value) were so manifestly flawed and inadequate as to weaken the Bank’s position (at paras. 117 – 121). The Bank had called for sight of Akai’s Bye-Laws precisely in the context of this transaction and so it was not unreasonable to attribute knowledge of their contents to the Bank. Reading the Bye-Laws and the ExCo minutes together weakened the Bank’s case. The minutes were obviously inadequate and served to make reliance on Mr Ting’s apparent authority even more irrational. Amongst their deficiencies were the facts that; they did not purport to be the minutes of a Board meeting, they did not mention the conflict of interest of two of the persons said to be present nor mention that they refrained from voting, they did not identify and benefit to Akai. Further, they were signed by Mr. Ting alone, the director with the most acute conflict of interest. Worst of all, they did not purport to authorise the most pernicious aspect of the transaction (that Akai would use the borrowed funds to benefit Singer).

**Knowing receipt**

Akai was, then, clearly entitled to common law damages because of the Bank’s sale of shares that belonged to Akai. Akai claimed, however, that the Bank was liable in knowing receipt. It did so in the hope of recovering more generous compensation. In essence, Akai claimed that the Bank retained the shares in circumstances in which it was
unconscionable for it to retain them (at para. 125). This is the test for knowing receipt that was enunciated in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* ([2001] 1 Ch 437 at 455). One question then was whether it was unconscionable for the Bank to have retained the shares (or the proceeds of sale of them). Lord Neuberger suggested that the facts of the case show that unconscionability can arise out of irrationality rather than dishonesty (at para. 134). To prove that it was irrational to rely on apparent authority is also to show unconscionability for the purposes of knowing receipt (at para. 135).

In the end, Lord Neuberger reached no firm conclusion on the knowing receipt point (though he was prepared to assume that Akai may well have had a claim in knowing receipt). There was no practical need to settle the point since Lord Neuberger was of the view that the equitable measure of compensation in this case would be the same as the common law damages to which Akai was undoubtedly entitled. Akai had to show that there was a causal connection between the Bank’s knowing receipt of the share in Akai Electric and the loss to Akai (*Target Holdings Ltd v Redfern* ([1996] 1 AC 421, 434G). Here the evidence strongly suggested that had it not been for the sale of the shares by the Bank, Akai would have retained them until they were worthless. Paradoxically, the Bank did Akai a favour by selling the shares while they still had some value. Akai was entitled either to the proceeds of sale or to an equivalent number of shares in Akai Electric (if they could still be obtained. Even had the principles of equitable compensation resulted in a measure of compensation that exceeded the common law damages to which Akai was
entitled, Lord Neuberger thought that the former should be brought in line with the latter. (at para. 155).

The decision in *Akai* shows the interaction between the common law and equity in three respects. First, it shows that claimants can be allowed to elect between remedies in common law and in equity. It shows that when it comes to the state of mind of a third party dealing with an unauthorised agent, the tests are the same for apparent authority and knowing receipt. Finally, equitable compensation for knowing receipt would in this case have come to the same amount as the damages awarded for conversion when the Bank sold the shares. It seems that Lord Neuberger was laying down a general approach that would, in any event, cap equitable compensation at the same level as common law damages.

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