

Chapter Two

AGENCY

A. INTRODUCTION¹

Basic agency and employment relationships underlay virtually all commercial dealings in the modern world. Agency relationships by and large do not themselves create new business forms; rather they are the glue that holds businesses together. As such, they define the rights and responsibilities of individuals who work for or on behalf of businesses. It is surprising that this essential subject today receives relatively little attention, since modern business is conducted almost entirely by agents and employees. To take an obvious example, a corporation, an artificial legal construct that has no physical being of its own, can act only through agents for everything it does. Whenever one person performs services for, or acts on behalf of, someone else, the principles of agency define the relationships and the responsibilities of both participants and of persons who deal with them. The most common agency relationship is the employment relationship,² but agency law is applicable in many other situations as well.

The principal sources of agency law today are the Second and Third Restatements of Agency. The American Law Institute—an association of lawyers, academics, and judges—authored the Restatements of Agency and, like all Restatements, their text and comments represent an effort to capture the law as developed by the courts. The Second Restatement of Agency was published in 1958, and the Third Restatement of Agency was published in 2006. Keep in mind that the Restatements are influential and are persuasive to many courts, but they are not binding.

Because of the relatively recent publication of the Third Restatement, most of the existing case law deals with the Second Restatement. Nevertheless, the basic principles of the Second and Third Restatements are largely the same. The materials in this Chapter will discuss and cite to both versions.

B. THE CREATION OF THE AGENCY RELATIONSHIP

The Second Restatement defines *agency* as the "fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject

¹A good portion of the material in this Chapter is taken from ROBERT W. HAMILTON, BUSINESS ORGANIZATIONS: UNINCORPORATED BUSINESSES AND CLOSELY HELD CORPORATIONS (1996). The material is reprinted with permission of Aspen Law and Business. Modifications and additions have been made for editorial purposes and to include material on the Third Restatement of Agency.

²Many aspects of employment law are governed by common law principles or statutes independent of agency law. For example, the employment at will doctrine is a common law doctrine that addresses duration of employment and grounds for termination. Statutes of long standing govern such matters as minimum wages, overtime pay, pay periods, and the like. Other statutes govern matters relating to the workplace, e.g., safety, sexual harassment, and a variety of other subjects.

to his control, and consent by the other so to act."³ The person who is acting for another is the *agent*; the person for whom the agent is acting is the *principal*.

An agency relationship is based on conduct by the principal and agent—the principal manifesting that he is willing to have another act for him and the agent manifesting a willingness to act. Thus, agency is basically a consensual relationship in which one person agrees to act for the benefit of another. Significantly, as long as the legal definition of agency has been met, an agency relationship is present, regardless of whether the parties intended to create such a relationship:

Agency is a legal concept which depends upon the existence of required factual elements: the manifestation by the principal that the agent shall act for him, the agent's acceptance of the undertaking and the understanding of the parties that the principal is to be in control of the undertaking. The relation which the law calls agency does not depend upon the intent of the parties to create it, nor their belief that they have done so. To constitute the relation, there must be an agreement, but not necessarily a contract, between the parties; if the agreement results in the factual relation between them to which are attached the legal consequences of agency, an agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow. Thus, when one who asks a friend to do a slight service for him, such as to return for credit goods recently purchased from a store, neither one may have any realization that they are creating an agency relation or be aware of the legal obligations which would result from performance of the service.⁴

Artificial entities such as corporations, trusts, partnerships, or limited liability companies may act as principals or as agents. The relationships are not limited to natural persons. In turn, an artificial entity can itself act only through agents. Thus, for example, the law of agency is involved whenever a corporation acts, whether it is writing a check, selling a product, or entering into a multi-billion dollar merger. Partnerships similarly involve the law of agency, with each partner being an agent for the partnership.

C. LIABILITY FROM THE AGENCY RELATIONSHIP

What liability is created when an agent interacts with a third party? This is the most common question that arises out of a principal-agent relationship. Both tort and contract liability will be discussed below.

1. TORT LIABILITY FROM THE AGENCY RELATIONSHIP

In general terms, the principal has the right to control the conduct of the agent with respect to matters entrusted to the agent.⁵ The principal can determine what the ultimate goal is, and the

³RESTATEMENT (SECOND) OF AGENCY § 1 (1958); *see* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

⁴RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b (1958); *see* RESTATEMENT (THIRD) OF AGENCY § 1.02 (2006).

⁵*See* RESTATEMENT (SECOND) OF AGENCY § 14 (1958); RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

agent must strive to meet that goal. The degree of control that the principal has over the acts of the agent may vary widely within the agency relationship. In this respect, the Second Restatement distinguishes between a master/servant relationship and an independent contractor relationship.⁶ A *master* is a principal who "employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service." A *servant* is an agent so employed by a master.⁷ In a way, the use of the words master and servant for this relationship is unfortunate, because those words may imply servility, household service, or manual labor. Nevertheless, under these definitions, most employment relationships are technically master/servant relationships.

Example: General Motors Corporation employs an individual to serve as head designer of a new automobile. His salary is \$300,000 per year. The designer is a "servant" in the Second Restatement terminology and General Motors is his "master."⁸

An *independent contractor* is a "person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking." An independent contractor may or may not be agent.⁹

Example: An attorney agrees to represent hundreds of persons on a contingency basis seeking to recover damages for injuries arising from exposure to asbestos. The attorney is an independent contractor, but not an agent.¹⁰

Example: A builder enters into a contract with the owner of a lot to build a house on the lot in accordance with certain plans and specifications prepared by an architect. The builder is an independent contractor, but he is not an agent. He is employed merely to accomplish a specific result and is not otherwise subject to the owner's control.

Example: A broker enters into a contract to sell goods for a manufacturer. His arrangement involves the receipt of a salary plus a commission on each sale, but the broker has discretion as to how to conduct his business. He determines which cities to visit and who to contact. He uses his own automobile to visit prospects. The broker is an agent and an independent

⁶See RESTATEMENT (SECOND) OF AGENCY § 2 (1958).

⁷See *id.* §§ 2, 220(1).

⁸Do you have any doubt about the correctness of this conclusion? If you do, consider this possible scenario: the chief executive officer of General Motors comes to the designer and says, "John, the board of directors liked your sketches for the new convertible. They feel, however, that it looks a little boxy and they think the headlights are too conspicuous. Please streamline it a little more and move the headlights into the front fenders." What should the head designer do? He makes the changes that are requested, thereby indicating clearly that he is a servant.

⁹See *id.* § 2(3).

¹⁰Do you agree that the attorney is not an agent in this situation? Does he consent to act subject to the control of the client? See Section XX. The attorney may be an agent in other roles, e.g., when negotiating a contract on behalf of his client.

contractor. He is not a servant.

Example: A customer of a brokerage firm directs the firm to sell on the New York Stock Exchange at the best price obtainable 100 shares of XYZ Stock owned by the customer. The brokerage firm, when executing this instruction, is both an agent and an independent contractor.

Example: Acme Superstores, a chain of grocery stores, enters into a contract with Gene's Pheasant Farm, Inc., by which Gene's promises to supply Acme with killed and dressed pheasants for sale by Acme. The contract gives Acme the power to direct Gene's operations to assure a continuing supply of fresh, high-quality pheasants. Acme is the principal and Gene's is an agent. Gene's may also be a servant if the degree of control maintained by Acme means that Acme may "control the physical conduct" of Gene's.

The distinction between an independent contractor who is an agent and one who is not depends on the degree and character of control exercised over the work being done by the independent contractor. In some instances, it may be difficult to determine whether an independent contractor is also an agent. Similarly, uncertainty may sometimes exist as to whether a person is a servant or an independent contractor. The Second Restatement of Agency contains a somewhat dated provision that gives guidelines for this latter issue.¹¹

The classification of an agent as a servant or an independent contractor is important primarily because different rules apply with respect to the liability of the principal for physical harm caused by the agent's conduct. A master is liable for torts committed by a servant within the scope of his employment, while a principal is not generally liable for torts committed by an independent contractor in connection with his work.¹²

Example: *P*, the owner of a successful retail operation with two stores, hires *D* to drive her delivery truck and to deliver goods to her two stores. Before doing so, *P* checks *D*'s driving record and arranges for him to go to a driving school for truck drivers. *D*'s record shows that he has had no accidents for 20 years, and he completes the driving school program without difficulty. Three weeks later, while driving *P*'s delivery truck, *D* is negligent and has a serious accident, injuring *X*. *P* is liable to *X* for his injuries.

In this example, *D* is a servant, and *P*'s liability is independent of whether *P* exercised due care in hiring *D*, or even whether she knew that *D* was her employee at all. *P*'s liability, however, only applies to actions within the scope of *D*'s employment. *P*'s liability in this situation may be described as "vicarious liability" and the consequence of "respondeat superior." *Vicarious liability* refers to the imposition of liability on one person for the actionable conduct of another. *Respondeat superior* is a Latin phrase that means "let the master respond." One reason that respondeat superior is applied in numerous cases is because the chances are very good that the

¹¹See RESTATEMENT (SECOND) OF AGENCY § 220(2) (1958). A more modern list might include factors such as whether the employer files a W-4 form for the employee, whether the employee is listed as such on insurance forms, and the like.

¹² See RESTATEMENT (SECOND) OF AGENCY §§ 219, 250 (1958); cf. RESTATEMENT (THIRD) OF AGENCY § 7.07 (2006) (imposing similar liability rules but not using the terms "master," "servant," or "independent contractor").

servant is judgment proof and has no insurance of his own, and therefore X's only recourse is against P.

Example: The manufacturer's broker who is selling goods in one of the above examples has an automobile accident while driving his own car to visit a prospect. The manufacturer is not liable for injuries to third persons arising from the accident. The same would be true of a person injured by the builder in the above example while working on the owner's house. Because the broker and the builder are both independent contractors, the general rule of non-liability for the principal applies.

Of course, the broker and the builder themselves would both be personally liable for the injuries that they caused in these examples, as a person is always responsible for his own torts. D, the servant in the above example, would also be personally liable for X's injuries, since he too is a tortfeasor.¹³ This illustrates the difference between direct liability (a person is always responsible for his own torts) and vicarious liability (a person is sometimes, but not always, responsible for the torts of another).

Notes

(1) As further justification for the doctrine of respondeat superior, consider the following:

What has emerged as the modern justification for vicarious liability is a rule of policy, a deliberate allocation of a risk. The losses caused by the torts of employees, which as a practical matter are sure to occur in the conduct of the employer's enterprise, are placed upon that enterprise itself, as a required cost of doing business. They are placed upon the employer because, having engaged in an enterprise, which will on the basis of all past experience involve harm to others through the torts of employees, and sought to profit by it, it is just that he, rather than the innocent injured plaintiff, should bear them; and because he is better able to absorb them, and to distribute them, through prices, rates or liability insurance, to the public, and so to shift them to society, to the community at large. Added to this is the makeweight argument that an employer who is held strictly liable is under the greatest incentive to be careful in the selection, instruction and supervision of his servants, and to take every precaution to see that the enterprise is conducted safely.

W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 69, at 500–01 (5th ed. 1984).

(2) For guidance on whether a servant/employee's actions are within the scope of his employment, see RESTATEMENT (SECOND) OF AGENCY §§ 228-237 (1958); RESTATEMENT (THIRD) OF AGENCY § 7.07(2) (2006).

(3) As mentioned, the general rule is that a principal is not liable for torts committed by an independent contractor agent. In *Anderson v. Marathon Petroleum Co.*, 801 F.2d 936 (7th Cir.

¹³ See RESTATEMENT (SECOND) OF AGENCY § 343 (1958); RESTATEMENT (THIRD) OF AGENCY § 7.01 (2006).

1986), the Seventh Circuit explained the rationale for this rule:

Generally a principal is not liable for an independent contractor's torts even if they are committed in the performance of the contract and even though a principal is liable under the doctrine of respondeat superior for the torts of his employees if committed in the furtherance of their employment. The reason for distinguishing the independent contractor from the employee is that, by definition of the relationship between a principal and an independent contractor, the principal does not supervise the details of the independent contractor's work and therefore is not in a good position to prevent negligent performance, whereas the essence of the contractual relationship known as employment is that the employee surrenders to the employer the right to direct the details of his work, in exchange for receiving a wage. The independent contractor commits himself to providing a specified output, and the principal monitors the contractor's performance not by monitoring inputs—i.e., supervising the contractor—but by inspecting the contractually specified output to make sure it conforms to the specifications. This method of monitoring works fine if it is feasible for the principal to specify and monitor output, but sometimes it is not feasible, particularly if the output consists of the joint product of many separate producers whose specific contributions are difficult (sometimes impossible) to disentangle. In such a case it may be more efficient for the principal to monitor inputs rather than output—the producers rather than the product. By becoming an employee a producer in effect submits himself to that kind of monitoring, receiving payment for the work he puts in rather than for the output he produces.

Since an essential element of the employment relationship is thus the employer's monitoring of the employee's work, a principal who is not knowledgeable about the details of some task is likely to delegate it to an independent contractor. Hence in general, though of course not in every case, the principal who uses an independent contractor will not be as well placed as an employer would be to monitor the work and make sure it is done safely. This is the reason as we have said for not making the principal vicariously liable for the torts of his independent contractors.

Id. at 938-39.

Despite this general rule, there are circumstances where liability is imposed on a principal for the torts of an independent contractor agent. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY §§ 212, 214-216, 250-267 (1958). Examples of such circumstances include nondelegable duties (such as duties associated with abnormally dangerous activities), torts that are authorized by the principal, and fraud or misrepresentation (in some situations) by the agent.

(3) The Third Restatement does not use the terms “master,” “servant,” or “independent contractor.” Instead, the Third Restatement simply defines an “employee” as “an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work,” and it provides that “[a]n employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment.” RESTATEMENT (THIRD) OF AGENCY § 7.07 (2006). Under the Third Restatement, therefore, there are “employee agents” and “nonemployee agents,” with the latter term analogous to the “independent contractor” language of the Second Restatement. The Third Restatement also retains some circumstances where liability is imposed

on a principal for the torts of a nonemployee agent. See RESTATEMENT (THIRD) OF AGENCY §§ 7.03-7.06, 7.08 (2006).

2. CONTRACT LIABILITY FROM THE AGENCY RELATIONSHIP

A contractual transaction between an agent and a third party may impose liability upon the principal, the third party, and/or the agent. This liability inquiry is often affected by the type of principal that is present in the transaction: (1) a “disclosed” principal; (2) a “partially disclosed” principal; or (3) an “undisclosed” principal.

A principal is *disclosed* if, at the time of the agent’s transaction, the third party has notice that the agent is acting for a principal and has notice of the principal’s identity.¹⁴ It may be, of course, that in a specific situation, a third person does not actually know who the principal is, but should be able to reasonably infer the identity of the principal from the information on hand. This is still a disclosed principal situation.¹⁵

A principal is *partially disclosed* if, at the time of the agent’s transaction, the third party has notice that the agent is or may be acting for a principal, but has no notice of the principal’s identity.¹⁶

Example: A offers to sell goods to TP, truthfully advising him that he is the manufacturer’s representative for a well-known manufacturer. The identity of the manufacturer is not disclosed. The manufacturer is a partially disclosed principal.

A principal is *undisclosed* if, at the time of the agent’s transaction, the third party has no notice that the agent is acting for a principal.¹⁷ In effect, the third party is dealing with the agent as though the agent is the sole party in interest.

a. LIABILITY OF THE PRINCIPAL TO THE THIRD PARTY

A principal will be liable on a contract between the agent and a third party when the agent acts with actual authority, apparent authority, or inherent authority. Even when the agent lacks one of these three types of authority, the principal may be liable under the doctrines of estoppel or ratification.

(1) Actual Authority

Actual authority (often described as *express authority* or simply by the words “authority” or

¹⁴See RESTATEMENT (SECOND) OF AGENCY § 4(1) (1958); RESTATEMENT (THIRD) OF AGENCY § 1.04(2)(a) (2006).

¹⁵See RESTATEMENT (SECOND) OF AGENCY § 9(1) (1958); RESTATEMENT (THIRD) OF AGENCY § 1.04(4) (2006).

¹⁶See RESTATEMENT (SECOND) OF AGENCY § 4(2) (1958). Instead of the term “partially disclosed” principal, the Third Restatement uses the term “unidentified” principal. See RESTATEMENT (THIRD) OF AGENCY § 1.04(2)(c) (2006).

¹⁷See RESTATEMENT (SECOND) OF AGENCY § 4(3) (1958); RESTATEMENT (THIRD) OF AGENCY § 1.04(2)(b) (2006).

"authorized") arises from the manifestation of a *principal to an agent* that the agent has power to deal with others as a representative of the principal.¹⁸ An agent who agrees to act in accordance with that manifestation has actual authority to so act, and his actions without more bind the principal.¹⁹ Put differently, if the principal's words or conduct would lead a reasonable person in the agent's position to believe that the agent has authority to act on the principal's behalf, the agent has actual authority to bind the principal.²⁰

Example: *P*, the owner of two retail stores, employs *C* to serve as credit manager. *P* has orally given *C* the authority to review and approve requests from customers for the extension of credit. *C* reviews the application of *Y* and approves him for the extension of credit. *C* has actual authority to approve *Y*, and *P* is bound by *C*'s decision.

Example: *P* goes to an office where, as he knows, several brokers have desks, and leaves upon the desk of *A*, thinking it to be the desk of *X*, a note signed by *P*, which states: "I authorize you to contract in my name for the purchase of 100 shares of Western Union stock at today's market." Unaware of the mistake, *A* comes to work, finds the note, and makes a contract with *T* in *P*'s name for the purchase of the shares. *A* has actual authority to make the contract, and *P* is bound by *A*'s action.

Actual authority may be *express* (e.g., oral or written statements, including provisions in the company's organizational documents) or *implied* (e.g., inferred from the principal's prior acts).²¹

Example: *P* is an elderly person living alone. He is befriended by *A*, a neighbor. *A* does errands for *P*, going to the store, helping *P* go to the doctor, and so forth. *P* has long had a charge account at the local grocery store that *A* has used frequently to charge groceries for *P*. The approval by *P* of *A*'s prior transactions would lead a reasonable person in *A*'s position to believe that he had authority to buy groceries for *P* in the future. This is implied actual authority based on *P*'s acceptance of the groceries in the past.²²

¹⁸See RESTATEMENT (SECOND) OF AGENCY §§ 7, 26, 32-34 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 2.01-2.02, 3.01 (2006).

¹⁹See RESTATEMENT (SECOND) OF AGENCY §§ 144, 186 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 6.01-6.03 (2006).

²⁰See RESTATEMENT (SECOND) OF AGENCY §§ 7, 26 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 2.01-2.02, 3.01 (2006).

²¹See RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c (1958) ("It is possible for a principal to specify minutely what the agent is to do. To the extent that he does this, the agent may be said to have express authority. But most authority is created by implication. * * * [Such authority may be] implied or inferred from the words used, from customs and from the relations of the parties. [It is] described as 'implied authority.'"); RESTATEMENT (THIRD) OF AGENCY § 2.02 (2006) (noting that an agent has actual authority "to take action designated or implied" in the principal's manifestations to the agent).

²²Cf. RESTATEMENT (SECOND) OF AGENCY § 43(2) (1958) ("Acquiescence by the principal in a series of acts by the agent indicates authorization to perform similar acts in the future."); RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. f (2006) ("On prior occasions the principal may have affirmatively approved of the agent's unauthorized act or silently acquiesced in it by failing to voice affirmative disapproval. This history is likely to influence the agent's subsequent

A common type of implied actual authority is incidental authority. *Incidental authority* is simply authority to do incidental acts that are related to a transaction that is authorized. As the Third Restatement explains:

If a principal's manifestation to an agent expresses the principal's wish that something be done, it is natural to assume that the principal wishes, as an incidental matter, that the agent take the steps necessary and that the agent proceed in the usual and ordinary way, if such has been established, unless the principal directs otherwise. The underlying assumptions are that the principal does not wish to authorize what cannot be achieved if necessary steps are not taken by the agent, and that the principal's manifestation often will not specify all steps necessary to translate it into action.²³

Example: *P* authorizes *A* to purchase and obtain goods for him but does not give him money to pay for them. There being no arrangement that *A* is to supply the money or buy upon his own credit, *A* has authority to buy upon *P*'s credit.

Example: *P* directs *A* to sell goods by auction at a time and place at which, as *P* and *A* know, a statute forbids anyone but a licensed auctioneer to conduct sales by auction. Nothing to the contrary appearing, *A*'s authority includes authority to employ a licensed auctioneer.

(2) Apparent Authority & Estoppel

Apparent authority arises from the manifestation of a *principal to a third party* that another person is authorized to act as an agent for the principal.²⁴ That other person has apparent authority and an act by him within the scope of that apparent authority binds the principal.²⁵ Put differently, if the principal's words or conduct would lead a reasonable person in the third party's position to believe that the agent (or other person) has authority to act on the principal's behalf, the agent (or other person) has apparent authority to bind the principal.²⁶

Apparent authority commonly arises when a principal creates the impression that broad

interpretation of instructions. If the principal's subsequent instructions do not address the history, the agent may well infer from the principal's silence that the principal will not demand compliance with the instructions to any degree greater than the principal has done in the past.”).

²³RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. d (2006); *see also id.* § 2.02(1) (stating that “an agent has actual authority to take * * * acts necessary or incidental to achieving the principal’s objectives”); RESTATEMENT (SECOND) OF AGENCY § 35 (1958) (“Unless otherwise agreed, authority to conduct a transaction includes authority to do acts which are incidental to it, usually accompany it, or are reasonably necessary to accomplish it.”).

²⁴*See* RESTATEMENT (SECOND) OF AGENCY §§ 8, 27, 49 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 2.03, 3.03 (2006).

²⁵*See* RESTATEMENT (SECOND) OF AGENCY § 159 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 6.01-6.02 (2006).

²⁶*See* RESTATEMENT (SECOND) OF AGENCY §§ 8, 27, 49 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 2.03, 3.03 (2006).

authority exists in an agent when in fact it does not. The theory is that if a third party relies on the appearance of authority, the third party may hold the principal liable for the action of the agent. As mentioned, the principal is bound by the agent's conduct within the scope of the agent's apparent authority, even though the conduct was not actually authorized by the principal.

Example: *P* gives *A*, an agent who is authorized to sell a piece of property on behalf of *P*, specific instructions as to various terms of the sale, including the minimum price (\$300,000) *P* is willing to accept. *P* informs possible buyers that *A* is his selling agent but obviously does not communicate *A*'s specific instructions to anyone but *A* (because to do so would be a virtual blueprint to possible buyers as to how to buy the property as cheaply as possible). *A* has actual authority only to enter a contract to sell the property at a price equal to or higher than \$300,000. *A* has apparent authority, however, to sell the property at any price given that *P* has represented to possible buyers that *A* is his agent.

Example: *A* signs a contract on behalf of *P* to sell *P*'s property to *TP* for \$275,000. *P* is bound on that contract because the action was within *A*'s apparent authority. Nevertheless, *A* has violated his instructions and is liable to *P* for the loss incurred.²⁷

The major difference between apparent authority and actual authority is that actual authority flows from the principal to the agent, while apparent authority flows from the principal to the third party. As previously mentioned, if the principal's words or conduct would lead a reasonable person in the *agent's* position to believe that the agent has authority to act on the principal's behalf, the agent has actual authority, but if the principal's words or conduct would lead a reasonable person in the *third party's* position to believe that the agent (or other person) has authority to act on the principal's behalf, the agent (or other person) has apparent authority.

In some circumstances, the scope of an agent's apparent authority will be equivalent to the scope of the agent's actual authority. For example, when a principal sends identical letters describing the agent's authority and its limits to both the agent and the third party, actual and apparent authority are co-extensive (assuming no other facts). As the above examples indicate, however, the scope of actual and apparent authority will not always be the same. It is, therefore, important to distinguish between the concepts and to recognize that liability for the principal may arise from statements or other manifestations made by the principal to the agent (actual authority), and/or from statements or other manifestations made by the principal to a third party (apparent authority).

Notes

(1) Apparent authority can exist even in the absence of a principal-agent relationship. For example, apparent authority can arise when a person falsely represents to a third party that someone else is his agent. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 2.03 (2006) ("Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."); *id.* § 2.03 cmt. a ("The

²⁷See Section XX.

[apparent authority] definition in this section does not presuppose the present or prior existence of an agency relationship * * * . The definition thus applies to actors who appear to be agents but are not, as well as to agents who act beyond the scope of their actual authority.”); *see also* RESTATEMENT (SECOND) OF AGENCY § 27 (1958) (describing apparent authority and noting that it is created by the principal’s conduct “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”).

(2) Apparent authority is based on the principal’s manifestations to a third party. Thus, apparent authority cannot be created by the mere representations of an agent or other actor. Not even the most convincing and persuasive person can create an agency or apparent agency relationship entirely on his own.

Example: John is a smooth-talking con man. He becomes friends with *X* and represents to *X* that he is an agent for General Motors seeking possible owners of new car franchises. John is very convincing, showing forged letters on GM letterhead, a forged identification card, and so forth. He persuades *X* that he will obtain a franchise for *X* if *X* will pay \$250,000. *X* does so. John disappears with *X*’s money. General Motors is not obligated to grant a franchise to *X* and is not otherwise liable for *X*’s loss.

(3) Apparent authority may be established through the agent’s title or position. Indeed, it is somewhat common for a third party to argue that the agent’s title or position, which was given to him by the principal, created a reasonable belief in the third party that the agent was authorized to act for the principal in ways that are typical of someone who holds that title or position. This notion that title or position conveys authority can also be used to establish actual authority to the extent that the agent reasonably believes that he has authority to act based on the title or position given to him by the principal.

For example, if *P* appoints *A* as “Treasurer,” and nothing more is stated, *A* will reasonably believe that he has the authority that Treasurers typically have, and third parties who deal with *A* (and are aware of his position) will reasonably believe the same. If *P* tells *A* that he will not have authority to write checks on the company’s account, *A* will not have actual authority to do so. Assuming that a Treasurer typically has the power to write company checks, however, *A* will have apparent authority to write checks with respect to third parties who are aware of his position but are unaware of the limitation on his authority. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY § 27 cmt. a (“[A]s in the case of authority, apparent authority can be created by appointing a person to a position, such as that of manager or treasurer, which carries with it generally recognized duties; to those who know of the appointment there is apparent authority to do the things ordinarily entrusted to one occupying such a position, regardless of unknown limitations which are imposed upon the particular agent.”); *id.* § 49 cmt. c (“Acts are interpreted in the light of ordinary human experience. If a principal puts an agent into, or knowingly permits him to occupy, a position in which according to the ordinary habits of persons in the locality, trade or profession, it is usual for such an agent to have a particular kind of authority, anyone dealing with him is justified in inferring that he has such authority, in the absence of reason to know otherwise. The content of such apparent authority is a matter to be determined from the facts.”).

(4) The doctrine of estoppel is closely related to the concept of apparent authority. Both doctrines focus on holding the principal responsible for a third party's belief that a person is authorized to act on the principal's behalf. *Compare* RESTATEMENT (SECOND) OF AGENCY §§ 27, 49 (1958) (discussing apparent authority), *and* RESTATEMENT (THIRD) OF AGENCY §§ 2.03, 3.03 (2006) (same), *with* RESTATEMENT (SECOND) OF AGENCY § 8B (1958) (discussing estoppel), *and* RESTATEMENT (THIRD) OF AGENCY § 2.05 (2006) (same). The doctrines, however, are distinct. The doctrine of apparent authority holds the principal responsible for the third party's belief because of the principal's manifestations of authority to the third party. By contrast, the doctrine of estoppel applies when the principal has not made any manifestations of authority to the third party at all. Instead, the principal is held responsible under the estoppel doctrine because the principal contributed to the third party's belief or failed to dispel it:

* * * The [estoppel] doctrine is applicable when the person against whom estoppel is asserted has made no manifestation that an actor has authority as an agent but is responsible for the third party's belief that an actor is an agent and the third party has justifiably been induced by that belief to undergo a detrimental change in position. Most often the person estopped will be responsible for the third party's erroneous belief as the consequence of a failure to use reasonable care, either to prevent circumstances that foreseeably led to the belief, or to correct the belief once on notice of it. * * *

RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt. c (2006). Thus, the estoppel doctrine may apply when apparent authority is unavailable. Consider the following example:

P has two coagents, A and B. P has notice that B, acting without actual or apparent authority, has represented to T that A has authority to enter into a transaction that is contrary to P's instructions. T does not know that P's instructions forbid A from engaging in the transaction. T cannot establish conduct by P on the basis of which T could reasonably believe that A has the requisite authority. T can, however, establish that P had notice of B's representation and that it would have been easy for P to inform T of the limits on A's authority. T detrimentally changes position in reliance on B's representation by making a substantial down payment. If it is found that T's action was justifiable, P is estopped to deny B's authority to make the representation.

Id. § 2.05 illus. 1; *see also id.* § 2.05 cmt. d (“The doctrine stated in this section may estop a person from denying the existence of an agency relationship with an actor when the third party would be unable to establish either the existence of a relationship of agency between the actor and the person estopped * * * or a manifestation of authority sufficient to create apparent authority * * *.”).

(5) Apparent authority and estoppel also differ to the extent that apparent authority may be created without the need to establish a detrimental change in position. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY § 8B cmt. b (1958) (“If the claim of a party to a transaction is based solely upon estoppel, he must prove a change of position which is not required in the case of apparent authority.”); RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. e (2006) (“To establish that an agent acted with apparent authority, it is not necessary for the plaintiff to establish that the principal's manifestation induced the plaintiff to make a detrimental change in position, in contrast to the showing required by the estoppel doctrine[.]”).

(3) Inherent Authority

According to the Second Restatement, the term “inherent agency power” (typically referred to as *inherent authority*) is used to describe “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 harmed by or dealing with a servant or other agent.”²⁸ That definition indicates that inherent authority is a distinct type of authority, but it says very little about when it arises.

Later sections, however, provide further guidance. A general agent²⁹ for a disclosed or partially disclosed principal has inherent authority to bind the principal “for acts done on his [the principal’s] account which usually accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, the other party reasonably believes that the agent is authorized to do them and has no notice that he is not so authorized.”³⁰

Example: *P* hires *A* to manage a branch store of *P*’s retail operations. *A* has authority to manage the store on a day-to-day basis but is told expressly that he has no authority to mark down the prices of goods without the prior approval of *P*. *A* nevertheless marks down slow-moving goods which are sold to third persons. There is no actual authority, but *P* is bound by inherent authority if the act of marking down prices usually accompanies managerial duties, and if a third party reasonably believed that *A* was authorized to do such an act.

In the above example, can an argument be made that there was apparent authority? After all, the principal gave *A* the position of “manager,” and it may be reasonable for third parties who know that *A* is a manager to believe that he has authority to mark down prices.³¹ In situations involving a disclosed or partially disclosed principal, therefore, the concepts of apparent authority and inherent authority may overlap.

In an undisclosed principal situation, however, inherent authority has independent significance. After all, apparent authority involves a third party who reasonably believes, based on the principal’s manifestations, that a person was authorized to act on the principal’s behalf.³² In an undisclosed principal situation, therefore, there can be no apparent authority, as the third party has no idea that a principal is involved in the transaction.³³ Even in the absence of actual and apparent

²⁸RESTATEMENT (SECOND) OF AGENCY § 8A (1958).

²⁹A “general agent” is “an agent authorized to conduct a series of transactions involving a continuity of service.” *Id.* § 3(1).

³⁰ *Id.* § 161.

³¹ See Section XX.

³² See Section XX.

³³See RESTATEMENT (SECOND) OF AGENCY § 194 cmt. a (1958) (“Since apparent authority is the power which results from acts which appear to the third person to be authorized by the principal, if such person does not know of

authority, however, an undisclosed principal can still be bound via inherent authority. Indeed, “[a] general agent for an undisclosed principal authorized to conduct transactions subjects his principal to liability for acts done on his account, if usual or necessary in such transactions, although forbidden by the principal to do them.”³⁴

Example: *P* employs *A* to manage his cigar bar, directing *A* to represent that he (*A*) is the owner, and to purchase no goods for the business except alcohol and bottled water, with all other goods to be supplied by *P*. *A* purchases cigars from *T* for the business. *P* is subject to liability to *T* for the price of the cigars.

Notes

(1) What is the rationale for inherent authority? Consider the following:

The principles of agency have made it possible for persons to utilize the services of others in accomplishing far more than could be done by their unaided efforts. * * * Partnerships and corporations, through which most of the work of the world is done today, depend for their existence upon agency principles. The rules designed to promote the interests of these enterprises are necessarily accompanied by rules to police them. It is inevitable that in doing their work, either through negligence or excess of zeal, agents will harm third persons or will deal with them in unauthorized ways. It would be unfair for an enterprise to have the benefit of the work of its agents without making it responsible to some extent for their excesses and failures to act carefully. The answer of the common law has been the creation of special agency powers or, to phrase it otherwise, the imposition of liability upon the principal because of unauthorized or negligent acts of his servants and other agents. These powers or liabilities are created by the courts primarily for the protection of third persons, either those who are harmed by the agent or those who deal with the agent. In the long run, however, they [i]nure to the benefit of the business world and hence to the advantage of employers as a class, the members of which are plaintiffs as well as defendants in actions brought upon unauthorized transactions conducted by agents.

RESTATEMENT (SECOND) OF AGENCY § 8A cmt. a (1958); *see also id.* § 161 cmt. a (“The basis of the [inherent authority] liability stated in this Section is comparable to the liability of a master for the torts of his servant. * * * In the case of the master, it is thought fair that one who benefits from the enterprise and has a right to control the physical activities of those who make the enterprise profitable, should pay for the physical harm resulting from the errors and derelictions of the servants while doing the kind of thing which makes the enterprise successful. * * *

the existence of a principal there can be no apparent authority.”); RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. f (2006) (“In contrast, apparent authority is not present when a third party believes that an interaction is with an actor who is a principal. If a third party believes that an actor represents no one else's interests, the third party does not have a reasonable belief in the actor's power to affect anyone else's legal position.”).

³⁴RESTATEMENT (SECOND) OF AGENCY § 194 (1958); *see also id.* § 195 (discussing the inherent authority of manager-agents in an undisclosed principal situation); *cf.* RESTATEMENT (THIRD) OF AGENCY § 2.06(2) (2006) (preserving what is effectively inherent authority (although not designated as such) in undisclosed principal situations).

Commercial 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. In the long run it is of advantage to business, and hence to employers as a class, that third persons should not be required to scrutinize too carefully the mandates of permanent or semi-permanent agents who do no more than what is usually done by agents in similar positions.”).

(2) The Third Restatement does not recognize “inherent authority” as an independent concept:

The term “inherent agency power,” used in Restatement Second, Agency, and defined therein by § 8A, is not used in this Restatement. Inherent agency power is defined as “a term used * * * 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 harmed by or dealing with a servant or other agent.” Other doctrines stated in this Restatement encompass the justifications underpinning § 8A, including the importance of interpretation by the agent in the agent’s relationship with the principal, as well as the doctrines of apparent authority, estoppel, and restitution.

RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b (2006). *But see id.* § 2.06(2) (preserving what is effectively inherent authority (although not designated as such) in undisclosed principal situations).

(4) Ratification

Even if an agent acts without authority, the principal will be liable to a third party if (1) the agent purports to act (or, under the Third Restatement, acts) on the principal’s behalf, and (2a) the principal affirmatively treats the agent’s act as authorized (*express ratification*), or (2b) the principal engages in conduct that is justifiable only if the principal is treating the agent’s act as authorized (*implied ratification*).³⁵ Significantly, ratification does not occur unless the principal, at the time of the ratification, is fully aware of all of the material facts involved in the original transaction.³⁶

Express ratification most commonly occurs through oral or written statements (e.g., a company resolution).³⁷ Implied ratification most commonly occurs when the principal has knowledge of an unauthorized transaction entered into purportedly on his behalf, but the principal

³⁵See RESTATEMENT (SECOND) OF AGENCY §§ 82-83, 85, 100, 143 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 4.01-4.03 (2006). Under the Second Restatement, ratification can occur only if the agent purports to act on the principal’s behalf, but under the Third Restatement, ratification can occur if the agent acts or purports to act on the principal’s behalf. *Compare* RESTATEMENT (SECOND) OF AGENCY § 85(1) (1958) *with* RESTATEMENT (THIRD) OF AGENCY § 4.03 (2006). For an explanation of the significance of this point, please see the “Notes” following this Section.

³⁶See RESTATEMENT (SECOND) OF AGENCY § 91 (1958); RESTATEMENT (THIRD) OF AGENCY § 4.06 (2006).

³⁷*Cf.* RESTATEMENT (SECOND) OF AGENCY § 93 (1958); RESTATEMENT (THIRD) OF AGENCY § 4.01(2) (2006).

nevertheless accepts the benefits of the transaction.³⁸

Example: *P* authorizes *A* to sell a refrigerator at a specified price without a warranty. *A*, purporting to have authority to do so on *P*'s behalf, contracts with *T* for the sale of the refrigerator at a lower price than specified and with a warranty of performance for two years. *T* pays part of the purchase price. *P* receives the monies paid by *T*, knowing all the facts. The contract as made between *A* and *T* is ratified.

Example: *P* owns an advertising agency and employs *A* to service existing accounts by purchasing space in advertising media. *A* does not have authority to set terms with clients. *A* executes an agreement with *T* that commits *P* to develop a new advertising campaign for *T*. *P* learns of the agreement and then accepts and retains advance payment made by *T* for the new advertising campaign. By accepting and retaining the payment, *P* has ratified the unauthorized agreement made by *A*.

Example: Without authority to bind *P*, *A* purports to rent machinery from *T* for *P*. *A* delivers the machinery to *P*, representing that *T* has loaned the machinery to *P* without requiring compensation. *P* uses the machinery. There is no ratification by *P* because he was unaware of the material facts related to the rental transaction.

Ratification has occurred as soon as the principal objectively manifests his acceptance of the transaction, even if the fact of ratification is not communicated to the third party, the agent, or any other person.³⁹ When ratification occurs, the effect is to validate the contract as if it were originally authorized by the principal. Thus, ratification imposes liability upon a principal in the same manner as if the principal had actually authorized the contract in the first place.⁴⁰ Nevertheless, ratification is not effective unless it occurs before the third party has withdrawn from the transaction. Similarly, ratification is ineffective if it would be unfair to the third party as a result of changed circumstances.⁴¹

Notes

(1) What function does ratification serve? Consider the following:

³⁸Cf. RESTATEMENT (SECOND) OF AGENCY §§ 98-99 (1958); RESTATEMENT (THIRD) OF AGENCY § 4.01 cmt. g (2006) (“A person may ratify an act * * * by receiving or retaining benefits it generates if the person has knowledge of material facts * * * and no independent claim to the benefit.”).

³⁹See RESTATEMENT (SECOND) OF AGENCY § 95 (1958); RESTATEMENT (THIRD) OF AGENCY § 4.01 cmt. d (2006) (“Ratification requires an objectively or externally observable indication that a person consents that another's prior act shall affect the person's legal relations. To constitute ratification, the consent need not be communicated to the third party or the agent. This is so because the focal point of ratification is an observable indication that the principal has exercised choice and has consented.”).

⁴⁰See RESTATEMENT (SECOND) OF AGENCY §§ 82, 100, 143 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 4.01(1), 4.02(1) (2006).

⁴¹See RESTATEMENT (SECOND) OF AGENCY §§ 88-89 (1958); RESTATEMENT (THIRD) OF AGENCY § 4.05 (2006).

Ratification often serves the function of clarifying situations of ambiguous or uncertain authority. A principal's ratification confirms or validates an agent's right to have acted as the agent did. That is, an agent's action may have been effective to bind the principal to the third party, and the third party to the principal, because the agent acted with apparent authority. If the principal ratifies the agent's act, it is thereafter not necessary to establish that the agent acted with apparent authority. Moreover, by replicating the effects of actual authority, the principal's ratification eliminates claims the principal would otherwise have against the agent for acting without actual authority. The principal's ratification may also eliminate claims that third parties could assert against the agent when the agent has purported to be authorized to bind the principal but the principal is not bound. * * *

RESTATEMENT (THIRD) OF AGENCY § 4.01 cmt. b (2006).

(2) Ratification cannot operate to prejudice the rights of persons who are not parties to the transaction, but who acquired rights or other interests in the subject matter of the transaction before the ratification occurred. See RESTATEMENT (SECOND) OF AGENCY § 101(c) (1958); RESTATEMENT (THIRD) OF AGENCY § 4.02(2)(c) (2006).

Example: Purporting to act for *P* but without power to bind him, *A* makes a contract for the sale of *P*'s land to *T*. *B*, not knowing this, offers *P* a smaller price than that called for by *T*'s contract. *P* accepts *B*'s offer; then learning of the contract with *T*, ratifies that. *B* is entitled to the land. *P* is subject to liability to *T* on the contract.

(3) As mentioned, ratification requires an agent to purport to act on the principal's behalf. See RESTATEMENT (SECOND) OF AGENCY § 85(1) (1958). Under the Second Restatement, therefore, there can be no ratification by an undisclosed principal. By definition, an agent for an undisclosed principal purports to act on his own behalf and not on the principal's behalf.

The Third Restatement changes this rule and allows ratification by an undisclosed principal by stating that a person may ratify an act "if the actor *acted or purported to act* as an agent on the principal's behalf." RESTATEMENT (THIRD) OF AGENCY § 4.03 (2006) (emphasis added). Because an agent for an undisclosed principal acts on the principal's behalf (even though he does not purport to do so), ratification by an undisclosed principal is permissible. See *id.* § 4.03 cmt. b ("The formulation in this section does not distinguish among disclosed principals, unidentified principals, and undisclosed principals. It is contrary to the rule in Restatement Second, Agency § 85(1), which states that an act may be ratified only if the actor purported to act as an agent. That rule limited ratification to situations in which the principal was disclosed or unidentified. In contrast, under the formulation in this section, an undisclosed principal may ratify an agent's unauthorized act.").

b. LIABILITY OF THE THIRD PARTY TO THE PRINCIPAL

When an agent makes a contract for a disclosed or partially disclosed principal, the third party is liable to the principal if the agent acted with authority (actual, apparent, or, under the Second Restatement, inherent), so long as the principal is not excluded as a party by the form or

terms of the contract.⁴² When an agent makes a contract for an undisclosed principal, the third party is liable to the principal if the agent had authority (actual or, under the Second Restatement, inherent), so long as the principal is not excluded by the form or terms of the contract, the existence of the principal is not fraudulently concealed, and there is no set-off or similar defense against the agent.⁴³

The fraudulent concealment exception merits some additional discussion. When an agent contracting on behalf of an undisclosed principal falsely represents that the agent is acting on behalf of himself, the Second and Third Restatements both provide that the third party can avoid the contract if the principal or the agent had notice that the third party would not have dealt with the principal.⁴⁴

Example: With authorization from *P*, his undisclosed principal, *A* contracts with *T* to sell and deliver to *T* 1000 shares in a corporation. Having no reason to suppose that *T* is unwilling to deal with *P*, *A* represents that he is acting for himself. *P* can enforce this contract.

Example: Same facts as above, except that *A* knows that *T* would not enter into any transaction with him if he knew that *P* was the principal. *A* denies the existence of *P* for this reason. *P* cannot enforce this contract if *T* elects to rescind.

Example: Same facts as the first example, except that *A* has no reason to believe that *T* would be unwilling to contract with *P* but this fact is known to *P*, who employed *A* for the purpose of concealing *P*'s interest in the transaction from *T*. *P* cannot enforce this contract if *T* elects to rescind.

Despite the general rules stated above, an undisclosed principal cannot bind a third party to a contract if the principal's role in the contract substantially changes the third party's rights or obligations:

The nature of the performance that a contract requires determines whether performance by an undisclosed principal will be effective as performance under the contract and whether an undisclosed principal can require that the third party render performance to the principal. Performance by an undisclosed principal is not effective as performance under a contract if the third party has a substantial interest in receiving

⁴²See RESTATEMENT (SECOND) OF AGENCY §§ 292-293 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 6.01(1), 6.02(1) (2006). Because ratification functions as a substitute for actual authority, ratification by the principal would also seem to bind the third party if such ratification would not be unfair to the third party as a result of changed circumstances. See Part XX.

⁴³See RESTATEMENT (SECOND) OF AGENCY §§ 302-304, 306, 308 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 6.03, 6.06, 6.11(4) (2006). As mentioned, apparent authority is inapplicable in the undisclosed principal situation. See Section XX. Once again, because ratification functions as a substitute for actual authority, ratification by the principal would also seem to bind the third party if such ratification would not be unfair to the third party as a result of changed circumstances. See Section XX.

⁴⁴See RESTATEMENT (SECOND) OF AGENCY § 304 (1958); RESTATEMENT (THIRD) OF AGENCY § 6.11(4) (2006).

performance from the agent who made the contract. This limit corresponds to the limit on delegability of performance of a duty as stated in [the Second Restatement of Contracts]. * * * The nature of the performance that a contract requires from a third party determines whether an undisclosed principal is entitled to receive that performance. An undisclosed principal may not require that a third party render performance to the principal if rendering performance to the principal would materially change the nature of the third party's duty, materially increase the burden or risk imposed on the third party, or materially impair the third party's chance of receiving return performance. These limits correspond to the limits imposed on assignment of a contractual right.⁴⁵

c. LIABILITY OF THE AGENT TO THE THIRD PARTY

If an agent contracts with a third party on behalf of a disclosed principal, the general rule is that the agent is not a party to the contract and is not liable to the third party.⁴⁶ This result is consistent with the third party's expectations—i.e., the third party expected that he was entering into a contract with the principal and not with the agent.

Example: *P* instructs *A* to purchase a computer on *P*'s behalf. *A* goes to *T*'s computer store and represents to *T* that he is buying for the account of *P*. A contract is entered into. *P* is liable on the contract, but *A* is not.

If an agent contracts with a third party on behalf of a partially disclosed or undisclosed principal, the general rule is that the agent is a party to the contract and is liable to the third party (regardless of whether the principal is also liable to the third party).⁴⁷ The third party's right to hold the agent responsible on contracts with partially disclosed principals is based on the common sense notion that a third party normally would not agree to look solely to a person whose identity is unknown for performance of the contract. If the third party does not know the identity of the principal, the third party cannot investigate the solvency and reliability of the principal; thus, the third party probably expected the agent to be liable. Similarly, the third party's right to hold the agent responsible on contracts with undisclosed principals is also consistent with the third party's expectations—i.e., the third party expected the agent to be a party to the contract because the agent presented the deal as if he were acting for himself. Moreover, if the third party is unaware of the principal's existence, the third party must be relying on the agent's solvency and reliability when entering into the contract.

Example: *P*, a well-known manufacturer, instructs *A* to offer to sell goods on *P*'s behalf to *T* without revealing *P*'s identity. *A* makes the offer and truthfully advises *T* that *A* is making the offer on behalf of a well-known manufacturer. *A* does not disclose *P*'s identity. *T* accepts the offer. Both *P* and *A* are liable on the contract.

⁴⁵RESTATEMENT (THIRD) OF AGENCY § 6.03 cmt. d (2006); *see* RESTATEMENT (SECOND) OF AGENCY §§ 309-310 (1958).

⁴⁶ *See* RESTATEMENT (SECOND) OF AGENCY § 320 (1958); RESTATEMENT (THIRD) OF AGENCY § 6.01(2) (2006).

⁴⁷ *See* RESTATEMENT (SECOND) OF AGENCY § 321-322 (1958); RESTATEMENT (THIRD) OF AGENCY § 6.02(2), 6.03(2), 6.09 (2006).

Example: Same facts as above, but *A* offers to sell the goods to *T* without disclosing that they are *P*'s goods and that he is selling the goods on *P*'s behalf. *T* accepts the offer. Both *P* and *A* are liable on the contract.

An agent who purports to act on behalf of a principal makes an implied warranty of authority to a third party. If the agent lacks the power to bind the principal, the agent is liable to the third party for breach of the implied warranty (unless the agent conveyed that he was not making such a warranty or the third party knew that the agent had no authority).⁴⁸ The agent may also be liable to the third party under a theory that he has tortiously misrepresented his authority.⁴⁹

Example: *A*, a mortgage broker claiming to act as agent for *P* Corporation, makes an oral contract to sell mortgage-backed securities owned by *P* Corporation to *T* Bank. *A* acted without actual, apparent, or inherent authority. *A* is subject to liability to *T* Bank for loss to *T* Bank resulting from *T* Bank's reliance on *A*'s implied representation that *A* had power to bind *P* Corporation.

Note

If an agent becomes a party to a contract under the general rules stated above, and if the third party breaches the contract in some manner, the third party may be liable to the agent. *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 6.03 cmt. e (2006) (“As a party to a contract made on behalf of an undisclosed principal, an agent may sue the third party in the agent's own name.”).

D. DUTIES OF THE AGENT AND THE PRINCIPAL TO EACH OTHER

1. THE AGENT’S DUTIES TO THE PRINCIPAL

An agency relationship has the important characteristic of being a *fiduciary* relationship. An agent is a fiduciary with respect to matters within the scope of his agency.⁵⁰ Basically, this means that an agent is held to a very high standard of conduct in carrying out his tasks for the principal. In general, an agent’s duties require the agent to act *loyally* and *carefully* when acting within the scope of the agency. Some examples of this loyalty obligation include the following: (1) an agent is accountable to the principal for any profits arising out of the transactions he is to conduct on the principal's behalf;⁵¹ (2) an agent must act solely for the benefit of the principal and not to benefit himself or someone else other than the principal;⁵² (3) an agent must refrain from

⁴⁸ *See* RESTATEMENT (SECOND) OF AGENCY § 329 (1958); RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006).

⁴⁹ *See* RESTATEMENT (SECOND) OF AGENCY § 330 (1958); RESTATEMENT (THIRD) OF AGENCY § 6.10 cmt. a (2006) (“An agent who falsely warrants authority may be subject to liability for fraud or negligent misrepresentation.”).

⁵⁰ *See* RESTATEMENT (SECOND) OF AGENCY § 13 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 1.01, 8.01 (2006).

⁵¹ *See* RESTATEMENT (SECOND) OF AGENCY § 388 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.02, 8.06.

⁵² *See* RESTATEMENT (SECOND) OF AGENCY § 387 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.01, 8.06 (2006).

dealing with his principal as an adverse party or from acting on behalf of an adverse party;⁵³ (4) an agent may not compete with his principal concerning the subject matter of the agency;⁵⁴ and (5) an agent may not use the principal's property (including confidential information) for the agent's own purposes or a third party's purposes.⁵⁵

As mentioned, the agency relationship requires an agent to act carefully as well. An agent "has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances."⁵⁶ Moreover, "[i]f an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents with such skills or knowledge."⁵⁷

In many circumstances, an agent also has a duty to disclose information to the principal. The agent must "use reasonable efforts give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person."⁵⁸ This disclosure obligation between parties in a fiduciary relationship differs dramatically from the lack of any duty to volunteer information in an arm's length transaction.

Example: *M* is looking for a site for his plant. He learns that *O* has a site for sale. The asking price is \$250,000. *M* and *O* negotiate and agree upon a price of \$247,500. In this negotiation, *O* does not disclose that he purchased the site for \$150,000 a few days before—information that would have been relevant to *M*'s decision to agree to the \$247,500 price. *O*'s failure to disclose this information is not a breach of any duty and *M* may not rescind the transaction.

Example: *P* retains *A* to purchase a suitable manufacturing site for him. *A* owns a suitable site which he offers to *P* for \$250,000, a fair price. *A* tells *P* all relevant facts except that a short time previously he purchased the site for \$150,000. *A* has breached his duty and the transaction may be rescinded by *P*.

An agent also has a duty to act only as authorized by the principal.⁵⁹ It should come as no

⁵³See RESTATEMENT (SECOND) OF AGENCY §§ 389, 391 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.03, 8.06 (2006).

⁵⁴See RESTATEMENT (SECOND) OF AGENCY § 393 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.04, 8.06 (2006).

⁵⁵See RESTATEMENT (SECOND) OF AGENCY §§ 395-396, 398, 402, 404, 422-423 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.05, 8.06, 8.12 (2006).

⁵⁶RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006); see RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

⁵⁷RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006); see RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

⁵⁸RESTATEMENT (SECOND) OF AGENCY § 381 (1958); see *id.* § 390 (imposing a duty to disclose on an agent who acts as an adverse party with the principal's consent); RESTATEMENT (THIRD) OF AGENCY §§ 8.06, 8.11 (1958).

⁵⁹See RESTATEMENT (SECOND) OF AGENCY §§ 383, 385 (1958); RESTATEMENT (THIRD) OF AGENCY § 8.09 (2006).

surprise, therefore, that an agent acting without actual authority is liable to his principal for any loss suffered by the principal (e.g., if an agent lacking actual authority binds the principal via apparent authority).⁶⁰

Example: *A* acts as *P* Insurance Co.'s agent for purposes of issuing policies of workers' compensation insurance. *A* issues a binder policy to *T*. *A* acts with apparent authority in issuing the policy but *A* issues it in a manner clearly prohibited by *A*'s agency agreement with *P* Insurance Co. *E*, an employee of *T*, suffers a job-related injury. *P* Insurance Company must pay the claim even though *A* acted without actual authority in issuing the policy. *A* exceeded *A*'s actual authority in issuing the insurance policy to *T*. *A* is subject to liability to *P* Insurance Co. for the amount of *E*'s claim against *P* Insurance Co. *A* is also subject to liability for any costs *P* Insurance Co. incurred in opposing *T*'s claim.

2. THE PRINCIPAL'S DUTIES TO THE AGENT

A principal's duties to an agent are not fiduciary in nature as fiduciary responsibilities run only from the agent to the principal.⁶¹ Nevertheless, a principal has several obligations to an agent. For example, a principal must perform his contractual commitments to the agent, must not unreasonably interfere with the agent's work, and must generally act fairly and in good faith towards the agent.⁶² Perhaps most importantly, if the agent incurs expenses or suffers other losses in carrying out the principal's instructions, the principal has a duty to indemnify the agent.⁶³

E. TERMINATION OF THE AGENT'S POWER

As previously discussed, the relationship between an agent and a principal is a consensual one.⁶⁴ Actual authority from that relationship terminates when the objective of the relationship has

⁶⁰See RESTATEMENT (SECOND) OF AGENCY §§ 399, 401 (1958); RESTATEMENT (THIRD) OF AGENCY § 8.09 (2006); *id.* § 8.09 cmt. b (“If an agent takes action beyond the scope of the agent's actual authority, the agent is subject to liability to the principal for loss caused the principal. The principal's loss may stem from actions taken by the agent with apparent authority, on the basis of which the principal became subject to liability to third parties. The principal's loss may include costs the principal incurs in defending against lawsuits brought against the principal by third parties.”); *see also id.* (“If an agent's action beyond the scope of the agent's actual authority causes loss to the principal, the agent is subject to liability to the principal for that loss even though the loss would have been greater had the agent acted consistently with the agent's actual authority. Were the rule otherwise, an agent might be tempted to act or to continue to act without actual authority in the hope that matters will turn out sufficiently well that the principal will not suffer loss. Moreover, the underlying premise of a relationship of agency is action by the agent that is consistent with the principal's manifestation of assent, not whether an agent's action is in fact beneficial to the principal.”).

⁶¹See Section XX.

⁶²See RESTATEMENT (SECOND) OF AGENCY §§ 432-437, 441 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 8.13, 8.15 (2006).

⁶³See RESTATEMENT (SECOND) OF AGENCY §§ 438-440 (1958); RESTATEMENT (THIRD) OF AGENCY § 8.14 (2006).

⁶⁴See Section XX.

been achieved, when the principal or the agent dies, and in a variety of other circumstances.⁶⁵ Actual authority also terminates when the principal revokes it or the agent renounces it.⁶⁶ If the agency relationship is based on contract, however, the decision to terminate actual authority may be a breach of that contract. Nevertheless, actual authority has ended, even though contractual liability may exist for its termination.⁶⁷ Stated differently, a principal or an agent always has the power to terminate actual authority, but he may not have the right.

Example: *P*, who owns a hotel, retains *A Corp.* to manage it. *P* and *A Corp.* enter into an agreement providing that, in exchange for *A Corp.*'s management services, *A Corp.* will receive a commission equal to five percent of the hotel's gross revenues. The agreement further provides that *A Corp.*'s authority shall be irrevocable by *P* for a period of 10 years. Two years later, *P* revokes. *A Corp.*'s actual authority is terminated, although *A Corp.* may have claims against *P* for breach of contract.

Because an inference of apparent authority may be based on the existence of prior actual authority, the termination of actual authority does not itself eliminate the apparent authority of an agent. It may be necessary to give notice of termination to third parties who dealt with the agent or who otherwise continue to believe that the principal has authorized the agent to act.⁶⁸

⁶⁵ See RESTATEMENT (SECOND) OF AGENCY §§ 105-124 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 3.06-3.10 (2006).

⁶⁶ See RESTATEMENT (SECOND) OF AGENCY § 117-119 (1958); RESTATEMENT (THIRD) OF AGENCY §§ 3.09-3.10 (2006).

⁶⁷ See RESTATEMENT (SECOND) OF AGENCY § 118 (1958); *id.* § 118 cmt. b (“The principal has power to revoke [authority] and the agent has power to renounce [authority], although doing so is in violation of a contract between the parties and although the authority is expressed to be irrevocable. A statement in a contract that the authority cannot be terminated by either party is effective only to create liability for its wrongful termination.”); RESTATEMENT (THIRD) OF AGENCY § 3.10(1) (2006); *id.* § 3.10 cmt. b (“A principal has power to revoke an agent's actual authority and the agent has power to renounce it. The power is not extinguished because an agreement between principal and agent states that the agent's actual authority shall be irrevocable or shall not be revoked except under specified circumstances. * * * Exercising the power to revoke or renounce may constitute a breach of contract.”).

⁶⁸ See RESTATEMENT (SECOND) OF AGENCY §§ 124A, 125 (1958); RESTATEMENT (THIRD) OF AGENCY § 3.11 (2006).