

The dangers for directors of innocently assuming personal liability

The recent High Court decision in *Dream Doors Ltd v Lodgeford Homes Ltd and Martin Lodge* highlights the potential risks for directors if they are not careful when entering into obligations on behalf of a company. Although in this instance the court was unwilling to impose any personal liability on the director concerned as it was satisfied the agreement in question was clearly with his company rather than him personally, the case reaffirms the need for directors to make it clear that they are acting as agent for a company rather than acting in a personal capacity.

The Facts

Martin Lodge ('M') was a director of Lodgeford Homes Ltd ('L'). Dream Doors ('D') entered into a franchise agreement which, according to the terms of the written agreement, was between D as franchisor and L as franchisee.

Two representatives signed the agreement on behalf of D. M signed the agreement on behalf of L, writing the words "*as a Principal*" beside his signature. However, the word 'Principal' was not defined anywhere in the agreement itself.

D later claimed that L had breached the terms of the agreement and sought to terminate it. Termination of the agreement triggered the application of a number of restrictive covenants affecting L.

D claimed that because M had signed the agreement he had personally accepted liability and should be bound by the terms of the agreement. D sought an injunction from the court to enforce these terms on both M and L.

Consequences

In considering whether to grant the appropriate relief, the court looked at how the written agreement was constructed and found that there were two possibilities:

- that the agreement was solely between D and L, and that M only signed the agreement on L's behalf - in other words the reference to 'principal' should be read as referring to L itself, not M; or
- there was no agreement between D and L, because M signed it personally as principal and intended to be bound by it and not L. The agreement should therefore properly be between D and M.

It determined that the only sensible interpretation was the first of the two above. Accordingly L was bound by the terms of the agreement but this did not mean that M was not personally liable. As a company L enjoyed separate legal personality. D tried to claim that the

agreement should be rectified so as to show that M was a party and it could then be enforced between D and M. However, the court felt that this was a fanciful argument. There was no persuasive evidence to suggest that M had not signed the agreement on L's behalf and that M should be considered as bound by it. Furthermore, M had never paid any consideration for the franchise and therefore the agreement would be ineffective.

The Lesson

Separate legal personality, agency and limited liability are key principles underpinning English company law. They allow directors to act as a human agent on behalf of a company and enter into binding contractual obligations, without those obligations being binding on them personally.

However, they are not absolute principles and there are a variety of circumstances where directors can find themselves personally liable for the obligations of their company.

In most cases this will involve an element of fraud, or less serious wrongdoing. However, a director can also end up subjecting themselves to this liability innocently where they lead the person they are dealing with to believe that they are contracting with the director personally rather than their company.

In this case, the court was satisfied that M was acting as an agent of the company. Certainly that is a result which makes commercial sense, as arguably on the facts of the case there was no legitimate basis for thinking otherwise (other than M adding the confusing words "as a Principal" to the signature block).

This practice is not something which should be copied by other directors, unless of course it is clearly understood and accepted that they are intending to enter into contracts in their personal capacity. Although M escaped personal liability in this case, this was only after expensive litigation had progressed to a High Court trial. This case reflects one specific aspect of the general need for directors to make sure that they make their capacity as a director, rather than an individual, clear to those who they are dealing with.

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