CHAPTER 1

AGENCY; THE SOLE PROPRIETORSHIP

1. THE SOLE PROPRIETORSHIP

The subject of this casebook is corporations and other business organizations. Business organizations take a variety of forms, some simple, some enormously complex. The most rudimentary form of business organization is the sole proprietorship, which is a firm that is owned by a single individual and is not cast in a legal form that can be utilized only by filing an organic document with the state under an authorizing statute.

The terminology business organization may seem to be an inappropriate characterization of a firm that has only a single individual owner and is not created pursuant to statute. However, there are two justifications for this characterization.

First, a firm that is wholly owned by an individual is nevertheless likely to have a degree of psychological and social identity separate from the individual. This separateness is often expressed by giving the firm its own name, like “Acme Shoe Company.” Furthermore, a sole proprietor usually will consider only a certain portion of her property and cash as invested in the firm, and will keep a separate set of financial records for the firm, as if the firm’s finances were separate from her own. Thus, if Alice Adams begins a new firm—say, Acme Shoe Company—she is likely to issue a balance sheet for Acme that does not show all of her assets and liabilities, but only those assets dedicated to, and those liabilities arising out, of the firm’s operations. In short, as a psychological matter Adams and those who deal with her are likely to regard Acme as an enterprise that has a certain degree of separateness from Adams herself and a certain dedicated amount of capital. As a matter of law, however, a sole proprietorship has no separate identity from its owner. All of a sole proprietor’s wealth is effectively committed to the firm, because an individual who owns a sole proprietorship has unlimited personal liability for obligations incurred in the conduct of the proprietorship’s business.

The second justification for considering a sole proprietorship to be an organization is that typically a sole proprietor does not conduct the proprietorship’s business by herself, but instead engages various people—managers, salespersons, technicians, and so forth—to act on her behalf, and subject to her control, in conducting the business. The employment by one person, P, of another, A, to act on P’s behalf, implicates the law of agency, which is an element of the law concerning
all forms of business organization. In short, the sole proprietorship form, simple as it is, implicates many of the basic issues in the law of business organizations—the internal structure of the organization; the location of control over the organization; the liability of owners for transactions engaged in by their agents; potential conflicts of interest between an organization and its agents; and conflicts of interest between an organization and those with whom it deals, such as creditors.

Although sole proprietorships are the most rudimentary form of business organization, and taken as a class account for substantially less income than corporations and several other forms, sole proprietorships are the most numerous type of business organization in the United States. Based on tax returns, in 2015 (the latest year for which the figures were available) there were 25.2 million sole non-farm proprietorships in the United States, with total gross receipts of $1.44 trillion. United States Internal Revenue Service, 37 Statistics of Income Bulletin Fall 2017, Sole Proprietorship Returns at 2–3.

2. AGENCY

RESTATEMENT THIRD §§ 2.01–2.03, 2.05, 3.01, 3.03, 3.06, 4.01–4.02, 6.01–6.03, 6.10, 8.14

[See Statutory Supplement*]

A. THE AUTHORITY OF AN AGENT

An agent is a person who by mutual assent acts on behalf of another and subject to the other’s control. The person for whom the agent acts is a principal. Agency law governs the relationship between agents and principals; the relationship between agents and persons with whom an agent deals, or purports to deal, on a principal’s behalf; and the relationship between principals and such persons. (For ease of exposition, persons with whom an agent deals, or purports to deal, on a principal’s behalf will be referred to as third persons). Principals are conventionally divided into three categories: disclosed, partially disclosed or unidentified, and undisclosed. A principal is disclosed if the third person is on notice both that the agent is acting on behalf of a principal and of the principal’s identity. A principal is partially disclosed or unidentified if the third person is on notice that the agent is acting on behalf of a principal, but is not on notice of the principal’s identity. A principal is

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* References in the Casebook to the Statutory Supplement are to Corporations and Other Business Organizations—Statutes, Rules, Materials, and Forms (M. Eisenberg ed., Foundation Press; revised annually).
undisclosed if the third person has no notice that the agent is acting on behalf of a principal rather than on his own behalf.

Agency is a consensual relationship. However, whether an agency relationship has been created does not turn on whether the parties either think of themselves as, or intend to be, principal and agent. Rather, "[a]gency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Restatement Third § 1.01. (In this Chapter the term Restatement Second refers to Restatement, Second, of Agency (1957), and the term Restatement Third refers to Restatement, Third, of Agency (2006).) "Whether a relationship is one of agency is a legal conclusion made after an assessment of the facts of the relationship and the application of the law of agency to those facts. Although agency is a consensual relationship, how the parties to any given relationship label it is not dispositive." Restatement Third § 1.02, Comment a.

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**Speed v. Muhanna**

Court of Appeals of Georgia, 2005.

274 Ga. App. 899; 619 S.E.2d 324.

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**BLACKBURN, PRESIDING JUDGE.**

... [O]n February 14, 1999, Speed injured his foot at a Sports Authority store. In November 1999, Speed retained Scott Zahler to represent him in pursuing any claims he might have “against Sports Authority, and any other Defendants later named or identified as a result of” the February 14 incident...

Over a year later, Speed was hospitalized at Henry Medical Center from January 9, 2002, to January 20, 2002, during which time he was treated by Muhanna for deep venous thrombosis in his right leg....

In June 2002, Zahler called Muhanna, told him that he was representing Speed in the premises liability case against Sports Authority, and asked Muhanna if he could depose him as Speed's treating physician in that case. When Muhanna wanted assurance that the action in which he was to be deposed was not a medical malpractice case, Zahler assured him that the case was against Sports Authority and not a medical malpractice case. Muhanna asked Zahler to put that assurance in writing.

On August 27, 2002, Zahler sent to Muhanna a letter, confirming... "that the subject matter of the deposition will be the care and treatment provided by you and Henry Medical Center in connection with Mr. Speed's medical condition. This is not a medical malpractice case and
neither now or in the future will you be subject to any type of malpractice claim.” (Emphasis supplied.)

Thereafter, Muhanna met with Zahler and gave his deposition as scheduled on September 10, 2002. During the deposition, Muhanna was questioned about his care and treatment of Speed during his January 2002 hospitalization at Henry Medical Center, as well as about any causal connections between Speed’s deep venous thrombosis and his prior foot injury at Sports Authority.

On January 8, 2004, using new counsel other than Zahler, Speed filed a medical malpractice suit against Muhanna alleging professional negligence in his care and treatment of Speed . . . . Muhanna filed an answer in which he asserted as a defense, among other things, that Speed had previously released any malpractice claim he might have against Muhanna and was thus barred from recovery in the action. On December 3, 2004, the trial court granted Muhanna’s motion for summary judgment as to Speed’s claim of medical malpractice on the ground that Zahler’s August 27, 2002 letter to Muhanna was a release of that claim. This appeal followed.

Speed argues that Zahler had no authority to release his claim against Muhanna. Speed points out that he retained Zahler to represent him in his premises liability case against Sports Authority, but never hired Zahler to pursue a medical malpractice claim against Muhanna; thus, Zahler had no authority to release the medical malpractice claim against Muhanna. We disagree.

As an initial matter, it appears that Zahler had been given actual authority to release Speed’s claims against Muhanna. In this case, Muhanna was contacted by Zahler, who represented Speed in his personal injury claims arising out of the incident which resulted in his injured foot. The only action pending at the time of contact was against Sports Authority. Zahler was authorized to investigate and pursue “any and all claims which [Speed] may have against Sports Authority, and any other Defendants later named or identified, as a result of” the incident at Sports Authority, and was making inquiries regarding Muhanna’s care and treatment of Speed prior to a severe deterioration in his medical condition. As Speed’s attorney, Zahler had authority to obtain Muhanna’s deposition testimony in exchange for payment as an expert witness or some other bargained-for exchange, such as a covenant not to sue or a release. When Muhanna expressed his reluctance to be deposed, Zahler assured Muhanna that “neither now or in the future [would he] be subject to any type of malpractice claim.” At no time did Zahler communicate to Muhanna any restrictions on his authority to act on Speed’s behalf. Thus, Zahler had actual authority to negotiate with Muhanna on Speed’s behalf.

Furthermore, even if he had not had actual authority to negotiate with Muhanna on Speed’s behalf, Zahler had apparent authority to do so...
Under Georgia law an attorney of record has apparent authority to enter into an agreement on behalf of his client and the agreement is enforceable against the client by other settling parties. This authority is determined by the contract between the attorney and the client and by instructions given the attorney by the client, and in the absence of express restrictions the authority may be considered plenary by the court and opposing parties. The authority may be considered plenary unless it is limited by the client and that limitation is communicated to opposing parties. Therefore, from the perspective of the opposing party, in the absence of knowledge of express restrictions on an attorney’s authority, the opposing party may deal with the attorney as if with the client, and the client will be bound by the acts of his attorney within the scope of his apparent authority. The client’s remedy, where there have been restrictions not communicated to the opposing party, is against the attorney who overstepped the bounds of his agency, not against the third party.


In this case, Zahler was representing Speed in the premises liability case against Sports Authority. Zahler’s authority from Muhanna’s perspective was plenary, and Zahler had apparent authority to elicit the cooperation and alliance of other potential defendants by giving assurances that no claim would be brought against them. Speed is bound by Zahler’s acts within the scope of that apparent authority.

Judgment affirmed.

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**NOTES ON SOURCES OF AGENT’S AUTHORITY**

Under the law of agency, a principal is liable to a third person on a contract entered into by an agent on the principal’s behalf if the agent had actual, apparent, or (traditionally) inherent authority to act on the principal’s behalf in the way that he did, or the principal ratified the act or transaction. Although a principal’s liability for an agent’s tortious and contractual transactions both reflect the concept that a principal may be responsible for acts of an agent, the two types of liability involve different requirements. Broadly speaking, a principal’s liability in tort requires a determination that the principal had the right to control the manner and means of the agent’s performance or work and that the agent acted within the scope of his employment. In contrast, a principal’s liability in contract requires a determination that the agent acted, or purported to act, on the principal’s behalf and had actual, apparent, or inherent authority to do so, or the
principal ratified the agent’s act. The various categories of authority will now be considered.

1. Actual Authority. An agent has actual authority to transact with third persons in a given manner on a principal’s behalf if the principal’s words or conduct would lead a reasonable person in the agent’s position to believe that the principal wishes the agent to so act. If an agent has actual authority to engage in a given type of transaction with a third person, and acts within the scope of that authority, the principal is bound to the third person.

Example I: 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 him, which states: “I authorize you to contract in my name for the purchase of 100 shares of GE stock at the market price.” A comes in, finds the note and, not knowing of P’s mistake, makes a contract with T, in P’s name, for the purchase of the GE shares. A had actual authority to make the contract.  

If an agent has actual authority to transact with a third person in a given way, and did, the principal is bound even if the third person did not know that the agent had actual authority, and indeed even if the principal was undisclosed, so that the third person thought the agent was herself the principal. Accordingly, an undisclosed principal is bound by his agent’s authorized transaction even though the agent purports to act strictly on her own behalf. One reason an undisclosed principal is bound is that she set the transaction in motion and stood to gain from it. A second reason is this: Even if the undisclosed principal was not directly liable to the third person, the agent would be. Therefore, the third person could sue the agent. If he did, the agent could then sue the principal for indemnification of the damages she had to pay the third person. (See Section 6 of this Note, infra.) Accordingly, allowing the third person to sue the undisclosed principal does not materially enlarge the principal’s liability and collapses the two lawsuits into one.

Actual authority is contractual, in that it arises out of an agreement between the principal and the agent. By and large, therefore, the scope of an agent’s actual authority is determined by the general principles of contract interpretation. There is, however, an important distinction between interpreting a conventional contract and interpreting an agency contact. Interpretation of a conventional contract usually focuses on the language of the contract and the surrounding circumstances when the contract was made. In contrast, interpretation of an agency contract is ambulatory, that is, it focuses on the reasonableness of the agent’s interpretation of his authority.

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1 In general, consensual but noncontractual transactions by an agent (for example, a filing) are treated the same as contractual transactions for agency-law purposes, and in any event do not often raise problems. Accordingly, what is said in this Note about contractual transactions normally applies to other consensual transactions as well.

2 All the Examples in this Note are literal or slightly modified versions of Illustrations in Restatement Second and Restatement Third. Examples written by the editors are labeled “Example,” followed by a roman numeral. Examples that are taken verbatim from the Restatement of Agency are labeled “Illustration,” followed by an Arabic numeral.
at the time he acts. As stated in Restatement Second § 33, Comments a and b:

a. Authority an ambulatory power.... [A]n agreement creating an agency relation has elements different from those of other contracts.... Whatever the original agreement or authority may have been, [an agent] is authorized at any given moment to do, and to do only, what he reasonably believes the principal desires him to do, in the light of what he knows or should know of the principal's purpose and the existing circumstances. [If the agent] knows facts which should lead him to believe that his authority is restricted or terminated, he has a duty to act only within the limits of the situation as it is currently known to him.

Illustrations....

2. P, the owner of a factory running on half time for lack of orders, before leaving for his vacation, directs his purchasing agent to "put in our usual monthly coal supply of 1000 tons." The following day a large order comes in which will immediately put the factory on full running time. It may be found that A is authorized to purchase sufficient coal to keep the factory running, this depending upon whether or not P can easily be reached, the amount of discretion usually given to A, the condition of P's bank balance, and other factors.

b. Authority distinct from contract of agency. An agent is a fiduciary under a duty to obey the will of the principal as he knows it or should know it. This will may change, either with or without a change in events. Whatever it is at any given time, if the agent has reason to know it, his duty is not to act contrary to it.... Thus, whether or not the agent is authorized to do a particular act at a particular time depends, not only on what the principal told the agent, but upon a great variety of other factors, including changes in the situation after the instructions were given. The interpretation of authority, therefore, differs in this respect from the interpretation of a contract, even the contract of agency.

The agent's authority may therefore be increased, diminished, become dormant or be destroyed, not only by further manifestations by the principal but also by the happening of events, dependent, in many situations, upon what the agent knows or should know as to the principal's purposes.

Restatement Third § 2.02, Comment c, makes essentially the same point: "[Q]uestions of interpretation that determine whether an agent acted with actual authority have a temporal focus that moves through time as the agent decides how to act, while questions of contractual interpretation focus on the parties' shared meaning as of the time of a promise or agreement." This point is exemplified by Illustrations 8 and 9:

8. [The directors of P Corporation approve a plan to upgrade a plant that is suitable for the manufacture of one product line. P Corporation's Executive Vice President tells M, the plant manager,
to contract with an engineering firm for a redesign of the production process that must precede the upgrade work. After adopting the resolution, the directors abandon the upgrade plan and so notify the Executive Vice President. No one tells M, but] M reads in the newspaper that P Corporation's directors have discontinued the sole product line manufactured in the plant. M no longer has actual authority to make the contract with T.

9. Same facts as [the bracketed language of Illustration 8], except that the upgrade plan depends on using a particular building technology. M is aware of this fact. After the directors adopt the resolution and M is directed to contract for the redesign work, M learns that regulatory restrictions will prevent P Corporation from using the particular technology on which the plan depends. M no longer has actual authority to make the contract with T.

2. **Actual Authority by Implication.** Actual authority may be either express or implied. "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. Thus, in the authorization to 'sell my automobile', the only fully expressed power is to transfer title in exchange for money or a promise to give money. In fact, under some circumstances ... there may ... be power to take or give possession of the automobile or to extend credit or to accept something in partial exchange. These powers are all implied or inferred from the words used, from customs and from the relations of the parties. They are described as 'implied authority.'" Restatement Second § 7, Comment c; see also Restatement Third § 2.02, Comment b.

A common type of implied actual authority is **incidental authority**, which is the authority to do incidental acts that are reasonably necessary to accomplish an actually authorized transaction or that usually accompany a transaction of that type. Here are two examples:

**Example II:** 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 has implied actual authority to employ a licensed auctioneer.

**Example III:** P authorizes A, a local broker, to sell land on P's behalf. It is the custom to make such sales by delivering a deed with certain covenants as to title. A has implied actual authority to execute and deliver proper deeds to purchasers and to insert in the deeds the usual covenants as to title.

3. **Apparent Authority.** An agent has apparent authority to act in a given way on a principal's behalf in relation to a third person if manifestations of the principal to the third person (or manifestations by the agent to the third person that the principal authorized the agent to make) would lead a reasonable person in the third person's position to believe that the principal had authorized the agent to so act. If an agent has apparent
authority and acts within the scope of that authority, the principal is bound. Here are four examples:

Example IV: P writes to A directing him to act as his agent for the sale of Blackacre. P sends a copy of this letter to T, a prospective purchaser. A has actual authority to sell Blackacre and, as to T, apparent authority.

Example V: Same facts as in Example IV, except that in the letter to A, P adds a postscript, not included in the copy to T, telling A to make no sale until after communication with P. A has no actual authority to sell Blackacre, but as to T, A has apparent authority.

Example VI: Same facts as in Example IV, except that after A and T have received the letters, P telegraphs a revocation to A. A has no actual authority to sell Blackacre, but as to T, A has apparent authority.

Example VII: P owns a granary and employs A to manage it. A's employment agreement with P states that A's authority to purchase grain is limited to transactions that do not exceed $5,000; larger purchases require P's express approval. This limit is unusual in the granary business. P directs A to tell T, a seller of grain, that A's authority to purchase grain is unlimited, because P believes this will induce T to give orders placed by A priority over orders placed by agents with limited authority. A represents to T that his authority to purchase grain is unlimited, and enters into a contract with T, on P's behalf, to buy $10,000 worth of grain. P is bound by the contract with T. A has actual authority to make the representation to T, and A has apparent authority to enter into the contract with T, because T reasonably believes A has authority to bind P to a contract to buy $10,000 worth of grain.

In most cases, actual and apparent authority go hand in hand, as Example IV suggests. For example, if P Bank appoints A as cashier, and nothing more is said, A will reasonably believe he has the authority that cashiers normally have (actual authority), and third persons who deal with A will reasonably believe the same thing (apparent authority). Apparent authority becomes salient in such a case if P Bank does not actually give A all the authority that cashiers usually have, and a customer deals with A, knowing that A is a cashier, but not knowing that P Bank has placed unusual limits on A's authority.

The apparent authority of A in the cashier hypothetical is a special type of apparent authority known as power of position. "[A]pparent 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." Restatement Second § 27, Comment a.

Example VIII: P bank appoints A as an information clerk, with authority only to answer depositors' questions. During alterations,
however, the bank directs A to occupy the space normally occupied by one of the tellers, and puts up a sign that says “Information Window.” The sign becomes displaced, and T, a depositor in the bank, makes a cash deposit with A, believing that A is a teller. P is bound by this transaction.

4. **Agency by Estoppel.** Another type of authority is known as “agency by estoppel.” The core of agency by estoppel is described as follows in Restatement Third § 2.05:

A person who has not made a manifestation that an actor has authority as an agent and who is not otherwise liable as a party to a transaction purportedly done by the actor on that person’s account is liable to a third party who is induced to make a detrimental change in position because the transaction is believed to be on the person’s account, if

1. the person intentionally or carelessly caused such belief, or

2. having notice of such a belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts.

Agency by estoppel is so close to apparent authority that for most practical purposes the former concept can be subsumed in the latter.

5. **Inherent Authority.** Under the doctrine of inherent authority, an agent may bind a principal in certain cases even when the agent had neither actual nor apparent authority. Restatement Second § 161 concerned the inherent authority of a general agent of a disclosed or partially disclosed principal. (Restatement Second § 3 defined a general agent as an agent who is authorized to conduct a series of transactions involving continuity of service. In contrast, a special agent was defined as an agent who is authorized to conduct only a single transaction, or only a series of transactions not involving continuity of service.)

This section provided that such a principal is liable for an act done on his behalf by a general agent even though the principal had forbidden the agent to do the act, if (i) the act usually accompanies or is incidental to transactions that the agent is authorized to conduct, and (ii) the third person reasonably believes the agent is authorized to do the act. Restatement Second § 194 concerned the inherent authority of agents of undisclosed principals. This Section provided that “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.” Restatement Second § 194 did not require that the third person

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3 Restatement Third § 2.01, Comment d states:

*General and special agents.* Courts have long distinguished between “general agents” and “special agents,” a distinction that rests on both the objects of the discretion granted an agent and the mode of regulating the agent’s exercise of discretion. The labels matter less than the underlying circumstances that warrant their application. The prototypical special agent is a real-estate broker who is authorized to conduct a single transaction. A special agent may also be authorized to conduct a series of transactions specified by the principal. The prototypical general agent is a manager of a business, who has authority to conduct a series of transactions and who serves the principal on an ongoing as opposed to an episodic basis. . . .
reasonably believed the agent was authorized to act. Indeed, such a requirement could not be imposed, because in the case of an undisclosed principal the third person will not know that he is dealing with an agent.

A major rationale of inherent authority, given in Restatement Second, is based on an analogy to the doctrine of respondeat superior:

...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. . . .

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... [The principal’s liability under the doctrine of inherent authority] is based primarily upon the theory that, if one appoints an agent to conduct a series of transactions over a period of time, it is fair that he should bear losses which are incurred when such an agent, although without authority to do so, does something which is usually done in connection with the transactions he is employed to conduct. Such agents can properly be regarded as part of the principal’s organization in much the same way as a servant is normally part of the master’s business enterprise. . . . The basis of [inherent authority] 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 rules imposing liability upon the principal for some of the contracts and conveyances of a general agent, whether or not a servant, which he is neither authorized nor apparently authorized to make, are based upon a similar public policy. 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.

Restatement Second § 8A, Comment a, § 161, Comment a.

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* Recall that the terms “master” and “servant” have technical meanings in agency law. (Footnote by ed.)
An alternative rationale for the doctrine of inherent authority is based on the principal's reasonable expectations. In a world with perfect information, faithful agents will follow all instructions impeccably. In the real world, however, agents acting in good faith will not infrequently deviate from their instructions, because agents, like everyone else, will make mistakes, which may take the form of misinterpreting their instructions or forgetting one of numerous instructions. Furthermore, an agent may reasonably believe that his principal's objective is best served by violating a particular instruction. A principal's instructions to her agent are necessarily given in the present to govern the future. The future, however, may develop in such a way that the agent reasonably believes that if the principal knew all the facts, she would not want the agent to follow a given instruction. Usually in such cases the agent could go back to the principal for further instructions. Sometimes, however, it is infeasible to take that course of action—for example, because a valuable opportunity must be taken immediately or not at all. These real-world facts are reflected in a passage in the Comment to Restatement Second § 8A: "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."

Given these realities, the doctrine of inherent authority is justified on the ground that it is or should be foreseeable to a principal, when he appoints an agent, that as a practical matter the agent, acting in good faith for the benefit of the principal, is likely to deviate occasionally from instructions. As between the principal—who appointed the agent, benefits from the agent's activities, and could or should have foreseen a certain range of deviations from his instructions to the agent—on the one hand, and the third person who contracts with the agent, on the other, a loss that results from a foreseeable deviation by the agent is better placed on the principal.

Restatement Third does not use the term "inherent agency power," on the ground that "[o]ther doctrines stated in this Restatement encompasses the justifications underpinning [the concept of inherent agency] including the importance of interpretation by the agent in the agent's relationship with the principle. . . ." Id. § 2.01 Comment b. The omission of the explicit term, inherent authority, from Restatement Third is unfortunate, but in various places the text and Comment of Restatement Third adopt positions that can best or only be explained by the concept of inherent authority. For example, Restatement Third § 2.02(2) defines the scope of actual authority in an expansive manner:

An agent's interpretation of the principal's manifestations is reasonable if it reflects any meaning by the agent to be ascribed by the principal and, in the absence of any meaning known to the agent, as a reasonable person in the agent's position would interpret the manifestations in light of the context, including circumstances of which the agent has notice. . . .
Comment b to this section makes clear that in determining an agent's actual authority, a literal interpretation of the principal's manifestations does not always govern:

An agent's understanding of the principal's interests and objectives is an element of the agent's reasonable interpretation of the principal's conduct. If a literal interpretation of a principal's communication to the agent would authorize an act inconsistent with the principal's interests or objectives known to the agent, it is open to question whether the agent's literal interpretation is reasonable.

Correspondingly, the Comment recognizes that an agent may properly act in a way that is knowingly at variance with the principal's original instructions if the agent believes that circumstances have changed since the initial instructions, if the principal were to reconsider the matter, different instructions would have been given, and it is impracticable to communicate with the principal for further clarification before action needs to be taken. For example, Restatement Third § 2.02, Illustration 22, provides:

[Blackacre is to be sold at an auction. P retains A to bid at the auction on P's behalf, directing A to buy Blackacre but to offer no more than $250,000.] P owns and operates a golf course on land that almost entirely surrounds Blackacre. A has notice of P's long-term business plan to enhance the aesthetic and athletic qualities of the course and thereby make it more profitable. At the auction of Blackacre, A learns for the first time that there will be one other bidder, B. A also learns that B's plan for using Blackacre is to construct a cement factory on it. A is unable to contact P to relay this information and receive further instructions. A succeeds in purchasing Blackacre for P by bidding $260,000. A acted with actual authority.

Similarly § 2.02, Illustration 5, provides:

P Corporation employs A as the Facilities Manager at an amusement park owned by P Corporation. A reports to B, P Corporation's Vice President for Leisure Activities. B directs A to arrange for the reseeding of the badly deteriorated lawn adjacent to the park's entrance. B also directs A to complete the reseeding by the end of the week. A purchases grass seed and directs groundskeepers to schedule time for reseeding. A then learns that the park location is in the path of a forecasted hurricane. A has actual authority to postpone the reseeding.

6. Termination of Agent's Authority. As a general rule, a principal has the power to terminate an agent's authority at any time, even if doing so violates a contract between the principal and the agent, and even if it had been agreed that the agent's authority was irrevocable. This rule rests largely on the ground that contracts relating to personal services will not be specifically enforced. (There is an important but limited exception to this rule, which applies to a type of relationship known as an agency (or power) coupled with an interest. This exception will be discussed in Chapter 8,
infra.) However, such a contract is effective to create liability for damages for wrongful termination. Here is an example:

*Example XI:* In consideration of A's agreement to advertise and give his best energies to the sale of Blackacre, its owner, P, grants to A “a power of attorney, irrevocable for one year” to sell it. A advertises and spends time trying to sell Blackacre. At the end of three months P informs A that he revokes. A's authority is terminated, but A has a right to damages for breach of contract.

What result if an agent forges the principal's name on an agreement with a third party while acting within the scope of the agent's apparent authority? Dreier represented Gardi in negotiating a settlement with JANA. While JANA had agreed to settle the dispute by paying Gardi $6.3 million, the parties disagreed whether the settlement should impose only unilateral or mutual obligations on the parties not to disparage the agreement. Gardi wanted the provision to be binding on both parties while JANA wished the provision to bind only Gardi. Dreier forged Gardi's signature on the version of the settlement agreeing only to unilateral non-disparagement. He then directed the settlement fund be issued to his trust account from which he embezzled the funds. When his skullduggery was discovered, Gardi sued JANA to reopen the dispute, arguing it was not bound by the settlement due to Dreier's forgery. The court reasoned:

Dreier served as the conduit for all the communications between his clients and JANA; there is no evidence that Gardi dealt with JANA. JANA was justified in believing that the ...[settlement] contained Gardi's signature. As a result of Dreier's fraud, JANA paid over $6.3 million, and should not be compelled to pay a second time. As between the Gardi Parties and JANA, the injury by Dreier's fraud must be allocated to the Gardi Parties, Dreier's principals.


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**Morris Oil Co. v. Rainbow Oilfield Trucking, Inc.**

_New Mexico Court of Appeals, 1987._

106 N.M. 237, 741 P.2d 840.

**GARCIA, JUDGE. ...**

Defendant Dawn appeals from the judgment rendered against it in favor of Morris Oil Company, Inc. (Morris), based upon a determination that Rainbow Oilfield Trucking, Inc. (Rainbow) was Dawn's agent when it incurred indebtedness with Morris. We affirm the trial court.
FACTS

Appellant Dawn, the holder of a certificate of public convenience and necessity, is engaged in the oilfield trucking business in the Farmington area. Rainbow was a New Mexico corporation established for the purpose of operating an oilfield trucking business in the Hobbs area. Defendant corporations entered into several contracts whereby Rainbow would be permitted to use Dawn’s certificate of public convenience and necessity in operating a trucking enterprise in Hobbs. Dawn reserved the right to full and complete control over the operations of Rainbow in New Mexico. Dawn was to collect all charges due and owing for transportation conducted by Rainbow and, after deducting a $1,000 per month “clerical fee” and a percentage of the gross receipts, was to remit the balance to Rainbow. Under a subcontract entered into by defendants, Rainbow was to be responsible for payment of operating expenses, including fuel; further, the subcontract provides that all operations utilizing fuel were to be under the direct control and supervision of Dawn. All billing for services rendered by Rainbow would be made under Dawn’s name, with all monies to be collected by Dawn.

Defendants also entered into a terminal management agreement which provided that Dawn was to have complete control over Rainbow’s Hobbs operation. The agreement further recited that Rainbow was not to become the agent of Dawn and was not empowered to incur or create any debt or liability of Dawn “other than in the ordinary course of business relative to terminal management.” The agreement recited that Rainbow was to be an independent contractor and not an employee, and that liability on the part of Rainbow for creating charges in violation of the agreement would survive the termination of the agreement. Dawn was to notify Rainbow of any claim of such charges whereby Rainbow would assume the defense, compromise or payment of such claims.

Rainbow operated the oilfield trucking enterprise under these contractual documents, during which time Rainbow established a relationship with plaintiff Morris, whereby Morris installed a bulk dispenser at the Rainbow terminal and periodically delivered diesel fuel for use in the trucking operation. The enterprise proved unprofitable, however, and Rainbow ceased its operations and ultimately declared bankruptcy, owing Morris approximately $25,000 on an open account.

When Morris began its collection efforts against Rainbow, it determined that Rainbow had ceased its operations, everyone associated with Rainbow had moved back to Texas and it did not appear likely that the account would be paid. Morris was directed by Rainbow’s representative in Texas to Dawn for payment of the account.

When Rainbow ceased its operations, Dawn was holding some $73,000 in receipts from the Hobbs operation. Dawn established an escrow account through its Roswell attorneys to settle claims arising from Rainbow’s Hobbs operation. When Morris contacted Dawn with regard to the outstanding account, it was notified of the existence of the
escrow account and was asked to forbear upon collection efforts, indicating that payment would be forthcoming from the escrow account. Dawn’s representatives indicated that it was necessary to wait for authorization from Rainbow’s parent Texas corporation before paying the account. At no time did Rainbow or Dawn question the amount or legitimacy of Morris’ open account balance.

Dawn’s principal [owner] further testified that the subcontract and terminal management agreement were cancelled by Dawn when he learned that Rainbow was incurring debts in Dawn’s name. The charges owing to Morris, however, were incurred in the name of Rainbow and not Dawn.

Although some claims were paid from the attorneys’ escrow account established by Dawn, there was no explanation at trial why the Morris claim was not paid. When Morris learned that the escrow funds had been disbursed without payment of its charges, it instituted this action and also sought to garnish the remaining $13,000 held by Dawn from the impounded funds. Rainbow did not defend, and the trial court entered a default judgment against Rainbow, from which it does not appeal.

DISCUSSION

The trial court found that Dawn retained the right to direct control and supervision of Rainbow’s New Mexico operations, and that in the course of those operations, Rainbow incurred a balance of almost $25,000 on an open account with Morris for fuel used in the New Mexico operations. The trial court further found that when Rainbow defaulted on payments on Morris’ account, Dawn made representations over a period of time concerning the existence of a fund held by Dawn to settle indebtedness created by Rainbow operating under the subcontract. The court determined that Morris delayed its collection efforts pending disbursement of the funds, and that Dawn was aware that Morris was relying upon Dawn’s representations that payment would be made from the impounded fund. The trial court concluded that Rainbow was at all times in its dealings with Morris the agent of Dawn and, therefore, Dawn was responsible for the account balance.

Dawn urges one point of error on appeal; that the trial court erred in finding liability based on a principal-agent relationship between the defendants. Dawn relies upon the language in the terminal management agreement which states:

4. Rainbow is not appointed and shall not become the agent of Dawn and is not empowered to incur or create any debt or liability of Dawn other than in the ordinary course of business relative to terminal management. Rainbow shall not enter into or cause Dawn to become a party to any agreement without the express written consent of Dawn.

5. Rainbow shall be considered an independent contractor and not an employee of Dawn.
Dawn's reliance upon these paragraphs of the agreement is unpersuasive for two reasons. First, the agreement specifically states that Rainbow may create liabilities of Dawn in the ordinary course of business of operating the terminal. There is no question that the liability to Morris was incurred in the ordinary course of operating the trucking business. Second, the recitation of the parties in their contractual documents need not bind third parties who deal with one of them in ignorance of those instructions. See South Second Livestock Auction, Inc. v. Roberts, 69 N.M. 155, 364 P.2d 859 (1961); see also Great Northern R.R. Co. v. O'Connor, 232 U.S. 508, 34 S.Ct. 380, 58 L.Ed. 703 (1914).

While Dawn argues from cases discussing apparent authority, we view this as a case of undisclosed agency. Rainbow contracted in its own name and not in the name of Dawn Enterprises, Inc. Thus, this case involves concepts relating to undisclosed agency rather than to apparent authority, and is governed by principles of undisclosed principal-agent contracts. See, e.g., 3 Am.Jur.2d Agency § 316 (1986).

It is well established that an agent for an undisclosed principal subjects the principal to liability for acts done on his account if they are usual or necessary in such transactions. Restatement Second § 194 (1958). This is true even if the principal has previously forbidden the agent to incur such debts so long as the transaction is in the usual course of business engaged in by the agent. Id.

The indebtedness in the instant case is squarely governed by well-established principles of agency where an undisclosed principal entrusts the agent with the management of his business. The undisclosed principal is subject to liability to third parties with whom the agent contracts where such transactions are usual in the business conducted by the agent, even if the contract is contrary to the express directions of the principal. Restatement Second § 195 (1958).

Dawn's reliance upon Bloodgood v. Woman's Ben. Ass'n, 13 P.2d 412 (N.M. 1932) is misplaced. Indeed, the case stands for the proposition that a principal may limit an agent's authority, and further, that the limitation will be binding upon a third party dealing with the agent if the third party has knowledge of the limitation of authority. Here there is no evidence that Morris had any actual knowledge of the existence of the Rainbow-Dawn agency, let alone any claimed limitations by Dawn on Rainbow's authority. It is undisputed that Morris thought it was dealing solely with Rainbow when it sold fuel.

Morris correctly observes that secret instructions or limitations placed upon the authority of an agent must be known to the party dealing with the agent, or the principal is bound as if the limitations had not been made. Chevron Oil Co. v. Sutton, 515 P.2d 1283 (N.M. 1973) . . .

Moreover, assuming arguendo that Dawn was not responsible for the indebtedness to Morris for the reasons urged on appeal, it is clear that Dawn ratified the open account after learning of its existence when

It was undisputed that in several telephone conversations between the principals of Dawn and Morris, the material facts of the Morris open account were disclosed to Dawn. At no time did Dawn dispute the legitimacy or amount of the open account, and indeed assured Morris that payment would be forthcoming from the funds retained from Rainbow’s revenues. Despite this, Dawn used the fund to pay itself a $1,000 per month clerical fee, to pay legal fees incurred as a result of its agency with Rainbow and to settle other claims arising from the Rainbow operations. Where the principal retains the benefits or proceeds of its business relations with an agent with knowledge of the material facts, the principal is deemed to have ratified the methods employed by the agent in generating the proceeds. See id. See also 3 Am.Jur.2d Agency § 194 (1986). The diesel fuel provided by Morris was used in Rainbow’s trucking operation. Dawn collected the receipts due to Rainbow. Dawn seeks to retain the benefits of the agency with Rainbow, and yet at the same time disclaims responsibility for the business of the agent by which the benefits were generated. This it cannot do. Ulibarri Landscaping Material, Inc. v. Colony Materials, Inc.

In sum, for the foregoing reasons, we affirm.

IT IS SO ORDERED. . . .

BIVINS and MINZNER, JJ., concur.

NOTES ON LIABILITY OF AGENTS WHO ACTED FOR DISCLOSED, PARTIALLY DISCLOSED, OR UNDISCLOSED PRINCIPAL

1. Disclosed Principal. If the principal was disclosed (that is, at the time of the transaction the third person had notice that the agent was acting on behalf of a principal, and also had notice of the principal's identity), and is bound by the agent's act because the agent had actual, apparent, or inherent authority or because the principal ratified the act, the general rule is that the agent is not bound to the third person. See Restatement Third § 6.01. The theory is that in such a case the third person did not expect the agent to be bound, he did expect the principal to be bound, and he should get just what he expected.

2. Undisclosed Principal. If a principal was undisclosed (that is, if at the time of the transaction the agent purported to act on his own behalf), the general rule is that the agent is bound even though the principal is also bound. See Restatement Third § 6.03. The theory is that the third person must have expected the agent to be a party to the contract, because that is how the agent presented the transaction. However, there is a quirk in the
law here. Under the traditional majority rule if the third person, after learning of an undisclosed principal's identity, obtains a judgment against the principal, the agent is discharged from liability even if the judgment is not satisfied. Similarly, if the third person obtains a judgment against the agent, the undisclosed principal is discharged from liability. Under the minority but better rule, neither the agent nor the principal is discharged if the third person obtains a judgment against the other, but instead is discharged only if the judgment is satisfied only by satisfaction of the judgment. This rule is adopted in Restatement Third § 6.09.

3. Partially Disclosed Principal. If the principal was partially disclosed (that is, if at the time of the transaction the third person had notice that the agent was acting on behalf of a principal, but did not have notice of the principal's identity), the general rule is that both the agent and the principal are bound to the third person. See Restatement Third § 6.02. The theory is that if the third person did not know the identity of the principal, and therefore could not investigate the principal's credit or reliability, he probably expected that the agent would be liable, either solely or alongside the principal.

NOTE ON RATIFICATION

Even if an agent has neither actual, apparent, nor inherent authority, the principal will be bound to the third person if the agent purported to act on the principal's behalf and the principal, with knowledge of the material facts, either (1) affirmed the agent's conduct by manifesting an intention to treat the agent's past conduct as authorized, or (2) engaged in conduct that is justifiable only if he has such an intention.

Manifesting an intention to treat an agent's conduct as authorized is sometimes known as express ratification. Here is an example:

Example IX: A, who has no authority to bind P, purports to represent P in buying a horse from T. Later, P affirms the transaction. By that act, P becomes a party to the transaction.

Engaging in conduct that is justifiable only if the principal intends to treat the agent's conduct as authorized is sometimes known as implied ratification. The most common example occurs where as a result of the purported agent's transaction, the principal, with knowledge of the facts, receives or retains something to which he would otherwise not be entitled:

Example X: P owns an advertising agency and employs A to service existing clients by purchasing space for the clients 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 retains an 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.
Ratification need not be communicated to the third person to be effective, although it must be objectively manifested by the principal. See Restatement Third § 4.01, Comment d. To be effective, however, a ratification must occur before either the third person has withdrawn or there has been a material change in circumstances that would make it inequitable to bind the third party unless the third party chooses to be bound. See Restatement Third § 4.05.

As Restatement Second § 82, Comment c pointed out, “The concept of ratification . . . is unique. It does not conform to the rules of contracts, since it can be accomplished without consideration to or manifestation by the purported principal and without fresh consent by the other party.” Restatement Third § 4.01, Comment b, provides the following rationale for the doctrine of ratification:

Ratification often serves the function of clarifying situations of ambiguous or uncertain authority. A principal’s ratification confirms or validates the 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. See § 2.03. If the principal ratifies the agent’s act, it is thereafter not necessary to establish that the agent acted with apparent authority . . . .

A related but different rationale for the doctrine was stated by Judge Posner in Goldstick v. ICM Realty, 788 F.2d 456, 460 (7th Cir. 1986):

... The best explanation [of the concept of ratification] may be that the principal would not have ratified the contract unless he had seen a commercial advantage in doing so, and that the advantage would be less if the ratification had no binding effect. Ordinarily a principal ratifies an agent’s unauthorized transaction in order to protect the principal’s relationship with the other party to the transaction, usually a customer or supplier: and for ratification to have this protective effect it has to be more than an idle gesture, signifying nothing because unenforceable.

A concept that is comparable to, but different from, ratification is authority by acquiescence. “[I]f the agent performs a series of acts of a similar nature, the failure of the principal to object to them is an indication that he consents to the performance of similar acts in the future under similar conditions.” Restatement Second § 43, Comment b. See also Restatement Third § 2.02, Comment b. Suppose, for example, an agent engages in a series of comparable purchases on the principal’s behalf. Prior to the first purchase, a reasonable person in the agent’s position would not have thought he had authority to enter into such a transaction. Nevertheless, the principal did not object to that purchase or to later comparable purchases when she learned of them. At that point, a reasonable person in the agent’s position would assume that the principal approved the agent’s engaging in such purchases. Accordingly, the principal’s acquiescence gives rise to actual authority and as to third persons who know of the acquiescence, the acquiescence also gives rise to apparent authority.
NOTES ON THIRD PERSON’S LIABILITY

The general rule is that if an agent enters into a contract with a third person on behalf of a principal and the agent’s principal is liable to the third person under the contract, then the third person is liable to the principal. See Restatement Third §§ 6.01–6.03. The major exception is that the third person is not liable if the principal is undisclosed and the agent or the principal knew that the third person would not have knowingly dealt with the principal. See Restatement Third § 6.03, Comment d. Where an agent has entered into a contract with a third person on behalf of a principal, whether the agent will be liable to the third person depends in the first instance on whether the principal is bound to the third person. If the agent had actual, apparent, or inherent authority, or the principal ratified the agent’s act, so that the principal is bound to the third person, the agent’s liability to the third person largely depends on whether the principal was disclosed, undisclosed, as discussed earlier.

1. Where the Principal Is Not Bound. If the principal is not bound by the agent’s act, because the agent did not have actual, apparent, or inherent authority, and the agent’s act was not ratified, the general rule is that the agent is liable to the third person. The agent’s liability in such cases is usually based on the theory that an agent makes an implied warranty of authority to the third person. However, a few authorities have adopted a theory that the agent can be held liable on the contract itself. In principle, the difference between the two theories might lead to a difference in the measure of damages: Under the liability-on-the-contract theory, the third person will recover against the agent the gains that the third person would have earned under the contract—essentially, expectation damages. In contrast, under the implied-warranty theory it might seem that the third person would recover only the losses he suffered by having entered into the transaction—essentially, reliance damages. However, both Restatement Second and Restatement Third, while adopting the implied-warranty theory, provide for an expectation measure of damages, just as if the liability-on-the-contract theory had been adopted. See Restatement Third § 6.10.

2. Liability of Agent to Principal. If an agent takes an action that he has no actual authority to perform, but the principal is nevertheless bound because the agent had apparent authority, the agent is liable to the principal for any resulting damages. See Restatement Third § 8.09, Comment b. Whether an agent is liable to the principal on the basis of an act that binds the principal by virtue of the agent’s inherent but not actual authority is unsettled.

3. Liability of Principal to Agent. If an agent has acted within his actual authority, the principal is under a duty to indemnify the agent for payments the agent made that were made necessary in executing the principal’s affairs. These include the following: (i) Authorized payments made by the agent on the principal’s behalf. (ii) Payments made by the agent to a third person under a contract on which the agent was authorized to make
himself liable (for example, where the agent acted on behalf of a partially disclosed or undisclosed principal). (iii) Payments of damages to third persons that the agent incurs because of an authorized act that constituted a breach of a contract with the third person for which the agent was liable to the third person. (iv) Expenses in defending actions brought against the agent by a third person because of the agent’s authorized conduct. See Restatement Third § 8.14.

B. THE AGENT’S TORTIOUS CONDUCT

A central element of the law of agency is the liability, if any, of the principal to a third person with whom the agent interacts. This kind of liability falls into two broad classes: liability for contracts made or purported to be made by the agent on the principal’s behalf, examined above, and liability for an agent’s torts.

The liability of a principal for a tort committed by his agent is commonly referred to as either vicarious liability, respondeat superior (“let the master answer”), or enterprise liability. These three terms have slightly different connotations, but at bottom they express the same idea, which has been well-summarized by Professor Fishman:

The adoption of enterprise liability under respondeat superior is justified on several policy grounds. First, the ability of the enterprise to spread the risk from losses is important. The enterprise is in a better position than . . . the injured third person to spread the risk of loss, either through insurance or the ability to factor the potential losses into the price for the goods produced. A second reason suggests that proper allocation of resources is promoted by requiring an enterprise to include in the price of its goods the costs of the accidents which are closely associated with the enterprise’s operations. A third reason . . . is that the [principal] is in a position to control the employee and placing the risk of loss here could lead to greater safety. A fourth reason is that it is considered more equitable to place the liability on the [principal], because it provides greater assurance that the accident victim will be paid, or because there is a societal preference to make certain losses costs of doing business rather than losses to be borne by individual households.


In the context of vicarious liability for an agent’s torts, traditionally a principal was referred to as a master and an agent was referred to as a servant. This approach was adopted in Restatement Second § 2, which defined a master as a principal who controls, or has the right to control, the physical conduct of an agent in the performance of the agent’s services, and a servant as an agent whose physical conduct in the
performance of services for the principal is controlled by or subject to the control of the principal. Restatement Second § 216 provided that a master was liable for the torts of his servants committed in while acting in the scope of their employment. Restatement Second § 228 defined the term scope of employment for this purpose as follows:

(1) Conduct of a servant is within the scope of employment if, but only if:

(a) it is of the kind he is employed to perform;
(b) it occurs substantially within the authorized time and space limits;
(c) it is actuated, at least in part, by a purpose to serve the master, and
(d) if force is intentionally used by the servant against another, the use of force is not unexpectable by the master.

(2) Conduct of a servant is not within the scope of employment if it is different in kind from that authorized, far beyond the authorized time or space limits, or too little actuated by a purpose to serve the master.

Restatement Third adopts a different terminology and a different test for vicarious liability. Rather than using the terms master and servant, Restatement Third uses the terms principal and employee. Under § 7.07(3), for the purpose of determining a principal's vicarious liability in tort, an “employee” is defined as an agent whose principal "controls or has the right to control the manner and means of the agent's performance of work...." Restatement Third § 7.07 also adopts a revised definition of course of employment:

(1) An employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment.

(2) An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer's control. An employee's act is not within the scope of employment when it occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer.

Koutsogiannis v. BB&T
Supreme Court of South Carolina, 2005.

Moore.

In July 1996, respondent financed the purchase of a car with a loan from ... BB&T. In May 1999, respondent made a full cash payment for
the month; however, the payment was improperly entered as a partial payment. BB&T claimed respondent owed the bank $23.76. Based on BB&T's own error, BB&T began collection efforts against respondent. Respondent continued to make regular payments, but then ceased payments in October 1999, due to BB&T's collection efforts and its inability to give him a correct pay-off figure.

BB&T referred the collection matter to an outside attorney. In negotiations with BB&T's attorney (Attorney), respondent's attorney attempted to establish a correct pay-off figure and sought to have BB&T correct the error on his credit report. When the attorneys could not reach a final agreement, BB&T commenced an action against respondent.

Meanwhile, respondent entered into a real estate contract to purchase a parcel of land with commercial potential. . . . Respondent lost the real estate deal due to BB&T's credit reporting error. After the real estate deal was lost, negotiations essentially ceased between the two attorneys and respondent filed counterclaims of libel, conversion, breach of contract accompanied by fraudulent intent, and gross negligence against BB&T. On behalf of BB&T, Attorney moved for summary judgment. The trial court granted summary judgment on both BB&T's claims and respondent's counterclaims in an order prepared by Attorney. The Court of Appeals reversed the court's order and stated respondent was never afforded an opportunity to argue the merits of his counterclaims. . . . Thereafter, respondent paid off the car loan and a jury trial was conducted on the counterclaims.

At trial, respondent sought to recover damages from BB&T based on BB&T's misconduct in handling the loan matter and vicarious liability for Attorney's misconduct in attempting to collect the debt and preparing the draft order for summary judgment. As to Attorney, respondent asserted Attorney engaged in dilatory tactics which intentionally prolonged the unsuccessful settlement negotiations. With respect to the preparation of the summary judgment order, respondent asserted Attorney intentionally sought to deceive the trial court and injure respondent.

BB&T requested a charge on the law of independent contractor.1 BB&T's theory was that even if Attorney's conduct could be considered wrongful, he was, nonetheless, an independent contractor for whose misconduct BB&T was not vicariously liable. The request for the charge was denied; however, the trial court gave a detailed and extensive charge

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1 The requested charge is as follows:

The principal's or master's liability is derived from his or her relationship to the agent, or servant. A master is one who has the right to control the manner and method of work performed. A servant is one whose work is subject to the supervision or control of the master. By contrast, an independent contractor is a person hired for a particular purpose or project, who is compensated on a project-by-project basis, and who exercises his own discretion over the manner and method of carrying out the work.
on the law of agency to the jury. The court further charged that the “acts of an attorney are directly attributable and binding upon the client.”

At trial, Attorney testified he was paid by BB&T on a case-by-case basis and that BB&T did not supervise him or instruct him as to how he should handle the case. Sonja Allen, a BB&T employee who Attorney was required to report to regarding respondent’s case, testified Attorney was a private lawyer who was sent cases by BB&T on a case-by-case basis. Allen stated she did not supervise Attorney in the sense that he was instructed on what methods to use to collect the debt. Allen stated Attorney kept her informed of significant events in the case. She stated she was aware there had been a summary judgment hearing and that Attorney had submitted documents for her approval before and after the hearing. She stated she would have reviewed the proposed summary judgment order prepared by Attorney.

The jury returned a verdict in favor of respondent on the counterclaim of gross negligence and awarded respondent $98,000. The jury found in favor of BB&T on the other counterclaims.

DISCUSSION

BB&T argues that because a client may not be vicariously liable for the conduct of its attorney, the trial court erred by failing to charge the jury on the law of independent contractor. We disagree.

The proper focus here is whether Attorney was acting within the scope of his representation when he committed the alleged acts of gross negligence. In the attorney-client relationship, clients are generally bound by their attorneys’ acts or omissions during the course of the legal representation that fall within the apparent scope of their attorneys’ authority. See, e.g., Shelton v. Bressant, 312 S.C. 183, 312 S.C. 208, 439 S.E.2d 833 (1993) (client bound by attorney’s actions in settlement of a case; acts of attorney are directly attributable to and binding upon client). As a result, BB&T can be held liable for its agent’s, Attorney’s, actions taken within his scope of representation, including possible torts committed by him. See Rickborn v. Liberty Life Ins. Co., 321 S.C. 291, 468 S.E.2d 292 (1996) (doctrine of apparent authority provides principal bound by agent’s acts when principal has placed agent in such position that persons of ordinary prudence, reasonably knowledgeable with business usages and customs, are led to believe agent has certain authority and they in turn deal with agent based on that assumption). Therefore, the trial court did not err by failing to charge the law of independent contractor and charging only the law of agency.

CONCLUSION

We find Attorney’s engagement in settlement negotiations and in the preparation of the proposed summary judgment order is clearly within

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2 It cannot be determined from the jury verdict whether the jury found in favor of respondent on the counterclaim of gross negligence due to BB&T’s own negligence or due to Attorney’s negligence.
the scope of authority set out to him by BB&T. Any misconduct engaged in by Attorney during those actions is directly attributable to BB&T.

AFFIRMED

Should a different conclusion be reached in Koutsogiannis if the attorney’s tortious conduct was intentional? Compare the majority and dissenting opinions in Horwitz v. Holabird, 212 Ill.2d 816, 816 N.E.2d 272 (Ill. 2004).

C. THE AGENT’S DUTY OF LOYALTY

**Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure**


We define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent. In addition in some situations it will pay the agent to expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions. However, it is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal’s viewpoint. In most agency relationships the principal and the agent will incur positive monitoring and bonding costs (non-pecuniary as well as pecuniary), and in addition there will be some divergence between the agent’s decisions and those decisions which would maximize the welfare of the principal. The dollar equivalent of the reduction in welfare experienced by the principal due to this divergence is also a cost of the agency relationship, and we refer to this latter cost as the “residual loss”. We define **agency costs** as the sum of:

1. the monitoring expenditures by the principal,
2. the bonding expenditures by the agent,
3. the residual loss.
Plaintiff desired to make a business investment. He engaged defendant as his agent to investigate and negotiate for the purchase of a route of coin-operated music machines. On June 2, 1947, relying upon the advice of defendant and the investigation he had made, plaintiff purchased such a business from Phillip Loechler and Lyle Mayer of Rochester, Minnesota, who will be referred to hereinafter as the sellers. The business was located at LaCrosse, Wisconsin, and throughout the surrounding territory. Plaintiff alleges that defendant represented to him that he had made a thorough investigation of the route; that it had 75 locations in operation; that one or more machines were at each location; that the equipment at each location was not more than six months old; and that the gross income from all locations amounted to more than $3,000 per month. As a matter of fact, defendant had made only a superficial investigation and had investigated only five of the locations. Other than that, he had adopted false representations of the sellers as to the other locations and had passed them on to plaintiff as his own. Plaintiff was to pay $30,620 for the business. He paid $11,000 down. About six weeks after the purchase, plaintiff discovered that the representations made to him by defendant were false, in that there were not more than 47 locations; that at some of the locations there were no machines and at others there were machines more than six months old, some of them being seven years old; and that the gross income was far less than $3,000 per month. Upon discovering the falsity of defendant’s representations and those of the sellers, plaintiff rescinded the sale. He offered to return what he had received, and he demanded the return of his money. The sellers refused to comply, and he brought suit against them in the district court of Olmsted county. The action was tried, resulting in a verdict of $10,000 for plaintiff. Thereafter, the sellers paid plaintiff $9,500, after which the action was dismissed with prejudice pursuant to a stipulation of the parties.

In this action, brought in Hennepin County, plaintiff alleges that defendant, while acting as agent for him, collected a secret commission from the sellers for consummating the sale, which plaintiff seeks to recover under his first cause of action. In his second cause of action, he seeks to recover damages for [losses caused by defendant’s wrong].

1. With respect to plaintiff’s first cause of action, the principle that all profits made by an agent in the course of an agency belonging to the principal, whether they are the fruits of performance or the violation of an agent’s duty, is firmly established and universally recognized. Smitz v. Leopold, 53 N.W. 719 (Minn. 1892). . . .
It matters not that the principal has suffered no damage or even that the transaction has been profitable to him. Raymond Farmers Elevator Co. v. American Surety Co., 290 N.W. 231 (Minn. 1940).

The rule and the basis therefore are well stated in Lum v. Clark, 57 N.W. 662 (Minn. 1894), where, speaking through Mr. Justice Mitchell, we said: “Actual injury is not the principle the law proceeds on, in holding such transactions void. Fidelity in the agent is what is aimed at, and, as a means of securing it, the law will not permit him to place himself in a position in which he may be tempted by his own private interests to disregard those of his principal. ... It is not material that no actual injury to the company [principal] resulted, or that the policy recommended may have been for its best interest. Courts will not inquire into these matters. It is enough to know that the agent in fact placed himself in such relations that he might be tempted by his own interests to disregard those of his principal. The transaction was nothing more or less than the acceptance by the agent of a bribe to perform his duties in the manner desired by the person who gave the bribe. Such a contract is void. This doctrine rests on such plain principles of law, as well as common business honesty, that the citation of authorities is unnecessary.”

The right to recover profits made by the agent in the course of the agency is not affected by the fact that the principal, upon discovering a fraud, has rescinded the contract and recovered that with which he parted. Restatement, Agency, § 407(2). Comment e on Subsection (2) reads: “If an agent has violated a duty of loyalty to the principal so that the principal is entitled to profits which the agent has thereby made, the fact that the principal has brought an action against a third person and has been made whole by such action does not prevent the principal from recovering from the agent the profits which the agent has made. Thus, if the other contracting party has given a bribe to the agent to make a contract with him on behalf of the principal, the principal can rescind the transaction, recovering from the other party anything received by him, or he can maintain an action for damages against him; in either event the principal may recover from the agent the amount of the bribe.”

It follows that, insofar as the secret commission of $2,000 received by the agent is concerned, plaintiff had an absolute right thereto, irrespective of any recovery resulting from the action against the sellers for rescission.

2. Plaintiff's second cause of action is brought to recover damages for (1) losses suffered in the operation of the business prior to rescission; (2) loss of time devoted to operation; (3) expenses in connection with rescission of the sale and investigation therewith; (4) nontaxable expenses in connection with the prosecution of the suit against the sellers; and (5) attorneys' fees in connection with the suit.

The case comes to us on a bill of exceptions. No part of the testimony of the witnesses is included, so we must assume that the evidence
establishes the items of damage claimed by plaintiff. Our inquiry is limited to a consideration of the question whether a principal may recover of an agent who has breached his trust the items of damage mentioned after a successful prosecution of an action for rescission against the third parties with whom the agent dealt for his principal.

The general rule is stated in Restatement, Agency, § 407(1), as follows: "If an agent has received a benefit as a result of violating his duty of loyalty, the principal is entitled to recover from him what he has so received, its value, or its proceeds, and also the amount of damage thereby caused, except that if the violation consists of the wrongful disposal of the principal's property, the principal cannot recover its value and also what the agent received in exchange therefore."

In Comment a on Subsection (1) we find the following: "... In either event, whether or not the principal elects to get back the thing improperly dealt with or to recover from the agent its value or the amount of benefit which the agent has improperly received, he is, in addition, entitled to be indemnified by the agent for any loss which has been caused to his interest by the improper transaction. Thus, if the purchasing agent for a restaurant purchases with the principal's money defective food, receiving a bonus therefore, and the use of the food in the restaurant damages the business, the principal can recover from the agent the amount of money improperly expended by him, the bonus which the agent received, and the amount which will compensate for the injury to the business."

The general rule with respect to damages for a tortious act is that "The wrong-doer is answerable for all the injurious consequences of his tortious act, which according to the usual course of events and the general experience were likely to ensue, and which, therefore, when the act was committed, he may reasonably be supposed to have foreseen and anticipated." 1 Sutherland, Damages (4 ed.) § 45, quoted with approval in Sargent v. Mason, 112 N.W. 255, 257 (Minn. 1907). . . .

Bergquist v. Kreidler, 196 N.W. 964 (Minn. 1924), involved an action to recover attorneys' fees expended by plaintiffs in an action seeking to enforce and protect their right to the possession of real estate. Defendant, acting as the owner's agent, had falsely represented to plaintiffs that they could have possession on August 1, 1920. It developed after plaintiffs had purchased the premises that a tenant had a lease running to August 1, 1922, on a rental much lower than the actual value of the premises. Defendant (the agent) conceded that plaintiffs were entitled to recover the loss in rent, but contended that attorneys' fees and disbursements expended by plaintiffs in testing the validity of the tenant's lease were not recoverable. In affirming plaintiffs' right to recover we said, 196 N.W. 966 (Minn. 1924): "... the litigation in which plaintiffs became involved was the direct, legitimate, and a to be expected result of appellant's misrepresentation. The loss sustained by plaintiffs in conducting that litigation 'is plainly traceable' to appellant's wrong and he should make compensation accordingly."
So far as the right to recover attorneys’ fees is concerned, the same may be said in this case. Plaintiff sought to return what had been received and demanded a return of his down payment. The sellers refused. He thereupon sued to accomplish this purpose, as he had a right to do, and was successful. His attorneys’ fees and expenses of suit were directly traceable to the harm caused by defendant’s wrongful act. As such, they are recoverable.

... The general rule applicable here is stated in 15 Am.Jur., Damages, § 144, as follows: “It is generally held that where the wrongful act of the defendant has involved the plaintiff in litigation with others or placed him in such relation with others as makes it necessary to incur expense to protect his interest, such costs and expenses, including attorneys’ fees, should be treated as the legal consequences of the original wrongful act and may be recovered as damages.”

The same is true of the other elements of damage involved. ...

Affirmed.

Restatement Third § 8.05, Illustration 1

“P, who owns a stable of horses, employs A to take care of them. While P is absent for a month, and without P’s consent, A rents the horses [for his own personal gain] to persons who ride them. Although being ridden is beneficial to the horses, A is subject to liability to P for the amount A receives for the rentals.”

Reading v. Attorney-General
[1951] App.Cas. 507 (H.L.)

Reading was a sergeant in the Royal Army Medical Corps during World War II, stationed in Cairo. In 1943, an unidentified man asked Reading whether he would assist in selling cases of whisky and brandy in Cairo, for which he would be paid a few pounds. About a month later Reading was met by a man named Manole, who told Reading that a truck, which Reading was to board, would come at a specified time and place. Reading, dressed in uniform, boarded the truck and conducted it through Cairo. By arrangement he met Manole later on the same day, and received an envelope which contained £2,000. This process was repeated on a number of occasions. In all, Reading was paid around £20,000. The Crown (that is, the English Government) later seized these amounts, on the ground that they had been paid to Reading “for accompanying ... a loaded lorry in and about Cairo whilst dressed in uniform and thereby falsely representing himself as acting in the course of his military duties ... in order to avoid police inspection of the said lorry.” Reading brought suit
to recover the seized amount. Justice Denning, at trial, dismissed Reading’s complaint:

In my judgment, it is a principle of law that if a servant, in violation of his duty of honesty and good faith, takes advantage of his service to make a profit for himself, in this sense, that the assets of which he has control, or the facilities which he enjoys, or the position which he occupies, are the real cause of his obtaining the money, as distinct from being the mere opportunity for getting it, that is to say, if they play the predominant part in his obtaining the money, then he is accountable for it to the master. It matters not that the master has not lost any profit, nor suffered any damage. Nor does it matter that the master could not have done the act himself. It is a case where the servant has unjustly enriched himself by virtue of his service without his master’s sanction. It is money which the servant ought not to be allowed to keep, and the law says it shall be taken from him and given to his master, because he got it solely by reason of the position which he occupied as a servant of his master. . . . [Reading] . . . was using his position as a sergeant in His Majesty’s Army and the uniform to which his rank entitled him to obtain the money which he received. In my opinion any official position, whether marked by a uniform or not, which enables the holder to earn money by its use gives his master a right to receive the money so earned even though it was earned by a criminal act. “You have earned,” the master can say, “money by the use of your position as my servant. It is not for you, who have gained this advantage, to set up your own wrong as a defence to my claim.”

The House of Lords affirmed.

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RESTATEMENT THIRD §§ 8.01–8.05

[See Statutory Supplement]

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D. IMPUTATION OF AGENT’S KNOWLEDGE

As seen in the preceding material, agency law empowers principals to enter into enforceable contracts with third parties through the acts of the agent. By doing so, agency law not only is facilitative of contracting but also makes business enterprises possible. The next case illustrates a potential downside for the principal’s engagement of an agent.
Carter v. Gugliuzzi
Supreme Court of Vermont, 1998.
168 Vt. 48, 716 A.2d 17.

Johnston, J.

Defendant Synergy Group, Inc., doing business as Smith Bell Real Estate, appeals from a superior court judgment in favor of plaintiff Diana Carter. Carter's suit alleged that Smith Bell, through its agents, had made a number of misrepresentations and omissions in connection with her purchase of a house. Smith Bell contends the court erred in ruling: ... that the knowledge of its agent concerning wind conditions on the property could be imputed to Smith Bell. ... We affirm the judgment imposing liability on Smith Bell ....

The material facts are largely undisputed: In 1990, Flavia Gugliuzzi and Ana Barreto (sellers) asked Ruth Bennett, a licensed real estate salesperson, to list their house for sale. ... Bennett, who worked for Smith Bell ... [and] worked under the supervision of David Crane, a licensed real estate broker and an officer, director, and shareholder of the company. In response to sellers' call, Bennett went to the house, located in the Pleasant Valley area of Underhill, to fill out a sales authorization, Multiple Listing Service (MLS) sheet, and a fact sheet highlighting special features of the house. ...

The court ... found that Crane knew, but did not disclose to Bennett or Carter, that the house was subject to frequent and severe winds, that one of the windows in the house had blown in years earlier, and that other houses in the area had suffered wind damage. Crane had lived in the Pleasant Valley area for seven years, had sold a number of nearby properties, and had been Underhill's zoning administrator. He was aware that Pleasant Valley occasionally experienced winds of over 80 miles-per-hour and often had winds in the 40 to 50 mile-per-hour range, and that many Valley residents, including Crane, had wind gauges on their homes to measure and compare wind speeds with their neighbors.

Diana Carter, a lawyer living in California, had been looking for a house to buy in Vermont since mid-1990. She contacted several realtors, including Liz Merrill, an agent from Lang Associates, who provided her with information on a number of houses, including the listing and fact sheets relating to the Underhill property. Carter was attracted by the size of the house, the acreage, and the fact that it was listed as being in "pristine" condition. Merrill, acting as a sub-agent for the seller, showed Carter the house twice. ... Bennett assured Carter and Merrill that there had been full disclosure. Carter's offer of $200,000 for the house was accepted in August 1990.

... Several months later, a series of high winds toppled several trees on the property, blew in a number of windows, tore shingles off the house and garage, and blew gutters off the house.
Carter sued sellers and Smith Bell for fraud, negligent misrepresentation, and breach of contract . . . .

Following a court trial, the court ruled, inter alia, that Crane’s knowledge of the presence of high winds was imputable to Smith Bell, and that the company, through its agents, was liable in tort for a number of misrepresentations and omissions, and for violations of the Act. The court found both Smith Bell and sellers liable for the wind damage, future replacement of windows, the cost of additional trees to create a wind break . . . . The total judgment was for $30,624 plus interest and costs . . . .

Smith Bell . . . contends the court erred in ruling that Crane’s knowledge about the presence of high winds on the property could be imputed to the company. Crane, to recall, had supervised and consulted with the listing agent, Ms. Bennett, inspected the property, and conveyed certain information concerning the house to Carter. Hence, the trial court’s threshold finding that Crane had operated as an agent of Smith Bell was thus amply supported by the evidence . . . .

A fundamental tenet of agency law holds that “the knowledge of an agent acting within the scope of his or her authority is chargeable to the principal, regardless of whether that knowledge is actually communicated.” Estate of Sawyer v. Crowell, 151 Vt. 287, 291, 559 A.2d 687, 690 (1989). Smith Bell argues that Crane’s knowledge about the high winds should not have been imputed to the company because it was obtained outside the scope of his employment. Carter, in response, asserts that the general rule has been abrogated by decisions suggesting that information obtained outside the scope of employment may nevertheless be imputed to the principal, at least where it appears that the information “is actually in [the agent’s] mind at the time he performs the act in question.” Simpson v. Central Vt. Ry., 95 Vt. 388, 395, 115 A. 299, 302 (1921).

The debate in this case is academic. For contrary to Smith Bell’s claim, the trial court did not find that Crane’s knowledge was obtained outside the scope of his employment. As noted earlier, the court found that Crane “had lived in the area, had listed and sold many nearby properties, and had been Underhill’s zoning administrator. Mr. Crane was aware that Pleasant Valley . . . had winds of over 80 m.p.h.” The court further noted that real estate licensees had a statutory duty to “fully disclose to a buyer all material facts within the licensee’s knowledge concerning the property being sold.” 26 V.S.A. § 2296(a)(10). Since the statute governing a real estate agent’s duty to disclose made “no distinction as to the source of the knowledge,” the court concluded that such knowledge was similarly imputable to the agent’s principal regardless of the source.

The court’s reasoning was sound. It is immaterial whether Crane’s information was derived from his residence in the area, his listing and sale of other properties in the area, or his experience as the town’s zoning
officer. A broker's statutory duty is to fully disclose all material facts within his or her knowledge. The rule reflects the reality that a broker's business consists precisely of acquiring and conveying information about the community, neighborhood conditions, comparable properties, and other local factors that may affect the value, marketing and sale of property. Such information is always, in effect, acquired in the "scope of employment." It is thus meaningless to attempt to parse a broker's knowledge about a given property on the basis of the precise time, date, or circumstances in which it was obtained. Crane's knowledge concerning the presence of high winds on the property was properly imputed to Smith Bell.

...[T]he judgment is affirmed.