

Editor's Note

ESSAR Insurance Services Limited, Managers of the Professional Indemnity Scheme in collaboration with Panel Solicitors **Reynolds Porter Chamberlain**, issue this quarterly bulletin to highlight risk management issues learned from their handling of claims.

BREACH OF WARRANTY OF AUTHORITY

Summary – Solicitors should not assume that the person who gives them instructions in fact has authority to do so. The onus is on solicitors to make appropriate enquiries to ensure that they have authority to act. A failure to do so is a matter of strict liability and can leave solicitors personally liable for wasted costs.

What is "warranty of authority"?

"*We act for...*" is a common introduction appearing on solicitors' first letter to the counterparty and other recipients in general. By stating this, solicitors impliedly warrant that they have proper authority to act on their client's behalf in respect of the relevant matter. Appropriate steps (see practical tips below) should be taken by solicitors before giving such a warranty of authority.

In particular, solicitors should place care in considering the scope of the warranty to be given. Absent express wording to the contrary, solicitors may be alleged to have warranted the identity of their client or the client's title to a property (see also competing views on this point in *Excel Securities PLC v Masood & Ors* [2009] EWHC 3912(QB)). Solicitors should carefully define key aspects of the warranty (such as who they are acting for, the scope of engagement and the extent of the authority given). This is to ensure such warranty is consistent with their scope of engagement and avoid terms which may broaden this scope, such as "undertakings".

What constitutes breach?

A breach occurs when solicitors give a warranty of authority which they do not in fact have, even if they honestly believed that they did. This situation may arise when the solicitors never had authority, or when their original authority has ceased for some reason. Such a breach commonly occurs in the following scenarios.

1. Deregistered company

- The general rule is that once a company has been dissolved, it is removed from the Companies Register and ceases to exist. A deregistered company can no longer commence an action, or have an action brought against it. In other words, solicitors' authority to act for a company ceases upon its deregistration, even if the deregistration occurred during litigation commenced with proper authority (see *Chan Chi Ming v Brilliant Rise Container Depot Ltd & Anor* [2009] 4 HKC 458).
- Subject to a subsequent validation order, if solicitors continue to act on the record this will be, by reason of the intervening deregistration, a breach of their warranty of authority.

2. Non-compliance with a company's Articles of Association ("**Articles**")

- A company's Articles serve as a statutory contract and framework for how the company operates, such as when and how it may commence legal proceedings. Failure to observe and comply with the Articles' requirements may render a company's act *ultra vires* (beyond its authority), meaning that solicitors acting on such instructions may be acting in breach of warranty of authority.
- This may occur where, contrary to express terms in the Articles, there is a failure to obtain prior approval from the company's members and/or directors (*Danish Mercantile Co v Beaumont* [1951] Ch. 680); or a failure to obtain prior written consent from a specified individual, e.g. a Chairman or specific Director (*Yifung Developments Ltd v Liu Chi Keung Ricky and Ors* [2017] 5 HKLRD 16).
- Care should also be taken when dealing with foreign companies, which may be subject to additional statutory and regulatory requirements on how the company should operate. For example, certain jurisdictions require a company to execute contracts by way of a seal and a failure to comply with this requirement may mean there is no proper engagement letter in place between the foreign company and its solicitors.

3. Incapacitated lay clients

- Where a lay client becomes incapacitated, the solicitors' authority to act on their behalf is terminated (*Yonge v Toynbee* [1910] 1 K.B. 215). This is the case even if the lay client gave the solicitors clear, unequivocal instructions before they became incapacitated.
- There is recent UK authority (*Blankley v Central Manchester and Manchester Children's University Hospitals NHS Trust* [2015] EWCA Civ 18) suggesting that the solicitors' authority may be "suspended" rather than "terminated" upon the lay client's incapacity. The solicitors' authority may be restored if the client regains capacity or an individual is appointed to continue the litigation on the client's behalf. However, this position has yet to be tested before the Hong Kong Courts, and it remains unclear whether it would be accepted.

4. Acting upon instructions of a third-party purporting to be acting on behalf of a principal

- Companies, especially those with cross-border or multinational operations, commonly instruct third-party agents (e.g., a law firm or an overseas business agent) to handle aspects of their affairs. Such agents may at times engage and instruct solicitors on behalf of their principal companies. If it later transpires that the agent did not have authority to act for the principal company, this will have a knock-on effect on any engagement brokered by the agent, including that with the solicitors.

What are the consequences?

1. For contentious matters

- The Court has inherent jurisdiction to strike out a party's name or action / claim for want of authority.
- When facing such an application to strike out, the burden lies with the solicitors to prove that they have authority to act. The action will stand or fall depending on the Court's determination of the question of authority.

2. For non-contentious matters

- Any agreements, negotiations or other kinds of commitment conducted by unauthorised solicitors will be invalid (unless subsequently ratified – see below). The client would generally not be bound by the solicitors' *ultra vires* actions.
- Any party who relied upon and/or suffered detriment as a result of the solicitors' breach of warranty of authority would have a separate cause of action against the solicitors personally.

3. Solicitors' personal exposure for wasted costs

- The Court may order the legal representatives concerned to meet the whole or any part of any wasted costs, including any costs incurred by a party as a result of (i) an improper or unreasonable act or omission, or (ii) any undue delay or other misconduct or default on the part of any legal representatives.
- If it is proven that the proceedings were commenced without authority, the Court may make a wasted costs order against the solicitors on an indemnity basis. It is usually immaterial whether the solicitors had acted *bona fide* and/or in reasonable reliance on instructions received, or had been deceived into believing that they had the authority to act for the client. The onus is always on the solicitors to prove that they have conducted due diligence and have made appropriate enquiries to satisfy themselves that they have authority to act. A failure to do so is a matter of strict liability (see *Grand Field Group Holdings* [2010] 4 HKLRD 487).

What are possible solutions?

Solicitors' breach of warranty of authority may be remedied by the client's ratification. For example, the Court may adjourn any application to strike out a company's name, with a view to having an appropriate meeting called to see whether the company will voluntarily ratify the solicitors' acts. If so, the defect in the proceedings will be cured and the strike-out application dismissed (*Danish Mercantile Co v Beaumont* [1951] Ch. 680).

However:

- Such ratification must be done within a reasonable time so that no unfair prejudice is caused to the other party.
- The ratifying party must adopt the proceedings and the solicitors' acts in their entirety. There can be no selective ratification.

Practical tips to avoid potential breaches

1. Conduct due diligence

- **Do** conduct due diligence and make appropriate enquiries to ensure there is proper authority to act (whether for a lay or corporate client).
- **Do** review Articles carefully to ensure the authority properly complies with the Articles.
- **Do** regularly review the company's status by conducting company searches.

2. Engagement letter

- **Do** specify the name and role of the individual who has the authority to instruct the solicitors on behalf of a corporate client.
- **Do** obtain supporting documents to ensure that the instructing individual(s) has/have proper authority to instruct solicitors (e.g. Articles, board resolution, power of attorney).
- **Do** ensure that the scope of a warranty of authority is consistent with the scope of the solicitors' engagement / instructions. Where solicitors do not have blanket authority to act in a matter, this should be made clear in the engagement letter, and mirrored in any warranty of authority given to counterparties in respect of that engagement.

3. Ensure compliance with foreign laws for overseas clients

- **Do** review and, where necessary, seek advice on foreign laws and regulations on obtaining proper authority for matters involving overseas clients.

4. On-going steps to ensure continuing authority

- **Do** conduct regular and continuing checks on the source of the authority, e.g. regularly reviewing a company's incorporation status, maintaining regular contact with a lay client to ensure that the authority has not been withdrawn or overridden or that the lay client has not become incapacitated for whatever reasons.
- **Do not** assume that an authority lasts indefinitely.

5. Training to staff members

- **Do** provide training to junior/support staff members on the importance and requirements of proper due diligence, e.g. appropriate steps on checking and verifying a third party's identity and their alleged representation of acting on behalf of a principal.

6. Be alert to changes in circumstances that may give rise to a need for a caveat as to authority

- **Do** be mindful of circumstances where a caveat as to authority may be appropriate, e.g. where the client may be abroad or where there may be any doubt as to the health or mental capacity of the client (see comments in *Yonge v Toynbee*).
- **Do** immediately give notice to other parties of circumstances where there is doubt about a warranty of authority to mitigate potential exposure (pending any ratification).
- **Do** be mindful that the nature and details of a caveat as to authority are highly fact-specific. Practitioners should exercise independent judgement in identifying and particularising these points.