THE LAW OF AGENCY AND EMPLOYMENT

SUPPLEMENTAL READINGS

Class 04

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EXAMPLES & EXPLANATIONS

Agency, Partnerships, and LLCs

Fourth Edition

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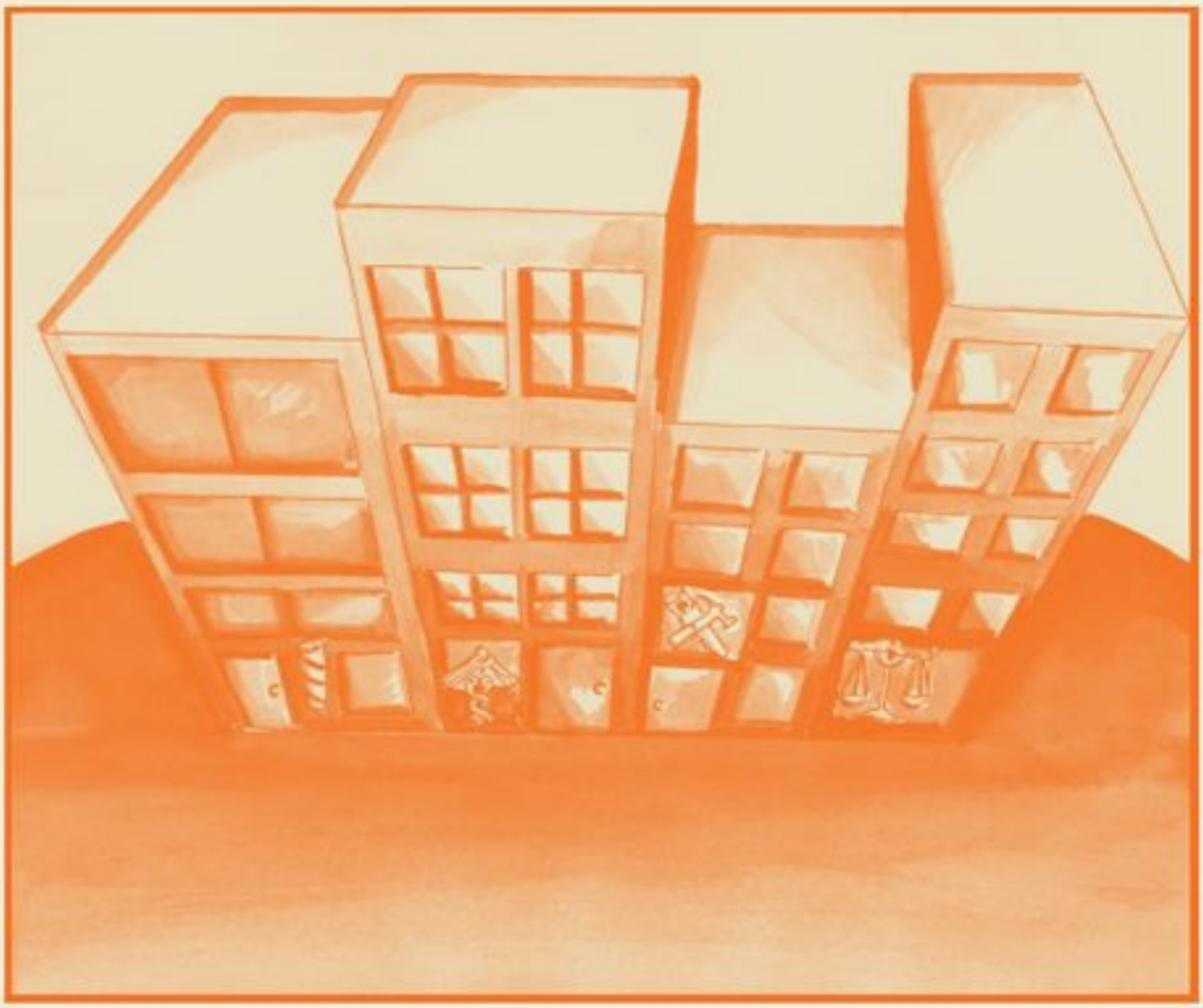

Wolters Kluwer
Law & Business

§1.1 THE AGENCY RELATIONSHIP DEFINED AND EXEMPLIFIED; ITS PLAYERS IDENTIFIED

§1.1.1 The Classic Definition

Agency is the label the law applies to a relationship in which:

- by mutual consent (formal or informal, express or implied)
- one person or entity (called the "agent")
- undertakes to act on behalf of another person or entity (called the "principal")
- subject to the principal's control.

§1.1.2 The Players: Principal and Agent; Their Ubiquity

Agency relationships are everywhere in the commercial world and in noncommercial realms as well. Whenever a person or organization seeks to act through the efforts of others, the legal concept of agency likely applies. For example:

- A student, seeking a place to live while attending law school, submits a rental application to the manager of an apartment building. Acting on behalf of the building owner, the manager checks the application and then accepts the student as a tenant. The manager acts as the owner's agent.
- A corporate shareholder, unable to attend the corporation's annual meeting, signs a "proxy" that authorizes another individual to cast the shareholder's votes at the meeting. By accepting the appointment, the proxy holder becomes the shareholder's agent.
- A landowner, preparing to leave for an around-the-world tour and wishing to sell Greenacre as soon as possible, gives a real estate broker a "power of attorney." This credential authorizes the broker to sell Greenacre on the owner's behalf, to sign all documents necessary to form a binding contract, and to close the deal. The broker is the owner's agent.
- A supermarket chain that is about to purchase fancy new computerized cash registers retains a consultant to advise on what type of registers to buy and to arrange the purchase of the new machines on the chain's behalf. The consultant acts as the chain's agent.
- A bank, knowing that not all customers like dealing with ATMs, hires tellers to handle customer deposits, withdrawals, and similar transactions. The tellers are agents of the bank.

In each of these situations, someone (the "principal") has asked someone else (the "agent") to provide services or accomplish some task on behalf of the principal and subject to the principal's control. In each situation the agent has agreed to do so. To each situation, the label of "agency" applies.[1]

Agency relationships also appear in literature, as in Longfellow's "Courtship of Miles Standish." Standish, seeking to court "the damsel Priscilla" but too shy to do so directly, entreats his friend John Alden to communicate to Priscilla the depth and direction of Standish's feelings. Alden agrees and becomes Standish's agent.[2] Fictional agents can also be less beneficent. In Dumas's *The Three Musketeers*, Cardinal Richelieu uses the infamous Lady de Winter as his agent to trick the Duke of Buckingham and steal the diamonds secretly given him by the Queen of France.[3]

An agent can be an individual human being or an organization, such as a limited liability company, corporation, not-for-profit corporation, general partnership, or limited partnership. The same is true for a principal. The R.2d mostly contemplates individual actors, while the R.3d gives considerable attention to organizations both as principals and agents. A machine or computer program, in contrast, cannot be an agent, even when serving an intermediary function.[4]

§1.1.3 The Role of Third Parties

The agency relationship may appear at first to involve only the principal and the agent. But principals typically use agents to deal with the rest of the world, or at least some part of it; thus the agent often functions as the principal's "interface" with others.[5] As a result, third parties figure prominently in the law of agency.

The R.2d reflects this situation with a paradigmatic approach to illustrations which has influenced generations of law school examples: *P* represents the principal; *A* the agent; and *T* the third party. The R.3d continues the use of *P* and *A*, but varies the letters designating third parties.

§1.2 CATEGORIES AND CONSEQUENCES: WHY DO THE LABELS MATTER?

Our system of law operates largely through a process of "categories and consequences"; that is, defining categories of behavior or characteristics and attaching consequences to those categories. This phenomenon is salient in agency law. People concern themselves with agency law labels because people are concerned about the consequences attached to those labels. For example, if *A* is an agent of *P*, then (among other consequences) *A* owes a duty of loyalty to *P* and *P* has certain obligations to indemnify *A*.[6]

This "category and consequences" architecture has two major practical implications for those dealing with agency law.

§1.2.1 The First Practical Implication: Sharpening the Questions We Ask

In the practice of agency law, the question "Is *X* an agent of *Y*?" is almost always an incomplete question and usually a bad one. The better question is, "For the purposes of [specified consequence], is *X* an agent of *Y*?" The latter question is better because the context (the specified consequence) directs the analysis toward the appropriate subcategories and sub-issues.

Example

In *Great Expectations*, Pip receives ongoing support from an unnamed benefactor who acts through Mr. Jaggers. In the following passage, which occurs just after Mr. Jaggers hands Pip a £500 note, Pip is speaking.

> I was beginning to express my gratitude to my benefactor for the great liberality with which I was treated, when Mr. Jaggers stopped me. "I am not paid, Pip," said he, coolly, "to carry your words to any one," and then gathered up his coat-tails, as he had gathered up the subject, and stood frowning at his boots as if he suspected them of designs against him.[7]

In this context, the question "Is Mr. Jaggers the agent of the unnamed benefactor?" would be at best overbroad. Mr. Jaggers seems to be the agent of the unnamed benefactor for the purposes of delivering money and perhaps information, but not for the purposes of receiving information. ◂

§1.2.2 The Second Implication: Which Drives the Analysis - Categories or Consequences?

If we think of legal rules as "if/then" structures,[8] then categories come before consequences. ***If*** a set of facts fits within category A, ***then*** the consequences of A result.

However, categories are labels for rules, and the rules are tools for achieving particular types of consequences. In most disputes, consequences drive the analysis. Which agency label or category applies depends on which consequence is at issue.

Example

Tort Victim claims that *Y* should be legally responsible for *X*'s tort. Most often, the key category will not be "agent" but rather "servant" (or "employee"), a quasi-subcategory of agent.[9] ◂

Example

Tenant claims to have given notice to Landlord by leaving a note with Landlord's custodian. The appropriate category is agent, and the appropriate subcategories are actual authority and apparent authority.[10]

In contrast, in transactional lawyering, categorization typically drives the analysis, at least initially. In most transactional situations, the relevant facts are not entirely set, and good legal work involves at least the following five steps:

1. Discerning and understanding the client's business objectives and the client's plans for achieving those objectives
2. Imagining the facts that will result from using those plans to pursue those objectives
3. Identifying relevant legal categories that might apply to those facts, thereby predicting unpalatable legal consequences that might result from such categories (sometimes known as "assessing the legal risk" or "determining exposures")
4. Rethinking the client's objectives and plans in light of the perceived legal risks (sometimes called "exposures")
5. Seeking to reconfigure the client's objectives and plans (and the resulting facts) so as to:
   - avoid the dangerous categorizations and thereby the unpalatable legal consequences while
   - still achieving most (and perhaps all) of the client's objectives.

Thus, in the transactional paradigm, while consequences remain all-important, it is mostly categories that drive the analysis.

§1.3 THE TWO ROLES OF AGENCY LAW: AUXILIARY AND CHOATE

Black's Law Dictionary defines "auxiliary" as "[a]iding or supporting," and "choate" as "[c]omplete in and of itself."[11] These two terms reflect the two different roles of agency law.

§1.3.1 Agency Law as the "Main Event"

Sometimes, agency law "in and of itself" provides the rule or rules sufficient to analyze a situation.

Example

X, while undertaking a task on behalf of *Y*, learns of a business opportunity different from but related to the task. Without obtaining *Y*'s consent or even informing *Y* of the opportunity, *X* takes the opportunity for herself. *Y* later claims that *X* must "disgorge" the profits realized from exploiting the opportunity. Agency law "in and of itself" can resolve this dispute: (1) Was *X* acting as *Y*'s agent? (2) If so, the agent's "duty of loyalty" applies and *X* must indeed disgorge the profits.[12] ◂

§1.3.2 Agency Law in Its Supporting Role

Often agency law plays only an auxiliary role, and the "main event" occurs in some realm of substantive law; for example, torts or contracts.[13]

Example

Hadley sues Baxendale, alleging breach of an oral contract for services. Hadley acknowledges that Baxendale himself never manifested assent to the alleged contract but asserts that one of Baxendale's clerks did so. Agency law determines whether the clerk's manifestations are attributed to Baxendale.[14] Although this auxiliary question can be dispositive, the "main event" is in the substantive arena of contract law. ◂

Of course, the agency analysis is unnecessary unless Hadley can prove *factually* that:

- the clerk made manifestations,
- which, even if treated (per agency law) as the manifestations of Baxendale,
- would suffice as a matter of *contract law* to establish a binding contract containing the terms relevant to the contract-law claim of breach.

Note that the situation is conceptually complicated because it involves

both:

- the interrelationship between contract law as the "main event" and agency law as the essential auxiliary; *and*
- the difference between the realm of legal rules and the realm of facts.

To make matters even more complicated:

- the legal rules determine which facts might be important, but, at the same time and interactively,
- what facts exist or might exist that help shape the legal analysis and can even determine which legal rules might be worth invoking.

Example

In the *Hadley-Baxendale* Example above, Hadley discovers to his chagrin that he cannot carry the burden of proving the necessary manifestations by Baxendale's clerk. This factual determination might cause Hadley to look to another area of substantive law, perhaps bailment. ◂

§1.4 CREATION OF THE AGENCY RELATIONSHIP

§1.4.1 The Restatements View of Creation

The first section of the R.3d describes the creation of an agency relationship as follows:

> Agency 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.[15]

Several aspects of this description warrant special attention. Some relate to elements necessary to create an agency relationship. Others relate to the consequences that follow when an agency relationship exists.

§1.4.2 Manifestation of Consent

The creation of an agency relationship necessarily involves two steps: manifestation by the principal and consent by the agent. The manifestation by or attributable to the principal[16] must somehow reach the agent, otherwise the agent has nothing to which to consent. When the agent then manifests consent, an agency exists—even though the principal may initially be unaware of the manifestation.

Example

Smitten with equal amounts of love and timidity, Miles Standish manages a face-to-face conversation with his friend John Alden, in which Standish asks Alden to speak to the fair Priscilla on Standish's behalf. Alden agrees, and an agency relationship exists. ◂

Example

Disappointed to learn that Yoram, her favorite guide, will be unavailable when she visits Alaska, Naomi sends him the following email: "Very disappointed. Will you locate and hire for me someone of comparable quality and price range for the dates I sent you?" Yoram hits the "reply" button and types, "Sure." He promptly receives an automated "out of the office" response, indicating that Naomi is gone for the weekend. A principal-agent relation now exists. It is irrelevant that the principal is as yet unaware of the agent's manifestation. ◂

Example

Yoram contacts Dennis, explains the situation, and determines that Dennis is willing and available for the time Naomi wants. Yoram then emails to Naomi a description of Dennis's qualifications and rate. Naomi promptly replies, "Fine. Go ahead." Yoram tells Dennis, "The job is yours." Dennis replies, "Great." Naomi and Dennis are now principal and agent; the principal's manifestation of consent was communicated indirectly but nonetheless effectively. ◂

§1.4.3 Objective Standard for Determining Consent

To determine whether a would-be principal and would-be agent have

consented, the law looks to their outward manifestations rather than to their inner, subjective thoughts.[17] The law's interpretive viewpoint is that of a reasonable person. In particular:

- Has the would-be principal done or said something that a person in the position of the would-be agent would reasonably interpret as consent by the would-be principal that the would-be agent act for the would-be principal?
- Has the would-be agent in response done or said something that a person in the position of the would-be principal would reasonably interpret as consent to act for the would-be principal?

Typically it is the parties' words that evidence their reciprocal consents. However, given the law's objective standard, a party's conduct can also evidence consent. For example, an agent can manifest consent by beginning the requested task.

Example

Rachael, the owner of Blackacre, writes to Sam: "Please act as my broker to sell Blackacre." Sam puts a "For Sale" sign on Blackacre. By beginning the requested task Sam has given the necessary manifestation of consent. An agency relationship exists. ◂

The objective standard also means that, in the eyes of the law, two parties can be agent and principal even though one of them had no subjective desire to create the legal relationship. Thus, even a reasonable *mis*interpretation can create an agency relationship.

Example

Frustrated by the recalcitrance of Thomas Becket, the Archbishop of Canterbury, Henry II of England exclaims, "Will nobody rid me of this troublesome cleric?" Four of Henry's barons overhear the remark and proceed to kill Becket, believing that they are acting on behalf of and subject to the control of the king. Although Henry later protests that he never intended for anyone to kill the Archbishop, the barons nonetheless acted as his agents. In these circumstances Henry's outward manifestation, reasonably interpreted, indicated consent. Even assuming that Henry's protest is genuine,

his subjective intent is irrelevant.

§1.4.4 Consent to the Business or Interpersonal Relationship, Not to the Legal Label

Agency is a legal concept—a label the law attaches to a category of business and interpersonal relationships. If two parties manifest consent to the type of business or interpersonal relationship the law labels "agency," then an agency relationship exists. The legal concept applies and the label attaches *regardless of whether the parties had the legal concept in mind and regardless of whether the parties contemplated the consequences of having the label apply*.

Sometimes when parties form a relationship, they expressly claim or disclaim the agency label. For instance, franchise agreements[18] often include a statement to the effect that "this agreement does not create an agency relationship" or that "the franchisee is not for any purposes the agent of the franchisor." Courts do consider such statements when trying to determine just what relationship the parties actually established. However, the parties' self-selected label is never dispositive and is relevant only as a window on the underlying reality. For example, a disclaimer of agency status may help show that neither party consented to act on the other's behalf and subject to the other's control. However, if the actual relationship between two parties evidences the elements necessary to establish agency, then all the disclaimers in the world will not deflect the agency label. To paraphrase a former president of the United States, "You can hang a sign on a pig and call it a horse, but it's still a pig."[19]

§1.4.5 Agency Consensual, but Not Necessarily Contractual; Gratuitous Agents

Agency is not a subcategory of contract law; not all consensual relationships belong to the law of contracts. Although agents and principals often superimpose contracts on their agency relationship,[20] the agency relationship itself is not a contract.

Therefore, since the doctrine of consideration belongs exclusively to the law of contracts, an agency relationship can exist even though the principal

provides no consideration to the agent. Agents who act without receiving any consideration are "gratuitous agents." In most respects, the rights and powers of gratuitous agents are identical to those of paid agents. The major exceptions concern the right of the parties to terminate the agency[21] and the standard of care applicable to the agent.[22]

§1.4.6 Formalities Not Ordinarily Necessary to Create an Agency

An agency relationship can exist even though the parties never express their reciprocal consents in any formal fashion. Ordinarily, the parties' consent need not be in writing. Indeed, as section 1.4.3 indicates, conduct alone can suffice; in the proper circumstances, words are not necessary.

However, in some jurisdictions the "equal dignities" rule applies. The rule: (i) is statutory; (ii) pertains to transactions that must be in writing in order to be enforceable; and (iii) provides that an agent can bind a principal to such transactions only if the agency relationship is documented in a writing signed by the principal. For example, California Civil Code section 2309 states: "An oral authorization is sufficient for any purpose, except that an authority to enter into a contract required by law to be in writing can only be given by an instrument in writing."

§1.4.7 Consent and Control

To create an agency, the reciprocal consents of principal and agent must include an understanding that the principal is in control of the relationship. "Since the whole purpose of the relation of agency is that the agent shall carry out the will of the principal,"[23] agency cannot exist unless the "acting for" party (the agent) consents to be subject to the will of the "acted for" party (the principal). The control need not be total or continuous and need not extend to the way the agent physically performs, but there must be some sense that the principal is "in charge." At minimum, the principal must have the right to control the goal of the relationship.[24]

Often the manifestations creating a relationship do not expressly address the issue of control. If the issue is in question, courts will examine how the relationship actually operated in order to decide whether the "acting for"

party consented to be controlled. The facts of the relationship may imply or negate consent.

Case in Point—Krom v. Sharp and Dohme, Inc.

A hospital patient caught hepatitis from contaminated blood and sought to sue the blood supplier for breach of warranty. To succeed, the patient had to show that he was in privity with the blood supplier, but it appeared that the hospital, not the patient, had made the purchase from the supplier. The patient claimed he was nonetheless in privity, asserting that the hospital was acting as his agent when it obtained the blood. The court rejected the patient's claim, noting that there was no indication that the hospital was in any way subject to the patient's control.[25]

While "consent to control" is an element necessary to establish an agency relationship, issues of control also play a major role in at least three other parts of agency law. It is important to keep all four roles distinct from each other. The other three roles are:

1. *Control as an element of "servant"/"employee" status*. Whether the principal has a right to control the physical performance of the agent's tasks determines whether the agent is a "servant" or "employee."[26] As discussed in Chapter Three, this issue is crucial to determining the principal's vicarious liability for certain torts committed by the agent.
2. *Control as a consequence*. As a consequence of agency status (rather than as an element necessary to create that status), the principal has the power to control the agent. Even though the agent may have consented to give the principal only limited control, once the agency relationship comes into existence, the principal has the power (though not necessarily the right) to control every detail of the agent's performance.[27]
3. *Control as a substitute method for establishing agency status*. When a creditor exercises extensive control over the operations of its debtor, that control can by itself establish an agency relationship. The R.2d and a few cases treat the debtor as the agent and the creditor as the principal. As a consequence, the creditor becomes liable for the debtor's debts to other creditors.[28]

§1.4.8 Consent to Serve the Principal's Interests

To create an agency relationship the agent must manifest consent to act *for* the principal; that is, the agent must manifest a recognition that serving the *principal's* interests is the primary purpose of the relationship. The facts of the relationship can and often do imply that recognition.

Example

A law student, rushing to prepare for graduation and the fabulous buffet party to follow, gives a friend a list of last-minute additions to the menu and asks the friend to "do me a favor and make sure the caterer includes these on the buffet." The friend agrees. The friend has impliedly recognized that the endeavor's primary purpose is to meet the law student's needs, not to serve any separate agenda the friend may have. ◂

§1.4.9 All Elements Necessary

Each element discussed above must be present for an agency to exist. For example, although a construction company's foreman may exercise detailed control over a work crew, the crew members are not the foreman's agents. They have consented to work on behalf of the construction company, not the foreman.[29] A physician provides her expertise for the benefit of her patient but has not consented to act on the patient's behalf or subject to the patient's control. A trustee acts on behalf of the trust beneficiary but is not subject to their control. Section 1.5.2 and Chapter 6 explain in more detail how to distinguish agency from other relationships.

§1.5 THE RELATIONSHIP BETWEEN AGENCY AND CONTRACT

§1.5.1 Contract as an Overlay to an Agency Relationship

Although agency itself is not a contractual relationship, the parties to an

agency can make contracts regarding their agency relationship. To take the most common example, the parties can agree that the principal will pay the agent for the agent's services. For further example, the parties can by agreement set a definite term to the relationship or limit the principal's right to control the agent with regard to matters connected with the agency.

Example

A manufacturing company plans to build a large plant and retains a "construction management" firm to manage the project on behalf of the manufacturing company. The contract between the manufacturing company and the construction management firm states: "Using reasonable care, FIRM will select the various contractors to build the plant, who shall then perform their work under contracts with COMPANY."

Contracts between agent and principal have limited impact. They can change the rights and duties that exist between agent and principal, but they cannot abrogate the powers that agency status confers on each party to the relationship. Thus, for example, despite any contract provisions to the contrary:

- the principal always has the power to control every detail of the agent's performance[30];
- the agent may have certain powers to bind the principal[31]; and
- both the principal and the agent have the power to end the agency at any time.[32]

When an agent or principal exercises a power in breach of the other's contract right, the injured party can bring an action for damages. But the exercise of power cannot be undone or enjoined.

§1.5.2 Distinguishing an Agency from a Mere Contractual Relationship

One of the most difficult lines for students (and sometimes lawyers) to draw is between an agent and an "independent contractor"—that is, a person who provides services simply as a party to a contract. "In any relationship created by contract, the parties contemplate a benefit to be realized through the other

party's performance. Performing a duty created by contract may well benefit the other party, but the performance is that of an agent only if the elements of agency are present."[33]

Example

Preparing for a daylong "callback" interview, a law student takes her "power suit" to the dry cleaner. For a fee, the dry cleaner provides a valuable service to the student, which benefits her. In ordinary parlance, the dry cleaner might be seen as cleaning the suit "on the student's behalf." ("Hey Charley. Who is this suit for?" "We're doing that one for Sarafina Student.") In agency law terms, however, the relationship is merely contractual. Reciprocal performance causes each party to benefit. However, in the language of R.3d, §1.01, neither party has consented to act "on the [other's] behalf and subject to the [other's] control." ◂

Example

A manufacturing company enters into a contract with a distributor, under which the distributor agrees to purchase a specified quantity of goods, conduct its marketing and sales efforts within specified requirements, and limit its sales to a specified territory. The contract permits either party to terminate the arrangement on 60 days notice, but, as a practical matter, the distributor needs the manufacturer's goods far more than the manufacturer needs the distributor's efforts. Also as a practical matter, the manufacturer may be able to exercise significant control over the distributor beyond the terms of the contract. Moreover, executives of the manufacturing company often refer to the distributor (and other companies like the distributor) as "crucial links in our distribution network." The relationship is not an agency. The distributor has "manifested assent" to the contract, not to "the principal's control." R.3d, §1.01. Although practically the manufacturer may be "in the driver's seat," formally—according to the parties' manifestation to each other—there is no driver's seat. Or rather, each party is driving its own separate, self-interested car. ◂

§1.6 INTERACTION BETWEEN STATUTES AND THE

COMMON LAW OF AGENCY

Although agency is a common law rubric, there is considerable interplay between statutory law and agency law. Statutes now govern key issues formerly left to the common law, and labels and principles from agency law inform both the drafting and interpretation of statutes.[34]

For example, one of the most important functions of agency law is to determine when information possessed by an agent is attributed to the principal.[35] However, a statutory rule may well displace the common law if the principal is an organization and the transaction at issue is subject to the Uniform Commercial Code or a business entity statute.[36]

Statutes have also displaced much of the common law applicable to employment relations. The National Labor Relations Act (governing unionization) is perhaps the predominant example. In addition:

> Employment legislation has modified common-law doctrine concerning the fellow-servant rule,[37] under which an employer is not liable for injuries inflicted on one employee by the negligent acts of another, unless the act violates an employer's nondelegable duties. Employment legislation such as Title VII expands an employer's nondelegable duties substantially, subjecting the employer under some circumstances to liability for employee conduct, such as sexually harassing behavior, that usually falls outside the scope of the common-law doctrine of *respondeat superior*. Workers' compensation legislation likewise imposes liability on the employer in circumstances under which the common law did not.[38]

The interplay works in the opposite direction as well, as agency concepts make their way into statutory formulations. The "servant" construct has been especially influential,[39] setting the scope for a wide range of statutes designed to regulate or tax the modern employment relationship. For example, the U.S. Supreme Court has held that:

> Where Congress uses terms that have accumulated settled meaning under…the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.…In the past, when Congress has used the term "employee" without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine.[40]

For purposes of federal employment law, this approach "means in essence that the term 'employee' is to be looked up in the dictionary of the common law."[41]

The interplay between common law and statute can produce confusing

results, particularly when a statute uses a label taken from agency law but attaches consequences that are at odds with basic agency law principles. For example, under the common law of agency, an agent always has the power, if not necessarily the right, to terminate the agency.[42] To exercise this power, an agent must communicate with the principal.[43] Yet several modern business law statutes refer to "an agent for service of process" while stating that the agent's resignation is effective only 31 days after the agent communicates with a specified public official.[44]

§1.7 MAJOR ISSUES IN THE LAW OF AGENCY

By way of an overview, the major issues in the law of agency can be organized according to the relationship among agency's three players: principals, agents, and third parties.

§1.7.1 Between the Principal and the Agent

Under What Circumstances Does an Agency Relationship Exist? As the R.2d explains, "Agency is a legal concept which depends upon the existence of required factual elements."[45] Agency law is therefore fundamentally concerned with whether particular kinds of relationships qualify as agency relationships. For example, must both parties subjectively consent to the relationship? Must they intend to create the legal relationship? Must they even be aware that they are creating the legal relationship? Must the agent be promised contract-like consideration by the principal?[46]

What Duties Does the Agent Owe the Principal? The principal relies on the agent to accomplish tasks. How perfect must the agent's performance be? In dealing with the principal, may the agent follow the rules for "arm's-length" transactions, such as might apply to the parties to an ordinary contract? In carrying out the tasks of the agency, must the agent think only of the principal's interests, or may the agent consider its own interests as well?[47]

What Duties Does the Principal Owe the Agent? Must the principal compensate the agent for the agent's efforts? Must the principal alert the agent to risks involved in the agent's task? If the agent somehow gets into

trouble, must the principal help out (or even bail out) the agent?[48]

§1.7.2 Between the Principal and Third Parties

If a Third Party Has Made a Commitment or Received a Promise in Dealing with an Agent, Under What Circumstances Can the Principal or Third Party Enforce the Commitment or Promise? People and organizations use agents to get things done, and often the agent's task involves making arrangements with third parties on the principal's behalf. For example, you might use a friend to make last-minute arrangements with the caterer you have hired for your graduation party. A bank might use its tellers to accept deposits from customers and give in return a paper evidencing the bank's resulting indebtedness (i.e., a deposit slip).

When an agency relationship involves this "arrangement making" function, it is essential that the principal be able to enforce commitments that are made by third parties to the agent. Otherwise, the agent could not accomplish much for the principal. The ability to bind third parties to the principal is thus an essential aspect of the agent's role, and questions about that aspect are therefore very important in the law of agency.[49]

Likewise, when an agency relationship involves the "arrangement making" function, it is essential that third parties be able to enforce against the principal commitments made by the agent. Otherwise agents could not accomplish much for principals; third parties would generally insist on "dealing direct." The ability to bind the principal to third parties is thus an essential aspect of the agent's role, and questions about that aspect are therefore very important in the law of agency.[50]

If the Agent Possesses Certain Information, Under What Circumstances Will the Law Treat the Principal as if the Principal Possessed That Information? In many situations the law cares whether and when a party has particular kinds of information. Since principals often act through agents, the law of agency must decide when to hold the principal responsible for information possessed by the agent.

For example, Sam sells Blackacre to Rachael, innocently assuring her that Blackacre contains no toxic waste. Sam uses an agent to consummate the sale, and Sam's agent knows that a former owner of Blackacre buried loads of noxious chemicals on the land. The agent does not disclose this

information to either Sam or Rachael. In Rachael's subsequent fraud suit against Sam, will the law attribute to Sam the knowledge possessed by his agent?[51]

If the Agent Conveys Certain Information, Under What Circumstances Will the Law Treat the Principal as if the Principal Had Conveyed That Information? In many situations the law cares whether and when a party communicates particular kinds of information. As with information *possessed* by an agent, the law of agency must decide when to hold the principal responsible for information *conveyed* by the agent.

For example, Sam uses an agent to sell Blackacre to Rachael. Without Sam's knowledge or consent the agent tells Rachael that Blackacre contains a lake "full of delicious trout." In fact, the lake contains nothing larger than minnows and the agent knows it. Will the law attribute the agent's statement to Sam?[52]

If an Agent's Acts or Omissions Cause Tort Injuries to a Third Party, Under What Circumstances Can the Third Party Proceed Directly Against the Principal? When an agent commits a tort, the injured party can of course proceed against the agent. The third party may, however, wish to pursue the principal. (For instance, the principal may have a deeper pocket or may make a less sympathetic defendant.) The law of agency must therefore determine under what circumstances a principal is liable for the tortious acts of its agent. For example, suppose the law student's friend, rushing to make last-minute arrangements with the caterer, drives negligently and runs over a dog. May the dog's owner recover damages from the law student? Or suppose a newscaster defames an innocent person. May the person sue the broadcast company?[53]

§1.7.3 Between the Agent and Third Parties

When an Agent Arranges a Commitment Between the Principal and a Third Party, Under What Circumstances May the Third Party Hold the Agent Responsible for the Commitment? This question is of great importance to both the agent and the third party. From the agent's perspective, the risks differ greatly as between merely arranging a contract for the principal and being personally liable for that contract's performance.

From the perspective of the third party, it may well have been the reputation of the agent, not the principal, that induced the third party to make the commitment in the first place.[54]

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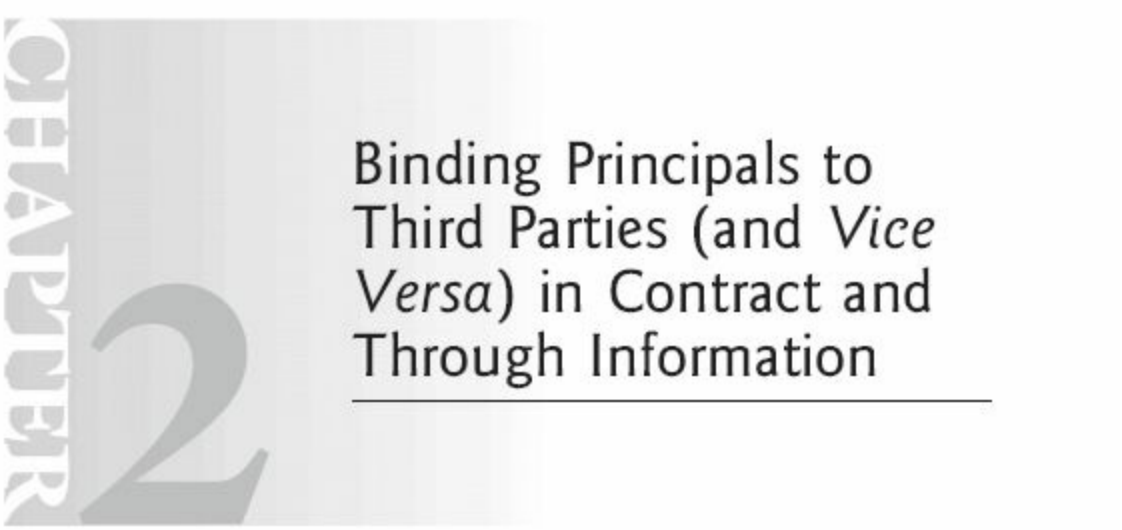
1. The law of agency also applies when a party merely appears to be authorized to act for another. Sections 2.3 and 2.5 discuss the law of "apparent authority" and "agency by estoppel."
2. Henry Wadsworth Longfellow, "The Courtship of Miles Standish," in *Hiawatha, the Courtship of Miles Standish, and Other Poems* (Oxford Univ. Press, 1925).
3. Alexandre Dumas, *The Three Musketeers* (Richard Pevear trans., Viking Adult, 2006) (1844).
4. Thus, the Uniform Computer Information Transactions Act, §102(a)(27) uses a label that is oxymoronic from an agency law perspective: " 'Electronic agent' means a computer program, or electronic or other automated means, used independently to initiate an action, or to respond to electronic messages or performances, on the person's behalf without review or action by an individual at the time of the action or response to the message or performance." For further discussion of statutory law's use of agency law concepts, see §1.6.
5. However, agency law also "encompasses the employment relation, even as to employees whom an employer has not designated to…interact with parties external to the employer's organization." R.3d, §1.01, comment *c*. In this context, the key agency issues are the agent's duty of loyalty to the principal and the question of whether the employer is automatically (vicariously) liable for torts committed by the employee within "the scope of employment." Section 4.1.1 discusses an agent's duty of loyalty. Section 3.2 discuss the notion of *respondeat superior*—vicarious liability for the torts of an employee.
6. See sections 4.1.1 (duty of loyalty) and 4.3.1 (principal's duty to indemnify).
7. Charles Dickens, *Great Expectations*, ch. 36.
8. See Introduction.
9. See section 3.2 discussing *respondeat superior*, which makes a "master" (or "employer") vicariously liable for the torts of a "servant" (or "employee").
10. For a discussion of these subcategories, see sections 2.2 (actual authority) and 2.3 (apparent authority).
11. Bryan A. Garner, ed., *Black's Law Dictionary* 8th ed. (West Group, 2004).
12. For a discussion of this aspect of the duty of loyalty, see section 4.1.1.
13. The phrase substantive law is most commonly used in contradistinction to procedural law. This book uses the phrase in contradistinction to agency law's auxiliary role.
14. For a discussion of the relevant theories of agency law, see sections 2.2 (actual authority), 2.3 (apparent authority), and 25 (estoppel).
15. R.3d, §1.01. R.2d §1 was to the same effect, but without gender-neutral language and without the embedded defined terms: "Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."
16. A manifestation can be "attributable to the principal" under the doctrines of agency law. See sections 2.2.2 (Modes of Communicating the Principal's Manifestations) and 2.4.8.
17. In this respect, agency law follows the modern approach to contract formation.
18. In a franchise agreement, one business ("the franchisor") authorizes another business ("the franchisee") to use the franchisor's name and trademark and to sell either a product produced by the franchisor or an array of services developed by the franchisor. In return, the franchisee typically pays an initial franchise fee plus an ongoing royalty, commission, or service fee. Franchise agreements typically obligate franchisees to operate their business in compliance with requirements set by the franchisor. These requirements can be quite detailed and comprehensive.

19. "Bush Assails 'Quota Bill' at West Point Graduation," N.Y. Times, June 2, 1991, at A32 (George Bush objecting to certain aspects of the 1991 Civil Rights bill: "You can't put a sign on a pig and say it's a horse.").
20. See sections 1.5, 4.1.6, and 4.3.3.
21. See section 5.2.4.
22. See section 4.1.4.
23. R.2d, Chapter 5, topic 1, Introductory Note.
24. If the control characteristic is lacking, the relationship cannot be a true agency. See Chapter 6, and especially sections 6.1.2, 6.2, and 6.3.2.
25. Krom v. Sharp and Dohme, Inc., 180 N.Y.S.2d 99 (1958).
26. "Servant" is R.2d terminology and found extensively in the case law. "Employee" is R.3d terminology.
27. An understanding between the principal and the agent may limit the principal's *right* to exercise control. If a principal violates that understanding when exercising the *power* of control, the agent may sue for damages and may also terminate the agency relationship. See sections 4.1.3 and 4.1.6.
28. See section 6.3 for an extensive discussion.
29. R.3d, §1.01, comment *g*. The foreman and crew are "co-agents" of the construction company. R.3d, §1.04(1). The foreman is a superior agent and the crewmembers are each subordinate agents. *Id*., §1.04(9).
30. See sections 4.1.3 and 4.1.6.
31. For example, if the principal allows the agent to run the principal's business and to appear as the owner, the agent has the power to bind the principal through "transactions usual in such businesses… although contrary to the directions of the principal." R.2d, §195. For further discussion, see section 2.6.2. See also section 2.3 (apparent authority).
32. See section 5.2.
33. R.3d, §1.01, comment *g*.
34. "Modern common law [agency] doctrines operate in the context of statutes," and statutes, both as drafted by legislatures and interpreted by courts, "incorporate definitions or doctrines that are drawn from the common law." R.3d, Introduction (2006).
35. See section 2.4.
36. See, e.g., Revised Uniform Partnership Act (1997), §102(e) (stating rules as to when "a person other than an individual knows, has notice, or receives a notification of a fact"), Uniform Limited Partnership Act (2001), §103(g) (same) and UCC §1-201(27) (stating rules for "[n]otice, knowledge or a notice or notification received by an organization"). But see Revised Uniform Limited Liability Company Act, §103, comment (stating that, in contrast to "previous uniform acts pertaining to business organizations…[f]or the most part, this Act relies instead on generally applicable principles of agency law").
37. Discussed briefly in section 4.3.2.
38. R.3d, Introduction.
39. Discussed in detail in section 3.2.2.
40. Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322-323 (1992).
41. Daniel S. Kleinberger, "Magnificent Circularity and the Churkendoose: LLC Members and Federal Employment Law," 22 Okla. City U. L. Rev. 477, 494 (1997).
42. See section 5.1.1.
43. See section 5.1.1.
44. ULLCA §110 (1996); ULPA (2001) §116; Re-ULLCA §115 (2006).
45. R.2d, §1, comment *b*.
46. See section 1.4.
47. See section 4.1.
48. See section 4.3.

49. Chapter 2 deals with such questions.
50. Chapter 2 also deals with such questions.
51. See section 2.4.4.
52. See section 2.4.6. See also section 3.4.2 (misrepresentation by an agent).
53. For a discussion of these questions, see Chapter 3.
54. See section 4.2.



§2.1 "BINDING THE PRINCIPAL"

§2.1.1 The Importance and Meaning of "Binding the Principal"

Perhaps the most important consequence of the agency label is the agent's power to bind the principal to third parties and to bind third parties to the principal. R.2d defines "power" as "the ability…to produce a change in a given legal relation (between the principal and third parties) by doing or not doing a given act,"[1] and, as explained previously, an agent's power to bind is central to an agent's ability to accomplish tasks on the principal's behalf.[2]

The concept of agency power is essentially a concept of attribution (sometimes called "imputation"). To the extent an agent has the power to bind (according to the several specific attribution rules discussed below), the agent's conduct is attributed to the principal. In the words of a venerable agency law maxim, *qui facit per alium facit per se*.[3] Thus, when a third party asserts that an agent's act or omission has "bound the principal," the third party wants the principal treated legally as if the principal itself had acted or failed to act.

Although the attribution rules differ depending on whether the underlying matter sounds in contract, sounds in tort, or concerns the

possession or communication of information, the concept of attribution is ubiquitous.

Example

An applicant to a law school is delighted to receive a letter, signed by the director of admissions, stating, “We are pleased to offer you a place in the incoming class.” The statement making the offer is legally attributable to the law school, even though the law school (a juridic person distinct from its director of admissions) never made the statement nor signed the letter.

Example

A company’s delivery van crashes into a parked car. The accident results from the van driver’s negligence, but the car owner seeks damages from the company. The car owner’s legal theory attempts to impute to the company the tort of the company’s driver.

Example

A discount warehouse in Iowa contracts with a railroad to transport 150 tractors from Newark, New Jersey, to the railroad’s terminal in Iowa City. The contract between the warehouse and the railroad specifies that the warehouse must pick up the tractors “within three days after receiving notice of their arrival at the Iowa City terminal, and WAREHOUSE shall pay storage fees at a rate of $500 per day for any delay in pick up.” The railroad gives notice of arrival by telephoning the loading dock at the warehouse after normal business hours and speaking to a janitor. The janitor fails to inform the warehouse, the warehouse fails to make a timely pick up, and the railroad claims storage fees. In assessing the storage fees, the railroad wants the warehouse treated as if the warehouse itself had received the notice.

Example

Sam sells Blackacre to Rachael, innocently assuring her that Blackacre contains no toxic waste. Sam uses an agent to consummate the sale (sign the closing documents, etc.), and that person knows that a former owner of Blackacre buried loads of noxious chemicals on the land. Sam’s agent does

not disclose this information either to Sam or to Rachael. In Rachael's subsequent suit to rescind the purchase, Rachael wants Sam treated as if he directly possessed and suppressed the information about the noxious chemicals.

Case in Point—State v. Dalseg

"In this consolidated appeal, Jeff Dalseg and Timothy Cestnik challenge the trial court's decision to deny them credit for time served in the Nisqually Tribal Jail 'work release' program. After the men had served more than 11 months of a 12-month work release sentence in the Nisqually program, the State learned that the program did not comply with the statutory requirements for work release and asked the court to order Dalseg and Cestnik to begin serving their sentences in one that did. The trial court agreed, denying the men credit for any time served. We reverse and remand, holding that Dalseg and Cestnik are entitled to day-for-day credit for time served in the Nisqually 'work release' program under the equitable doctrine of credit for time served at liberty.… The trial court erred when it denied equitable relief on the ground that 'the Nisquallies' were at fault 'for running them into the wrong program.' Dalseg's and Cestnik's judgment and sentences specifically authorize them to serve their sentences in the Nisqually Tribal Jail work release program. This specific authorization cloaked the Nisqually Tribal Jail officials with apparent authority to execute the sentences. Thus, the Nisqually corrections officers acted on behalf of the State when they enrolled Dalseg and Cestnik in a day reporting program rather than a statutorily-compliant work release program. The error made by Nisqually corrections officers in interpreting and executing the judgment and sentences is attributable to the State."[4]

Attribution can also work in favor of the principal, as when a person seeks to hold a third party to a contract entered into by an agent or to information received or communicated by an agent.

Example

An art dealer's employee attends an auction on the dealer's behalf and makes the winning bid on a painting. Later, the dealer tenders payment and seeks to compel the auction house to deliver the painting. The dealer seeks to be

treated as if it itself had made the winning bid.

Example

A residential lease allows either party to terminate on 60 days' notice. The landlord's resident manager gives the proper 60-day notice to a tenant, but the tenant fails to vacate the apartment. In the subsequent eviction action, the landlord wishes to be treated as if it itself had given the requisite notice.

§2.1.2 "Binding the Principal" and Questions of Agency Power

Agency law uses its concept of power to analyze "binding the principal" questions. The question of "Under the law of agency, did *X's* act or omission bind *Y*?" thus becomes "Under the law of agency, did *X* have the power to bind *Y* through that act or omission?" Agency law approaches questions of power through five attribution rules. An agent can have the power to bind a principal through:

1. actual authority (including express and implied actual authority);
2. apparent authority;
3. estoppel;
4. inherent power[5]; and
5. ratification.

More than one subcategory of agency power may apply in any particular situation. Indeed, in practice parties often argue attribution rules in the alternative. For example:

- When *X* made this contract on behalf of *Y*, *X* had actual authority to do so. *Y* is therefore bound.
- And, even if *X* lacked actual authority, *X* had apparent authority and so *Y* is bound.
- And, even if *X* lacked both actual and apparent authority, *X* had the inherent power to bind *Y*, and so *Y* is bound.
- And, even if *X* lacked both the authority and power to bind *Y*, estoppel applies and so *Y* is bound.
- And, even if *X* lacked both the authority and power to bind *Y* and

estoppel does not apply, *Y* subsequently ratified *X*'s act and so *Y* is bound.

This chapter discusses how each of the five attribution rules pertains to binding a principal in contract and also considers how, in contractual and similar matters, a principal can be bound by information that an agent or apparent agent receives, knows, ought to know, or communicates.[6]

§2.1.3 Attribution (Imputation): Transaction Specific and Time Sensitive

Attribution (also called "imputation") is always transaction specific. For instance, the attribution question is not whether "*A* had apparent authority to bind *P*," but rather whether "*A* had apparent authority to bind *P* when *A* did *X*."

Because attribution is transaction specific, attribution is also time sensitive. With the exception of ratification,[7] all attribution rules are applied exclusively as of the time that relevant transaction occurred.

Example

T claims that P is bound to a contract formed last Friday at 3 P.M., when T and A made certain reciprocal manifestations. The attribution analysis focuses on whether *last Friday at 3 P.M.* A had the power to bind P to the contract through those manifestations. ◂

Example

T rents an apartment from P on a month-to-month lease. T claims to have given notice of termination to A on the last day of last month and further claims that the notice is effective against P. The attribution analysis focuses on whether *on the last day of last month* A had the power to bind P by receiving notices related to the lease. ◂

§2.1.4 Distinguishing the Power to Bind from the Right to Bind

As will be discussed throughout this chapter and the next, various

circumstances can *empower* an agent to bind the principal. An agent has the *right* to bind the principal only to the extent that the principal has authorized the agent to do so. A principal gives this authorization in the same way (and often at the same time) that the principal initiates the agency relationship—namely, by making a manifestation that reaches the agent.[8]

To the extent an agent has the right to bind a principal, the agent automatically has the power to do so. It is possible, however, for an agent to have the *power* to bind while lacking the *right*. In such circumstances, if the agent exercises the power and binds the principal, the agent wrongs the principal. Then, consistent with the right/power distinction:

- the agent is liable to the principal for the wrongful conduct, but
- the principal is nonetheless bound to the third party.

Example

Rachael, the owner of Rachael's Service Station, promotes Sam to the position of general manager and puts him in charge of the station's day-to-day operations. Although service station managers ordinarily place orders for batteries, tires, and other accessories, Rachael instructs Sam to leave that ordering to her. Nonetheless, Sam orders batteries. Under the doctrines of apparent authority and inherent agency power,[9] Rachael is bound, even though Sam had no right (vis-à-vis Rachael, his principal) to place the order. ◂

For a graphic illustration of the relationship between the right to bind and the power to bind, see Figure 2-1.

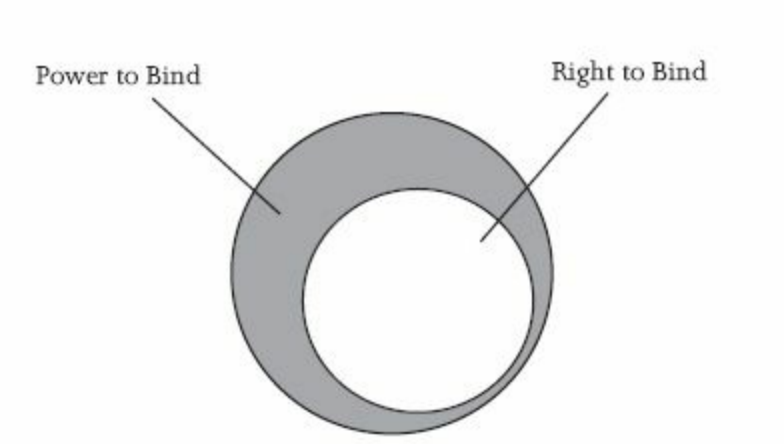


Figure 2-1. The Right to Bind and the Power to Bind

§2.2 ACTUAL AUTHORITY

§2.2.1 The Interface Function and the Agent's Authorized Power to Bind (Actual Authority)

For an agency relationship to come into existence, the principal must manifest consent to have the agent act on the principal's behalf with respect to some goal, task, or set of responsibilities. In many instances, the authorized zone of endeavor involves some "interface" function; that is, some tasks or responsibilities through which the agent connects the principal with third parties.

Example

Rachael hires Sam, an attorney, to represent her as vendee in a real estate closing. Part of Sam's function is to serve as Rachael's interface with the title insurance company, Rachael's lender, the vendor (through the vendor's attorney, if the vendor has an attorney), the vendor's real estate agent, the "closer," etc. ◂

Example

Ofek is hired as a cashier at UpscaleandPricey Jeans, Inc. Her core function is to be the company's interface with its customer at the crucial moment of sale. ◂

This interface function is ubiquitous in, but not essential to, agency relationships.

Example

A Christmas tree farm hires Al to tend and eventually harvest acres of pine trees. Al's ordinary, authorized responsibilities do not include any contact with customers, vendors, or the public. ◂

Where agency involves an interface function, the principal's

manifestation to the agent necessarily creates “actual authority” in the agent. Actual authority means an agent’s authorized (rightful) power to act on behalf of the principal vis à vis third parties.[10] Authorized acts can include the negotiation and making of agreements, and also the receipt, possession, and communication of information.

This section considers the power-to-bind ramifications of actual authority. Chapter 4 considers the ramifications for the obligations between principal and agent.

§2.2.2 Creation of Actual Authority

Essential Mechanics (Elements) Paralleling the creation of the agency relationship itself, creation of actual authority involves:

- an objective manifestation by the principal
- followed by the agent’s reasonable interpretation of that manifestation
- which leads the agent to believe that it is authorized to act for the principal.

“This standard requires that the agent’s belief be reasonable, an objective standard, and that the agent actually hold the belief, a subjective standard.”[11]

Example

Two traveling salespeople, Bernice and Joe, are in the hotel bar. As Joe gets up to get another bowl of pretzels, Bernice says, “It’s Happy Hour. While you’re up, order another round of drinks for us and charge them to me.” Joe orders the round and charges the price to Bernice’s room. In doing so, Joe has acted within his actual authority. Bernice’s statement constituted the necessary manifestation and Joe’s action reflects his interpretation of that manifestation. In the circumstances, Joe’s interpretation is certainly reasonable. ◂

Example

Same situation as above, except that when Joe gets to the bar he discovers that Happy Hour has ended and that prices have returned to the regular,

undiscounted rate. From the bar he conveys that information back to Bernice, who responds by waving her hand in a forward motion. When Joe charges the drinks to Bernice's room, he is acting within his actual authority. Given Bernice's specific reference to Happy Hour, it would initially have been unreasonable for Joe to charge the drinks at the regular rate. However, after checking with Bernice, he received a fresh and different manifestation.

Restatement on Point—R.3d, §2.02, Ill. 4

"P, a photographer, employs A as a business manager. P authorizes A to endorse and deposit checks P receives from publishers of photographs taken by P. Based on P's statements to A, A believes A's authority is limited to endorsing and depositing checks and does not include entering into agreements that bind P in other respects. A endorses and deposits a check from T, a magazine publisher, made payable to P. Printed on the back of the check is a legend: 'Endorsement constitutes a release of all claims.' It is beyond the scope of A's actual authority to release claims that P has against T." The result would be the same even if A could *reasonably* have believed that he or she was authorized to endorse the check. Actual authority requires A's actual as well as reasonable belief.

Scope of Authority Agency law uses the term "scope of authority" to refer to and delineate the extent of an agent's actual authority

Modes of Communicating the Principal's Manifestation The principal's manifestation can reach the agent directly or indirectly, and a manifestation that reaches the agent through intermediaries can certainly give rise to actual authority. Indeed, when the principal is an organization (e.g., a corporation, a limited liability company), an agent normally receives communication "from" the principal via the conduct of co-agents.

Example

The board of directors of Scrooge, Inc. ("Scrooge") adopts a resolution allowing a 10 percent Christmas discount for any tenant who pays the January rent before December 25. The secretary to the board writes and distributes throughout the organization a memo based on the resolution. In

due course, Robert Cratchit, chief rent clerk for Scrooge in the London area, receives a copy of the memo. He then has actual authority to accept 10 percent discounted rent as full payment for January obligations. ◂

Manifestation through Inaction In some circumstances, the principal's manifestation can consist of inaction. When silence, reasonably interpreted, indicates consent, a principal's silence can "speak [or manifest] volumes." For example, when an agent takes particular action, the action comes to attention of the principal, and the principal makes no objection, the agent may well have actual authority to repeat the action in similar circumstances.

Example

For years, the mechanics at Rachael's Service Station have, on an ad hoc basis, offered a 10 percent discount to regular customers on major service jobs. Rachael, the owner, has never explicitly authorized the practice, but she has been aware of it and has not previously objected to it. As a result of Rachael's silent acquiescence, the mechanics have actual authority to offer the discount. The acquiescence satisfies the "manifestation" requirement. ◂

Assessing the Reasonableness of the Agent's Belief Agency law determines the reasonableness of the agent's interpretation by considering the same types of information that figure into determinations of reasonableness in other areas of law. In the words of the R.2d: "All…matters throwing light upon what a reasonable person in the position of the agent at the time of acting would consider are to be given due weight."[12] In the words of the R.3d: "An agent's understanding of the principal's objectives is reasonable if it accords with the principal's manifestations and the inferences that a reasonable person in the agent's position would draw from the circumstances creating the agency."[13]

The Restatements' references to "reasonable person" reflect an objective standard. In determining the scope of an agent's actual authority, what matters is the principal's objective manifestation and the agent's reasonable interpretation of that manifestation. Any unexpressed, subjective intent of the principal is irrelevant.[14]

Fiduciary Duty and the Reasonableness of the Agent's Interpretation The R.3d makes an interesting connection between the agent's fiduciary duty and

the reasonableness of the agent's interpretation. To be reasonable, an agent's interpretation must be made "in light of the context," which includes "the agent's fiduciary duty to the principal."[15] This black letter statement has significant practical implications:

> An agent's fiduciary position requires the agent to interpret the principal's statement of authority, as well as any interim instructions received from the principal, in a reasonable manner to further purposes of the principal that the agent knows or should know, in light of facts that the agent knows or should know at the time of acting. An agent thus is not free to exploit gaps or arguable ambiguities in the principal's instructions to further the agent's self-interest, or the interest of another, when the agent's interpretation does not serve the principal's purposes or interests known to the agent. This rule for interpretation by agents facilitates and simplifies principals' exercise of the right of control because a principal, in granting authority or issuing instructions to an agent, does not bear the risk that the agent will exploit gaps or ambiguities in the principal's instructions. In the absence of the fiduciary benchmark,…the principal would be at greater risk in granting authority and stating instructions in a form that gives an agent discretion in determining how to fulfill the principal's direction.[16]

Principal's Control of Agent's Interpretation A principal can protect against ambiguity by being careful to give clear and specific instructions. Moreover, a principal can always cut back or countermand previously granted authority simply by making an appropriate manifestation and seeing that it reaches the agent. Except in extraordinary circumstances, the later manifestation "trumps" the earlier one. Once the agent knows that the principal wants to remove some or all of the agent's authority, the agent can no longer reasonably believe that it has the authority the principal wants to remove.

Example

Rachael, the owner of Rachael's Service Station, decides that she can no longer afford the 10 percent discount. She calls the mechanics together and says, "Effective right now, no more 10 percent discounts." The next day, one of the mechanics, momentarily forgetting Rachael's instruction, offers the discount to a customer. In doing so, the mechanic has acted without actual authority. After Rachael's instruction, the mechanic cannot *reasonably* believe himself authorized to give 10 percent discounts. ◂

In some circumstances, the principal's countermanding manifestation can change the agent's actual authority even before the agent learns of the manifestation. If the agent has reason to know of the new instructions, then almost by definition the agent's interpretation of the principal's prior manifestation are no longer reasonable.

Example

Bligh dispatches Ahab to buy a load of whale blubber and ship it to New York City "ex *Peerless*." After Ahab has bought the blubber but before he has made the shipping contract, Bligh sends the following text message to Ahab: "doubts re Peerless in water use another ship." Text messages are a common means of communication between Bligh and Ahab. Unfortunately, Ahab has let his cell phone battery run down and does not retrieve Bligh's message until after the blubber is loaded on the *Peerless*. Even though Ahab did not actually know of the new instructions when he made the shipping contract for Bligh, Ahab had reason to know—that is, if had he acted reasonably and kept his cell phone in working condition he would have received Bligh's message. Therefore, Ahab's interpretation of his original instructions was no longer reasonable. ◂

In cutting back or countermanding previously granted authority, the principal may be breaching a contract between the principal and agent.[17] The principal may also be leaving intact the agent's inherent power to bind the principal or an enforceable appearance of authority, or both.[18]

§2.2.3 Irrelevance of Third-Party Knowledge (Unidentified and Undisclosed Principals)

Typically, a third person dealing with an agent knows or has reason to know that the agent is acting as such and also knows or has reason to know who (or what) the principal is. In this situation, agency law characterizes the principal as "disclosed."[19] However, the elements for creating actual authority involve the principal and the agent and have nothing to do with what third parties may or may not know.[20] In determining the existence and extent of an agent's actual authority, the law focuses on the relationship between the principal and the agent (the *inter se* relationship). An agent can thus have actual authority (and therefore power to bind the principal to third parties) even though at the time of the "binding" act or omission the principal is:

- *unidentified* (i.e., the third party knows or has reason to know that the agent is acting for another, but not who that other is);[21] or even
- totally *undisclosed* (i.e., the third party neither knows nor has reason

to know that the agent is acting as an agent and perforce cannot know the principal's identity).

By definition, when the principal is undisclosed or unidentified, the third party can learn of the agent's actual authority only after the agent's exercise of that authority. Nonetheless, if the authority existed at the time of the transaction, the principal is bound.

Example

A power company authorizes a coal broker to buy coal for it. The broker contracts to buy the coal in its own name. When the seller later prepares to deliver the coal to the broker, the seller discovers that the broker has gone out of business. Then the seller discovers that the broker was making the purchase on the power company's behalf and had actual authority to do so. By asserting actual authority, the seller can hold the *undisclosed principal* (the power company) to the contract. Because actual authority is at issue, it is irrelevant that at the time of contracting the seller was ignorant of the agency relationship. ◂

Example

An attorney contacts an art dealer and contracts to buy a famous Picasso print. The attorney explains that she is acting for a client but declines to identify the client. (The client dislikes notoriety.) If the art dealer later learns the identity of the *unidentified* principal (the client) and can prove that the attorney acted with actual authority, then the art dealer can enforce the contract against the client.[22] ◂

§2.2.4 Actual Authority: Express and Implied

In addition to the authority expressly indicated by the principal's words and other conduct, an agent may also have *implied* actual authority. The concept is "black letter" in R.2d, but relegated to the comments in R.3d.[23]

That change does not affect the way the concept operates in practice. R.2d, §35 states: "Unless otherwise agreed, authority to conduct a transaction includes authority to do acts which are incidental to it, usually accompany it,

or are reasonably necessary to accomplish it." Sometimes the implication is based on custom or past dealings. Other times, "the principal's objectives and other facts known to the agent" cause an agent to infer that a particular act is authorized.[24]

Comment *b* to R.2d, §35 states the very simple rationale for the concept of implied authority. "In most cases the principal does not think of, far less specifically direct, the series of acts necessary to accomplish his objects." Implied actual authority fills in the gaps.[25]

Example

An insurance broker acted as local agent for an insurance company, with express authority to conduct business for the company in the locality. Although the insurance company had given no express instructions to the broker on how to handle cancellation notices received from policyholders, the broker had implied authority to receive such notices. Accordingly, notice to the broker was notice to the insurance company.

Case in Point—Dweck v. Nasser

"A minority stockholder, and former president, chief executive officer, and director of a closely held corporation seeks to enforce a settlement agreement terminating the litigation between herself and the defendant [Nasser], the majority stockholder. On November 19, 2007, [Shiboleth] a long-time attorney, business associate, and close personal friend of the defendant agreed to a settlement after protracted negotiations.… [Nasser subsequently refused to sign the settlement agreement, asserting that he had never authorized Shiboleth to settle the dispute without Nasser's review of the settlement document. The court disagreed on several grounds, one of which was implied actual authority.].… Nasser directed Shiboleth to settle the action and permitted him to speak "in his name." Moreover, he told Shiboleth that he would execute any agreement that Shiboleth and Heyman presented to him. Given this behavior and Shiboleth's long-standing close personal and business relationship with Nasser, it was reasonable for Shiboleth to assume he was authorized to settle the litigation. At his deposition, Shiboleth testified that he had settled many cases for Nasser in the past and that in those circumstances Nasser would instruct him to: '[D]o what you want. That

means settle it in our implied terms. That's the way we communicate for twenty years. When he tells me to do what you understand or what you want, in terms of settling a case…you are…authorized to settle the case.' "[26]

The express manifestations of the principal can always negate implied authority.

Example

Sartre authorizes Camus to negotiate the sale of a plot of land owned by Sartre.[27] In that locality, land sales are almost always done by warranty deed, a custom that would ordinarily give Camus implied actual authority to sign a warranty deed on Sartre's behalf. However, Sartre tells Camus, "Existence is uncertain. Use a quit claim deed only." Camus lacks actual authority to adhere to the local custom.

§2.2.5 Binding the Principal and Third Party in Contract via Actual Authority

If an agent acting with actual authority makes a contract on behalf of a principal, then the principal is bound to the contract as if the principal had directly entered into the contract. In almost all circumstances, the third party is likewise bound on the contract to the principal.

Example

Sam, a research scientist, instructs Irv, his lab manager, "Get me a maintenance contract on the electron microscope. Make sure that we have service 24/7/365. I don't care what it costs." Irv enters into a contract with Selma's Service Company, signing the contract, "Irv, as manager for Sam." Sam, the disclosed principal, is bound to the contract.

Example

Same situation, except that Irv signs the contract in his own name, without having made any reference to Sam. Sam, the undisclosed principal, is bound to the contract.

Example

Same situation, except that Irv enters into the contract through a phone conversation with Selma, explaining, “I’m making this agreement for the lab’s owner.” Sam, the unidentified/partially disclosed principal, is bound to the contract. ◂

§2.2.6 Binding the Principal via Actual Authority: Special Rules for Contracts Involving Undisclosed Principals

When the principal is undisclosed, the third party is sometimes entitled to: (i) insist on rendering performance to the agent; or (ii) escape the contract entirely.

Rendering Performance to the Agent The third party may insist upon rendering performance to the agent if the contract requires the third party to perform personal services, or if in some other way rendering performance to the undisclosed principal would significantly change the third party’s burden. This rule fits the expectations of the third party, who entered into the contract expecting to render performance to the agent, not the principal. Deviating from that expectation is fair only if the deviation does not significantly alter the third party’s burdens.[28]

Escaping the Contract Entirely In a narrow range of circumstances, a third party may escape entirely a contract made with an agent for an undisclosed principal. Escape is possible if either:

- the contract so provides; that is, the contract states that it is inoperative if the agent is representing someone; or
- a special (very difficult to establish) kind of fraud exists:
  — the agent fraudulently represented that the agent was not acting for the principal;
  — the third party would not have entered into the contract knowing the principal was a party; and
  — the agent or undisclosed principal knew or should have known that the third party would not have made the contract with the principal.

Misrepresentation of the principal's role is insufficient without the other elements. Mere failure to disclose the principal's existence is always insufficient.

Example

A guitar maker has a guitar for sale. A musician wishes to buy but knows that, due to a longstanding feud, the guitar maker will refuse to sell the guitar to him. The would-be buyer therefore asks a friend to make the purchase. The guitar maker says to the friend, "I care about the guitars I make. I want to be sure that they're treated with respect." The friend responds, "Don't worry. I've wanted one of your guitars for a long time. I am looking forward to playing this one for years to come. I'll take good care of it." The guitar maker agrees to a deal, but learns the truth before the friend takes possession of the guitar. The guitar maker is not obligated to go through with the sale. The agent affirmatively misrepresented the principal's role, that misrepresentation induced the seller to make the contract, and both the agent and the principal knew that the guitar maker would not have made a contract with the principal. ◂

Example

A railroad company wishes to acquire three parcels of land for a new line. The company fears that the landowners will ask too much money if they learn that the railroad needs the land. It also fears the same result if the landowners are contacted by someone representing an unnamed principal. The company therefore uses three different "straw men." Each of these agents individually approaches one of the landowners. Each of the agents affirmatively states that he or she is acting on his or her own account. Each negotiates for and signs a land purchase contract in his or her own name. Later, before the purchases are closed, the landowners learn that the railroad is the actual purchaser and seek to avoid or renegotiate the deals.

The landowners are bound to the original deals. The agents did actively misrepresent the role of the undisclosed principal, but neither the agents nor their undisclosed principal had reason to know that the third parties would refuse to contract with the principal. To the contrary, both the agents and principal thought the third parties would be delighted to contract with the railroad—but at a substantially higher price. ◂

§2.3 APPARENT AUTHORITY

§2.3.1 The Misnomer of "Apparent Authority"

"Apparent authority" is a misnomer. The term refers to the power to bind, not the right. The power derives from the *appearance* of legitimate authority; the doctrine exists to protect third parties who are misled by appearances.[29]

§2.3.2 Creation of Apparent Authority

Mechanics Apparent authority exists when:

- one party ("apparent principal") makes a manifestation, which
- somehow reaches a third party, and
- which alone or (more often) in the context of other circumstances causes the third party to reasonably believe that another party ("apparent agent") is indeed authorized to act for the apparent principal.

In the words of R.3d, §2.03: "Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."[30]

Relationship to Actual Authority Apparent authority can coexist and be coextensive with actual authority.

Example

Two traveling salespeople, Bernice and Joe, are in the hotel bar. As Joe gets up to get another bowl of pretzels, Bernice says, "While you're up, order another round of drinks for us and charge them to me." Joe orders the round and charges the price to Bernice's room. If the bartender overheard Bernice's instructions, Joe had apparent as well as actual authority to charge the drinks.

Apparent authority can also extend an actual agent's power to bind the principal beyond the scope of the agent's actual authority.

Example

An Art Collector arranges for Broker to attend a forthcoming art auction and bid on certain items on Collector's behalf. Collector sends a letter to the Auction House, stating, "At your upcoming auction, Broker will represent me and is authorized to bid on my behalf." In the past Broker has often placed bids for Collector in excess of $50,000. This time Collector tells the Broker, "Don't bid more than $25,000 on any item." Collector does not, however, communicate this limit to the Auction House. Although the Broker's actual authority to bid is limited to $25,000 per item, the limit does not apply to the Broker's apparent authority.

Apparent authority can also exist where no actual agency exists.

Example

The Art Collector arranges for Broker to attend a forthcoming art auction and bid on certain items on Collector's behalf. Collector sends a letter to the Auction House, stating, "At your upcoming auction, Broker will represent me and is authorized to bid on my behalf." Subsequently Collector changes his mind and instructs Broker not to bid for him. Collector neglects, however, to inform Auction House of this change. Although Broker has no actual authority to bind for Collector, Broker does have apparent authority.

The Question of Reliance When a third party seeks to bind an apparent principal by claiming apparent authority, must the claimant show detrimental reliance? The question is imprecise (as will be seen), and the answer is somewhat complex.

Under both the R.2d and R.3d, the claimant's inference of authority must be traceable to (and therefore, in some sense, rely on) the principal's manifestation.[31] (first occasion for reliance—Point 1—in the timeline shown in Figure 2-2).

Must there be further reliance? In particular, must a claimant show that the appearance of authority caused the claimant to act to the claimant's detriment? (second occasion for reliance—Point 2—in Figure 2-2). Neither

Restatement has this requirement, but many jurisdictions do. Indeed, some opinions refer to apparent authority as *agency by estoppel*.[32]

This doctrinal difference may have little practical significance. If a false appearance of authority does not cause a third party to act or omit to act to its detriment, then a claim will rarely be worth pursuing.

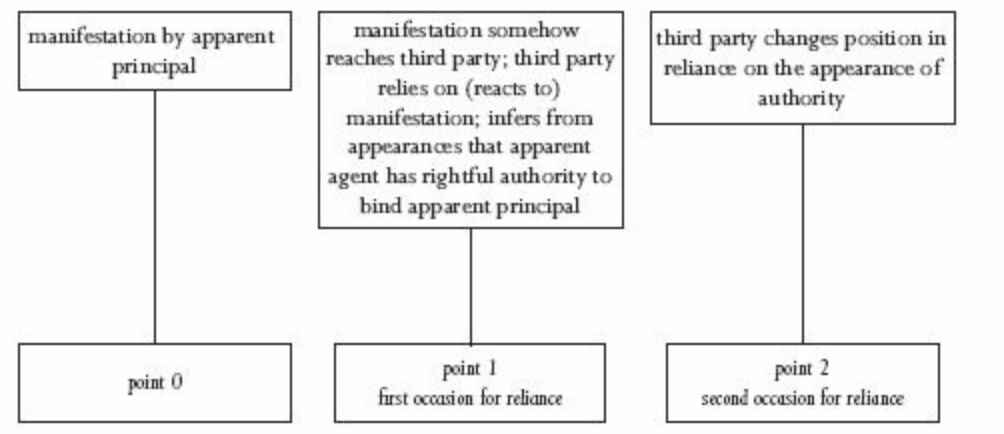


Figure 2-2. The Role of Reliance in Creating Apparent Authority

§2.3.3 The Necessary Peppercorn of Manifestation

For apparent authority to exist, the third party must be able to point to at least some peppercorn of manifestation attributable to the apparent principal. This peppercorn must form the basis of the third party's reasonable belief that the apparent agent is actually authorized.

The R.3d uses the phrase "traceable to the principal's manifestations" to express this requirement. The "traceable" requirement means that, with one rarely important exception (discussed below), the statements of the apparent agent cannot by themselves give rise to apparent authority.[33]

Example

A silver-tongued salesman, nattily dressed and appearing for all the world to be precisely whom he claims to be, rings your doorbell and introduces himself as a representative of the Acme Burial Insurance Company. He shows you an impressive, glossy brochure and a printed contract form. You sign on the dotted line and give the man a $100 down payment. You later discover that the silver-tongued fellow had no connection whatsoever with Acme and that he had created the phony brochures and contract forms as

props. Unfortunately, you have no recourse against Acme. Although your belief that the salesman was acting for Acme may have been reasonable, you cannot point to any manifestation by or attributable to Acme, the apparent principal. Consequently, there is no apparent authority.

An apparent agent can supply the necessary peppercorn of manifestation only if the apparent agent: (i) is actually authorized to act for the principal; and (ii) while actually authorized, accurately describes the extent of its authority. Every agent has the implied actual authority to accurately describe the agent's own actual authority,[34] and such accurate descriptions are therefore attributable to the principal.

Example

You operate a horse ranch. One day a woman approaches you and informs you that she buys horses on behalf of Acme Rodeo Company and that she has the authority to pay up to $2,500 per horse. At that time, her statements are accurate. Two weeks later she returns and purports to commit Acme to purchase a quarter horse for $2,200. Unbeknownst to you, however, three days earlier Acme had expressly restricted her authority to purchases of $1,700 or less. You should be able to hold Acme to the contract through an apparent authority claim. You can certainly show a manifestation attributable to the apparent principal. When the buying agent earlier described her buying authority, she acted within her implied actual authority. That description is therefore a manifestation attributable (and therefore "traceable") to Acme.

§2.3.4 Noteworthy Modes of Manifestation

Through Intermediaries A manifestation that reaches the third party through intermediaries can still give rise to apparent authority.

Example

Acting on instructions from Art Collector, Art Collector's personal secretary sends a letter to the Auction House stating: "On behalf of Art Collector, I am writing to inform you that, at your upcoming auction, Broker will be representing and bidding for Art Collector." Broker has apparent authority to bid for the Art Collector, even though Art Collector herself (the apparent

principal) never personally made the relevant manifestation. The secretary's letter constitutes a manifestation *attributable* to Art Collector because the secretary's communication, made within the scope of the secretary's actual authority, binds (i.e., is attributable to) the secretary's principal.[35]

By Position Sometimes the principal's sole manifestation to the third party may be to put an agent in a particular role. In light of local custom and standard business practices, that role may by itself cause a third party to believe reasonably that the agent has certain authority. This type of apparent authority is sometimes called *authority by position*.

Example

The owner of a dry cleaning store hires Ralph to work at the counter, and expressly authorizes him to accept clothes for cleaning, give receipts, return cleaned clothes to customers, and accept payment from customers. Although the owner expressly forbids Ralph to promise to have any garment cleaned in less than two working days, Ralph promises a law student to have her "interview suit" cleaned "by tomorrow." The doctrine of apparent authority may hold the dry cleaning store to Ralph's promise. Ralph's position (as counter clerk) constitutes the necessary manifestation. The question is whether, based on that bare manifestation, the customer reasonably believed that Ralph had the authority to make the promise. Since it is customary for counter clerks to tell customers when clothes will be ready, and since 24-hour service is not unusual in the dry cleaning business, the answer is probably yes.[36]

Example

After lengthy negotiations with a claims adjuster and without any lawsuit having been filed, an attorney purports to settle her client's insurance claim for $25,000. Unless the client has given the attorney actual authority to settle for that amount, the client is not bound. The mere position of an attorney does not create apparent authority to bind a client to a settlement.[37]

Under the doctrine of "apparent authority by position," the word "position" refers not to physical location but rather to a person's recognized role within an organization and the functions normally performed by a person

in that recognized role. In some instances—as in the above Example with Ralph and the dry cleaning—a person's physical position signals that the person has a particular function and role on behalf of the principal. Even then, however, the physical location is merely evidence of the organizational position.◂

Apparent Authority by Position within Organizations Large organizations dominate our economy, and those organizations inevitably distribute responsibilities across many positions. Moreover, even in a small organization employees can have substantially different functions, which may be reflected in job titles.

It is therefore necessary to consider what apparent authority, if any, attaches to positions and titles within an organizational hierarchy. In general:

> [A]n agent is sometimes placed in a position in an industry or setting in which holders of the position customarily have authority of a specific scope. Absent notice to third parties to the contrary, placing the agent in such a position constitutes a manifestation that the principal assents to be bound by actions by the agent that fall within that scope.[38]

Example

Rachael is employed as a "purchasing agent" by Snerdly Manufacturing, LLC. Rachael has the apparent authority to make ordinary and usual purchases on Snerdly's behalf.◂

The particularities of an organization's structure may influence the apparent authority analysis.

> Observing a systematic hierarchy, a third party might reasonably infer that the organization is represented by a particular agent whose acts and statements are compatible with the agent's situation within the organization. Questions of apparent authority in this context often turn on the interplay between general definitions or authority associated [e.g., by custom] with specific positions and observed characteristics of how the organization actually functions.[39]

More particularly:

- *CEO or president*—apparent authority for transactions within the organization's ordinary course of business
- *general manager*—apparent authority for transactions within the organization's ordinary course of business
- *vice president*—no apparent authority, because the title lacks any

generalized meaning; however, a "vice president for/of [some specific function]" might have apparent authority to commit the organization to matters normally handled by the person in charge of that function

- *corporate secretary*—apparent authority to certify copies of corporate documents
- *branch manager*—in most jurisdictions, no *per se* apparent authority to bind the principal, but probably apparent authority to communicate decisions on significant matters made by the principal and, in some jurisdictions, apparent authority to make decisions ordinarily made at the branch level

Example

The CEO of Oz Balloon Tours, Inc., purports to commit the company to sell its sole balloon. The CEO has no apparent authority for this extraordinary transaction. ◂

Example

Same facts, except that the company has 20 balloons, regularly buys new ones, and sells used ones. The CEO has apparent authority to sell one or several used balloons. ◂

Example

Rachael is the vice president for marketing for Sammada, LLC, a company that puts on rock concert tours and is known to spend tens of thousands of dollars in advertising. Rachael has apparent authority to enter into a $15,000 radio "buy" in a local media market to advertise a concert sponsored by Sammada. ◂

An agent's apparent authority can be augmented if the organization provides the agent with standardized form contracts.

Example

Rosencrantz is a branch manager for the First Bank of Polonius, with actual authority to approve loans in amounts less than $50,000. The Bank provides

Rosencrantz with copies of a form loan agreement, the first page of which carries the Bank's name and states in bold print: **NOT VALID FOR LOANS IN EXCESS OF $100,000.** Rosencrantz uses a copy of the form agreement to commit the Bank to lend Laertes $75,000. The Bank is probably bound. It is unclear whether Rosencrantz's position as branch manager suffices to create apparent authority for a $75,000 loan. However, Rosencrantz's possession of the form agreements (a manifestation traceable to the Bank), coupled with his position, probably does.

By Acquiescence Sometimes the principal makes the necessary manifestation by acquiescing in an agent's conduct.

Example

On several occasions, the caretaker of an apartment complex contracts with a roof repair service to fix a leaking roof. Each time, the repair service sends an invoice to the owner of the complex, and each time the owner pays. The repair service has no other contact with the owner. On the next service call, all goes as usual except that the owner refuses to pay. The owner claims that "the caretaker has no authority to order repairs." Even if the owner is correct as to the caretaker's actual authority, the repair service can still collect. By paying the previous invoices without comment, the owner of the complex has made the predicate manifestation to "clothe" the caretaker with apparent authority to order repairs from that particular repair company.

Example

After the first two days of trial, attorneys for the two sides negotiate a settlement. With the parties present in open court, the two attorneys read the settlement into the record. Neither party objects. Both parties are bound to the settlement regardless of whether either attorney had actual authority to settle. The clients' acquiescence imparted apparent authority to their respective counsel.[40]

By Inaction In limited circumstances, an apparent principal's inaction may constitute a manifestation. For an apparent principal's inaction to give rise to apparent authority, the following criteria must be met:

- Someone (including the apparent agent) must assert that the apparent agent has actual authority.
- The apparent principal must be aware of those assertions and fail to do anything to contradict them.
- The third-party claimant must reasonably believe that the apparent agent is authorized.
- The third-party claimant must be aware of:
  — the assertions themselves,
  — the apparent principal's knowledge of the assertions, and
  — the apparent principal's failure to contradict the assertions.
- The third party's reasonable belief that the apparent agent is authorized must be traceable to the apparent principal's failure to contradict the assertions.[41]

In these circumstances, the apparent principal's silence amounts to acquiescence and is a manifestation that is known to the third party.[42]

Case in Point—Azur v. Chase Bank, USA, Nat. Ass'n.

"Francis H. Azur filed suit against Chase Bank, USA, alleging [*inter alia]* violations of 15 U.S.C. §§1643 and 1666 of the Truth in Lending Act (TILA) …after Azur's personal assistant, Michele Vanek, misappropriated over $1 million from Azur through the fraudulent use of a Chase credit card over the course of seven years.… [W]e must evaluate whether Azur's §§1643 and 1666 claims are precluded because Azur vested Vanek with apparent authority to use the Chase credit card.… Vanek's responsibilities consisted of picking up Azur's personal bills, including his credit card bills, from a Post Office Box in Coraopolis, Pennsylvania; opening the bills; preparing and presenting checks for Azur to sign; mailing the payments; and balancing Azur's checking and savings accounts at Dollar Bank. According to Azur, it was Vanek's job alone to review Azur's credit card and bank statements and contact the credit card company to discuss any odd charges. Azur also provided Vanek with access to his credit card number to enable her to make purchases at his request.… Azur's negligent omissions led Chase to reasonably believe that the fraudulent charges were authorized. Although Azur may not have been aware that Vanek was using the Chase credit card, or even that the Chase credit card account existed, Azur knew that he had a

Dollar Bank checking account, and he did not review his Dollar Bank statements or exercise any other oversight over Vanek, his employee. Instead, Azur…[failed] to separate the approval and payment functions within [his] cash disbursement process. Had Azur occasionally reviewed his statements, Azur would have likely noticed that checks had been written to Chase. Because Chase reasonably believed that a prudent business person would oversee his employees in such a manner, Chase reasonably relied on the continuous payment of the fraudulent charges."[43]

§2.3.5 The Third Party's Interpretation: The Reasonableness Requirement

Mere Belief Is Insufficient For apparent authority to exist, a manifestation attributable to the apparent principal must cause the third party to believe that the apparent agent has authority. Mere belief, however, is not enough. Apparent authority will exist only to the extent that the third party's belief is reasonable.

In determining whether a third party has reasonably interpreted the apparent principal's manifestations, the law considers the same kinds of information that are relevant to determining whether *an agent* has reasonably interpreted the manifestation of its principal.[44] Apparent authority analysis thus parallels actual authority analysis, except that apparent authority focuses on the interpretations of the third party, not the agent. We can therefore adapt R.2d, §34, comment *a* to read: "All matters throwing light upon what a reasonable person in the position of the [third party] at the time of acting would consider are to be given due weight."[45]

Case in Point—Streetman v. Benchmark Bank

The Streetmans' business collapsed when their bank stopped honoring plaintiffs' overdraft checks. Asserting that the bank's loan officer had promised that the bank would honor "all overdrafts," the Streetmans sued. The court first held that the loan officer had no actual authority to make the promise. On the issue of apparent authority, the court stated: "The undisputed evidence clearly shows that the Streetmans knew from dealing with their previous bank that banks have lending limits; consequently, they knew that

[the loan officer's] authority was limited and that he could not agree to pay 'all overdrafts' drawn on their account. Moreover, a reasonably prudent person would not believe that Watts was acting within the scope of his authority by promising to pay 'all overdrafts' drawn on the account."[46]

The Third Party's Duty of Inquiry Sometimes an apparent principal's manifestations create an appearance of authority, but it remains unreasonable for a third party to act upon that appearance without knowing more. The reasonable interpretation requirement thus imposes a duty of inquiry on the third-party claimant.[47] For instance, the manifestation itself may be ambiguous. Or the apparent agent's conduct may be sufficiently unusual as to raise doubts. In such circumstances, the third party cannot reasonably interpret the manifestation as an indication of authority without first making some inquiry of the apparent principal.

Case in Point—Truck Crane Service Co. v. Barr-Nelson

A supplier of construction services and a general contractor dispute whether the general contractor is liable to the supplier for services furnished to a subcontractor. The president of the general contractor writes a letter denying liability. The supplier subsequently telephones the general contractor and talks with a vice president. Without consulting the president and without actual authority, the vice president acknowledges the liability and signs an agreement guaranteeing the subcontractor's payment. When the general contractor repudiates the vice president's action, the supplier claims that the vice president had apparent authority to make the acknowledgement and sign the guarantee. A court holds otherwise, stating: "The fact that the [supplier] had been notified in writing by [the general contractor's] president that [the general contractor] denied liability for these services put the [supplier] on inquiry as to the authority of any other employee to countermand such a position."[48]

The Role of the Apparent Agent's Conduct With the one exception discussed in section 2.3.3 (the Example about the horse buyer), the apparent agent's conduct cannot satisfy the manifestation requirement. That conduct can, however, enter into the reasonableness determination. Plausible behavior by the apparent agent will buttress the third party's claim; implausible

behavior will undercut it.

Irrelevance of Apparent Agent's Purpose A person with apparent authority can bind the apparent principal to a contract even if the person does not intend to benefit the apparent principal and even if the person is lying about being authorized.

Example

A bank teller accepts a customer's deposit of $9,000 in cash, deciding at that moment to pocket the cash for himself. The teller prints the customer her receipt and then "goes on break" and never returns (absconding with the $9,000). When the teller accepted the deposit, he lacked the actual authority to act for the bank.[49] He continued to have apparent authority by position, however, and the bank must credit the customer's account with $9,000.

§2.3.6 The Necessity of Situation-by-Situation Analysis

Although an apparent agent may have apparent authority as to a wide range of acts and as to a wide range of third parties, each claim of apparent authority must be analyzed separately—even different claims from the same claimant. The reasons for this approach inhere in the elements necessary to create apparent authority. For any given claim of apparent authority, the third party must show that, at the relevant moment:

1. a manifestation had occurred that was attributable to the apparent principal;
2. the manifestation had reached the third party;
3. the manifestation caused the third party to believe that the apparent agent was authorized; and
4. the third party's belief was reasonable.

If the apparent principal has made more than one manifestation, element one may vary from claimant to claimant. Elements two, three, and four may vary depending on the identity of the third-party claimant and on the specific act claimed to be authorized. For example, two different third parties may draw different conclusions from the same manifestations. Or, two different third

parties may draw the same conclusion, but for one—possessing knowledge or expertise lacked by the other—the conclusion may not be reasonable. Similarly, even with regard to the same third party, one act may reasonably appear authorized while another act may not.

Given the necessity of situation-by-situation analysis, efforts to counteract an impression of apparent authority will be effective only to the extent that the counteracting manifestations timely reach the relevant third party.

Example

Rachael, the owner of Rachael's Service Station, decides that she can no longer afford the 10 percent discount she has long offered to regular customers. She calls her mechanics together and says, "Effective right now, no more 10 percent discounts." The next day, one of the mechanics, momentarily forgetting Rachael's instruction, offers the discount to a customer. The customer accepts and leaves the car for servicing. When the customer returns to pick up the car, the mechanic says, "Hey, I'm sorry. I forgot. We don't give 10 percent discounts anymore." The customer is nonetheless entitled to the discount. Based on past dealings, the mechanic had apparent authority by acquiescence. Although the mechanic now lacks actual authority, the apparent authority remains intact because Rachael's counteracting manifestation has not reached the third party. ◂

§2.3.7 "Lingering" Apparent Authority

The doctrine of "lingering" apparent authority is the agency law's analog to the concept of inertia.[50] "[I]t is reasonable for third parties to assume that an agent's actual authority is a continuing or ongoing condition."[51] Therefore, a person's apparent authority can continue after the person's actual authority has ended.

Example

A landlord fires her resident manager, effective immediately, giving the manager 30 days notice to vacate the apartment designated as the manager's apartment. The landlord then sends a letter to each tenant in the building,

explaining the situation and stating that all inquiries, notices, and payments should be made directly to the landlord. The next morning, before the letter has arrived, a tenant delivers his rent to the former resident manager, who accepts the rent as if nothing had happened. Although the former resident manager lacked actual authority to accept the rent, apparent authority still existed. ◂

How long apparent authority can linger depends on the circumstances. The more substantial the transaction involved, the more likely it is that the third party has a duty to reconfirm the purported agent's *bona fides*. Likewise, it matters how distant in time the transaction is from the most recent manifestation traceable to the purported principal. The overarching question is whether the third party's belief continues to be reasonable.

§2.3.8 Rationale of the Apparent Authority Doctrine

When a person purports to bind another in an interaction with a third party but lacks the actual authority to do so, the law must decide which of two relatively blameless parties will bear any resulting loss—the apparent principal or the third party.[52] For two different (though compatible) reasons, where apparent authority existed, the law puts the loss on the apparent principal:

1. So long as the third party has not been careless or silly, any loss resulting from the misapprehension of authority should be imposed on the party who could have prevented the misapprehension in the first place.
2. Any loss should be imposed so as not to disrupt normal commercial operations.

The first rationale is reflected in the doctrine's requirement that the third party's belief be reasonable. The second rationale is served because the doctrine permits a commercial entity to rely on the appearance of authority so long as the appearance can be traced back to a manifestation of the apparent principal and the commercial entity acts reasonably in interpreting that manifestation.

§2.3.9 Apparent Authority and Principals That Are Not Fully

Disclosed

An agent for an undisclosed principal can never have apparent authority, because by definition the third party is unaware that the agent is acting for any principal at all. It is therefore impossible for the third party to claim that, at the relevant moment, the agent appeared to be acting for the actual principal.[53]

As to an agent for an unidentified (partially disclosed) principal, apparent authority is possible in theory but rare in practice. The third party must be able to point to some manifestation attributable to the principal that supports an inference that the agent has actual authority to act for *some* principal but which does not disclose the identity of the actual principal.

Example

P, an importer, has purchased a shipment of steel from Brazil and retains *A*, a customhouse broker, to clear the steel through customs. That task requires posting security for any custom duties that may be due, and customhouse brokers typically obtain security bonds on behalf of their clients. Without disclosing *P*'s identity, *A* arranges for *T*, an insurance company, to post a surety bond for the duties on *P*'s steel. *A* has apparent authority to bind *P* to pay *T* for the bond. *P* has provided *A* with the information about the shipment, which *A* needs in order to arrange the bond, and *T* is aware that *A* has obtained that information for the owner of the steel. *P* has thus made a manifestation that *A* is authorized to act on *P*'s behalf, even though neither the manifestation nor any other circumstances have disclosed *P*'s identity.[54]

§2.3.10 Binding the Principal and Third Party in Contract via Apparent Authority

With regard to binding a principal to contracts, apparent authority creates essentially the same results as actual authority.[55] If an apparent agent, acting with apparent authority, makes a contract on behalf of an apparent principal, then the principal is bound just as if the principal had itself entered into the contract. The third party is likewise bound to the contract.

§2.4 ATTRIBUTION OF INFORMATION

§2.4.1 The Attribution Function and Its Connection with Non-Agency Law

One of the most important functions of agency law is to treat the principal as if the principal knows, receives, or communicates information actually known, received, or communicated by an agent. Other law determines the significance of the attributed information.

Example

A contract between Hunter, Inc., and Rabbit, Inc., requires Hunter to provide Rabbit "48 hours advance notice of any deliveries." The shipping clerk of Hunter telephones Rabbit to give notice of a forthcoming delivery and speaks to a night janitor. Agency law determines whether that conversation constitutes notice to Rabbit. From there, the contract and contract law take over and determine the significance of notice given or omitted. ◂

Example

Injured by a defective widget, a tort victim claims that the manufacturer should be liable for punitive damages, and alleges that "said Defendant knew that the said widget design was defective and prone to inflict serious injuries, and said Defendant had known of this defect and danger for at least five years before the sale of the widget that injured Plaintiff in that Defendant's chief engineer knew of said defect." Whether the manufacturer "knew" what the chief engineer knew is a question of agency law. Whether knowingly selling a dangerously defective product should result in punitive damages is a question of tort law. ◂

§2.4.2 Attribution as of When?

Attribution of information is always time specific, with one party or another asserting that *at some relevant moment* some person knew, received, or communicated some particular piece of information. Like the consequences of attribution,[56] the relevant moment is determined by other law. To borrow a

famous comment from the Watergate crisis, agency law determines "what did he know and when did he know it."[57] Other law determines which "when" matters.

Example

In the products liability Example involving the defective widget, tort law determines that the relevant moment is the moment at which the manufacturer sold the widget that injured the plaintiff. (If the jurisdiction recognizes a post-sale duty to warn, a later moment might be relevant as well.) ◂

§2.4.3 Attribution of Notice and Notification Received by an Agent

Some legal rules and many contracts require or authorize one person to give "notice" of certain facts to another person or to send another person a "notification." Often a person will attempt to give notice or send notification to a principal by giving the notice or sending the notification to an agent. If the agent has actual or apparent authority to receive the notice or notification, then notice or notification to the agent has the same effect as notice made directly to the principal.[58] The attribution occurs regardless of whether the agent informs the principal of the notice or notification, unless when the agent received the notice or notification: (i) the agent was acting adversely to the principal; and (ii) the third party knew or had reason to know that the agent was so acting.

§2.4.4 Attribution of Facts Known by an Agent

Basic Rule If an agent has actual knowledge of a fact concerning a matter within the agent's actual authority, the agent's knowledge is attributed to the principal. As with the attribution of notice or notification, attribution of a fact occurs regardless of whether the agent communicates the fact to the principal, unless at the relevant moment of attribution:[59] (i) the agent was acting adversely to the principal; and (ii) the third party claiming the benefit of the principal's attributed knowledge knew or had reason to know that the agent was so acting.

Example

Caesar wishes to buy an apartment building for investment purposes and retains Brutus as his agent to find and negotiate the purchase of a good property. Brutus comes into contact with Anthony, who offers a seemingly attractive building for sale at an attractive price. However, when Brutus researches the neighborhood, he learns that the city has just approved a permit to open a halfway house across the street. Anthony offers Brutus $1,000 “so that what Caesar doesn’t know won’t hurt me.” Brutus accepts, and Caesar buys the property. When Caesar subsequently claims fraud in the inducement, Anthony cannot successfully defend by claiming that Caesar knew about the halfway house. Beginning when he accepted the bribe and continuing through the closing of the deal, Brutus was acting adversely to Caesar and Anthony knew it.

The Auditor Cases Agency law has recently evolved to address the so-called “imputation defense” for auditing firms.

Case in Point—NCP Litigation Trust v. KPMG LLP:

“In the mid-1990s, two officers of a corporation intentionally misrepresented details concerning the corporation’s financial status to an independent auditing firm. That firm in turn failed to detect those misrepresentations for several years. After subsequent audits revealed the officers’ fraud, the corporation was forced to acknowledge previously unreported losses of tens of millions of dollars and to declare bankruptcy. A litigation trust, acting as the corporation’s successor-in-interest and representing the corporation’s shareholders, filed suit against the auditor for negligently conducting the audit. The trial court granted the auditor’s motion to dismiss based on the imputation doctrine, which holds that knowledge of an agent generally is attributed to its principal. The trial court concluded that the fraud was imputable to the litigation trust, as the corporation’s successor, and that the litigation trust cannot sue the auditor unless the auditor intentionally and ‘material[ly] participat[ed]’ in the fraud.… We hold that the imputation doctrine does not bar corporate shareholders from recovering through a litigation trust against an auditor who was negligent within the scope of its engagement by failing to uncover or report the fraud of corporate officers and

directors."[60]

Complexities as to Source and Permanence of Agent's Knowledge Suppose an agent learns a fact "off" the job—either (1) before becoming an agent, or (2) while an agent but while "off duty." Is the fact attributed the principal?

Suppose that during the agency relationship an agent knows a fact related to his or her duties, but by the time the fact is relevant to legal relations of the principal, the agent has forgotten the fact. Is the principal still "charged" with knowledge of the fact?

The answers to each of these questions is yes, and the rationale is straightforward. An agent's duties include communicating to the principal any information that the agent has reason to know might be of interest or importance to the principal.[61] The rules for attributing information assume that the agent fulfills the duty and that the principal does not forget.

Case in Point—Engen v. Mitch's Bar & Grill

A bartender serves a patron a couple of drinks, after which the patron assaults another patron. The victim sues the bar for negligence, contending that: (i) the bartender knew from her own "off the job" experience as the assailant's girlfriend that the assailant was prone to violence after a couple of drinks; and (ii) the bartender's knowledge was attributable to the bar, since the fact concerned a matter within the bartender's actual authority (making judgments about who could be served). The bartender's knowledge is attributed to the bar, despite the "off the job" source of the information.[62]

§2.4.5 Information That an Agent Should Know but Does Not

According to the R.2d and most courts, the unknown information is not attributed to the principal.[63]

Restatement on Point

P employs *A*, who is president of a bank, to purchase notes for him. *A* is a member of the discount committee of the bank and, if he attended to his duties properly, would know that *B* had obtained a specific negotiable note

from *T* by fraud. Further, had he made the inquiries that his duty to *P* required, he would have learned this. Not having performed his duties properly, he does not know this fact and purchases the note from *B* for *P*. *P* does not hold the note subject to *T*'s interest because of *A*'s conduct, since there was no duty of care by *P* to ascertain the fraud in the original transaction.[64]

R.3d takes a contrary position: "Notice is imputed to a principal of a fact that an agent knows or has reason to know…if knowledge of the fact is material to the agent's duties to the principal.…"[65]

§2.4.6 Information Communicated by an Agent to Others

If an agent acting with actual or apparent authority

- gives notice to a third party, or
- makes a statement or promise to a third party,[66] or
- makes a misrepresentation to a third party,[67]

the information conveyed has the same legal effect under contract law as if the principal had conveyed the information directly.[68]

§2.4.7 Direction of Attribution

Agency law attribution works in only one direction—upward, from agent to principal. "Notice of facts that a principal knows or has reason to know is not imputed downward to an agent."[69]

Case in Point—Knox-Tenn Rental Co. v. Home Ins. Co.

A patient brings a malpractice case against a hospital and several doctors who work as employees of the hospital. The hospital and doctors tender defense of the case to their professional liability insurer, under a policy naming as insureds both the hospital and its employee doctors. The insurance company desires to "reserve its rights"—that is, take up the defense of the case while reserving the right to later assert that the case is not covered by the policy. Under the insurance contract, in order to reserve its rights, the insurance

company must give notice to each insured. Assuming that the hospital will pass on the information to the doctors, the insurance company gives notice to the hospital but not individually to the doctors. The insurer has waived its reservation as to the doctors, because notice received by a principal (the hospital) is not attributed downward (to the employee doctors).[70]

Similarly, imputation does not work "sideways"; that is, attribution is to the principal and not to affiliates or owners of the principal.

Case in Point—Specialized Tours, Inc. v. Hagen.

The sole shareholder of a corporation sold his stock in the corporation, warranting that, to his knowledge, the corporation was not in violation of any government regulations. In fact, the corporation was in violation, and its general manager knew of the violation. In the buyer's breach of warranty case, the court properly refused to attribute the general manager's knowledge to the shareholder, because: (i) as a matter of agency law, the general manager is an agent of the corporation (not the shareholder); and (ii) as a matter of corporate law, the corporation is a "person" legally separate from its owner (the shareholder).[71]

§2.4.8 Information Attribution Within Organizations

Even most small businesses have multiple agents, and large organizations can have thousands. When a principal is an organization, information attribution can produce untoward effects—especially if "the left hand doesn't know what the right hand is doing." Attribution can occur even when the agent with the attributed knowledge is not the person acting for the principal in the transaction at issue.

Example

Sylvia, the executive vice president of Widget, Inc. ("Widget"), purchases a products liability insurance policy for Widget, and on Widget's behalf signs an application stating that Widget knows of no present facts that would give rise to a claim under the policy. Sylvia has canvassed all top-level Widget employees via email and knows of no such facts. Unfortunately, Widget's risk assessment coordinator does know of one potential claim but has

neglected to tell Sylvia. The facts as to the claim are relevant to the risk manager's authorized tasks and are therefore attributed to Widget. Widget's application therefore contains a material, false statement, and the insurance company is entitled to an appropriate remedy.[72]

§2.5 ESTOPPEL

To establish apparent authority, a third party must show some manifestation of authority attributable to the principal. But what if:

- an asserted principal has made no such manifestation and has merely sat by while someone else has claimed an agency relationship;
- the claims of authority have led third parties to extend credit, incur costs, or otherwise change their position; and
- the asserted principal knew of the claims and of the danger to third parties and yet did nothing?

In such situations, apparent authority is rarely applicable, because only in very narrow circumstances can the asserted principal's inaction serve as a manifestation.[73] To prevent injustice beyond those narrow circumstances, the Restatements and some courts use the concept of *estoppel*. In the words of R.3d:

> 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 subject to liability to a third party who justifiably 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 belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts.[74]

In concept, the distinction between apparent authority and estoppel is clear enough. Unlike apparent authority, estoppel can apply even though the claimant can show no manifestation attributable to the asserted principal.[75] Estoppel liability can arise from the asserted principal's mere negligent failure to protect against a misapprehension.

Unfortunately, the case law often blurs this distinction. Many

jurisdictions make detrimental reliance an element of apparent authority and even refer to apparent authority as “agency by estoppel.” Moreover, most situations that give rise to apparent authority also give rise to estoppel. If an asserted principal makes a manifestation sufficient to support a reasonable inference of authority (i.e., to create apparent authority), the asserted principal can probably be said to have “intentionally or carelessly caused such belief” (i.e., estoppel).[76] The R.3d attempts to eliminate this latter source of confusion by defining estoppel to apply only in the absence of a manifestation by the asserted principal.

§2.6 INHERENT AGENCY POWER

§2.6.1 A Gap-Filling Doctrine Based on Fairness

In some situations, an agent has neither actual nor apparent authority, and estoppel does not apply. Yet the agent’s position creates the potential for mischief with third parties.

Example

Noam purchases Eli’s Dry Cleaning, does not change the business name, and hires Eli to manage the dry cleaning store. Although dry cleaning stores customarily order cleaning solvent in large quantities, Noam instructs Eli never to buy more than $50 worth of solvent at a time and has no reason to believe that Eli will disregard these instructions.

However, Eli does disregard them and places a phone order for solvent costing $450. The seller of the solvent believes that Eli is still the owner. Eli has acted without actual authority; his principal’s manifestations expressly prohibit the order Eli made. Eli has also acted without apparent authority; there can be no apparent authority by position when the principal is undisclosed.[77] ◂

To deal with such situations (and others as well),[78] the R.2d and some courts use the doctrine of *inherent agency power*.[79] The doctrine imposes *enterprise liability*; that is, it places the loss on the enterprise that stands to benefit from the agency relationship. As explained by the R.2d:

> 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.[80]

In the dry cleaner Example above, there is no culpable conduct on Noam's part. To the contrary, Eli has caused mischief while acting counter to Noam's wishes. Yet the third party is also without blame, and the policy issue arises: As between the principal and the third party, who should bear the risk of the agent's misconduct? Who should have the burden of pressing claims against the agent or absorbing the harm the agent has caused?[81]

§2.6.2 A R.2d Rule of Inherent Power: Unauthorized Acts by a General Agent

When a principal entrusts an agent with ongoing responsibilities, the notion of an enterprise fairly applies. As a result, the agent has the inherent power to take certain actions even though the principal may have forbidden those actions. The R.2d and many cases use the category of "general agent" as the entrance criterion to this type of inherent power.

General and Special Agents Defined — If a principal authorizes an agent "to conduct a series of transactions involving a continuity of service,"[82] the law labels the agent a *general agent*. If, in contrast, a principal authorizes the agent only to conduct a single transaction, or to conduct a series of transactions that do not involve "continuity of service," then the law labels the agent a *special agent*.

Perhaps the simplest example of a general agent is an employee in charge of a store, a factory, or other place of business. It is not necessary, however, to have wide-ranging or important responsibilities in order to be a general agent. A full-time photocopy clerk is a general agent with regard to photocopying duties.

In theory, the "special vs. general" distinction is an "either/or" matter. That is, with regard to any particular responsibility, an agent must be either a general agent or a special agent. In practice, however, this either/or categorization encounters many gray situations.

It is possible for an agent to be a general agent with regard to some matters and a special agent with regard to others. The key factor separating general agency status from special agent status is whether the agent has an ongoing responsibility.

Example

A bank employs Larry as a teller. One day, the bank asks Larry to deal with a caterer and arrange refreshments for a retirement party. With regard to his teller duties, Larry is a general agent. With regard to the party arrangement, Larry is a special agent. ◂

Inherent Agency Power of General Agents Under the R.2d doctrine of inherent agency power:

- if the agent is a general agent with actual authority to conduct certain transactions,
  — the agent is acting in the interests of the principal, and
  — the agent does an act usual or necessary with regard to the authorized transactions,
- then the act binds the principal regardless of whether the agent had actual authority and even if the principal has expressly forbidden the act.

Although this rule applies in slightly different forms to all principals,[83] it makes the most difference for undisclosed and partially disclosed principals. With a disclosed principal, apparent authority by position will typically produce the same result as inherent power. With an undisclosed or partially disclosed principal, however, apparent authority is of no help.

Example

Sylvia decides to enter the silk importing business. The trade is notoriously biased against women, and she fears that her company will suffer if her interest in it is known. She therefore hires Phil as her general manager, but sets up the company so that Phil appears to the outside world as the owner. It is common in this trade for silk importers to sell to large customers on credit, but Sylvia instructs Phil never to extend more than $50,000 of credit to any

customer without Sylvia's approval. One day, in order to close an important deal, Phil agrees, without consulting Sylvia, to extend $150,000 of credit to one customer. Although Phil acted without actual or apparent authority, Sylvia, the company's true owner and Phil's undisclosed principal, is bound. "An undisclosed principal who entrusts an agent with the management of his business is subject to liability to third persons with whom the agent enters into transactions usual in such businesses and on the principal's account, although contrary to the directions of the principal."[84]

Policy-Based Limitations to the Rule This rule of inherent agency power has two policy-based limitations. The rule does not apply if either: (i) the third party knows that the agent is acting without authority; or (ii) the agent is not acting in the principal's interest. If the third party knows of the lack of authority, then the third party is not innocent, which renders inapposite a key aspect of the rule's rationale.[85] If the agent acts on the agent's own behalf, the conduct is not part of the enterprise from which the principal stands to benefit which renders inapposite another key aspect of the rule's rationale. Remember, however, that apparent authority might exist.

§2.6.3 R.3d's Approach

R.3d expressly declines to use the concept of inherent agency power,[86] but states a black letter rule for undisclosed principals that produces essentially the same results: "An undisclosed principal may not rely on instructions given an agent that qualify or reduce the agent's authority to less than the authority a third party would reasonably believe the agent to have under the same circumstances if the principal had been disclosed."[87]

§2.7 RATIFICATION

§2.7.1 The Role, Meaning, and Effect of Ratification

Ratification occurs when a principal affirms a previously unauthorized act. Ratification validates the original unauthorized act and produces the same legal consequences as if the original act had been authorized.[88] If, for

instance, a party ratifies a contract, the ratification binds both that party and the other party to the contract.

Example

Toklas is a janitor in a large residential apartment complex. She has neither actual nor apparent authority to act for the owner of the complex in renting apartments. She also lacks inherent agency power. Nonetheless, she shows apartment 101B to Alice and agrees to rent the apartment to her on a six-month lease. Later, when Alice telephones the rental office to check on her move-in date, she speaks to the actual owner. The owner says, "Well, you know Toklas had no business renting that apartment to you. She's just the janitor. But we'll go ahead." The owner has ratified Toklas's previously unauthorized actions, and Alice and the owner are both bound to the lease. ◂

Ratification typically concerns "the making or breaking of a contract,"[89] although both R.2d and R.3d contemplate the ratification of torts.[90]

In theory, *as between the principal and the third party*, ratification matters only when no other attribution rule applies. If an actor has actual, apparent, or inherent authority, or if estoppel applies, the third party has no need to show that the principal retroactively validated the act. In practice, however, "[r]atification often serves the function of clarifying situations of ambiguous or uncertain authority,"[91] and in litigation, parties often argue ratification in the alternative. In addition—*as between the principal and the agent*— "[r]atification…exonerates the agent against claims otherwise available to the principal on the basis that the agent's unauthorized action has caused loss to the principal,"[92] except where the principal has ratified to "cut his losses."

Example

Acting beyond his authority, Edmund sells and delivers to Lucy goods belonging to Peter. Peter decides to go through with the contract, even though he might have made a better deal elsewhere. Edmund is not liable to Peter for acting without authority, even if Peter could prove with requisite specificity the availability and value of the "better deal." ◂

Example

Acting beyond his authority, Edmund sells and delivers to Lucy goods belonging to Peter. Lucy then resells the goods to an innocent third party and fails to pay Peter. Peter files suit against Lucy for the contract price, in essence ratifying the sale. Edmund remains liable to Peter for any damages resulting from the unauthorized sale. ◂

§2.7.2 Mechanics of Ratification

For ratification to occur, certain preconditions must exist and the purported principal must embrace the previously unauthorized act ("affirmance").

Preconditions Ratification can occur only in the context of certain preconditions:

- There must have been some transaction or event involving an unauthorized act.
  — Typically, someone ("the purported agent") will have purported—either expressly or impliedly—to act on behalf of another (the "purported principal") in some transaction with a third party.
  — Under the R.3d, ratification can apply as well to the unauthorized act of an agent for an undisclosed principal.[93]
- At the time of the unauthorized act, the purported principal must have existed and must have had capacity to originally authorize the act.[94]
- At the time of the attempted ratification:
  — the purported principal must have knowledge of all material facts; and
  — the third party must not have indicated—either to the purported agent or to the purported principal—an intention to withdraw from the transaction (i.e., the transaction must still be available to ratify).

Affirmance—the Act (or Inaction) of Ratification If the necessary preconditions exist, a purported principal ratifies by either:

- making a manifestation that, viewed objectively, indicates a choice to treat the unauthorized act as if it had been authorized; or
- engaging in conduct that is justifiable only if the purported principal

had made such a choice.

In the simplest of situations, a purported principal affirms just by stating a choice.

Example

Having read that car dealers generally make better deals for male customers than for female customers, Sally hires Ralph to purchase a used car on her behalf. She specifically instructs him, however, not to buy any foreign-made car. Purporting to act on Sally's behalf, Ralph makes a great deal on a used BMW. When Sally hears of the deal, she says, "Okay, for a deal like that I don't have to 'Buy American.' I'll take the car." Sally has ratified the deal. ◂

Affirmance occurs when the manifestation occurs. The manifestation need not reach the third party to be effective.[95]

A purported principal can also affirm through inaction—that is, by failing to repudiate the act "under such circumstances that, according to the ordinary experience and habits of men, one would naturally be expected to speak if he did not consent."[96] Such failure to repudiate creates a situation resembling agency by estoppel.

Example

Acting without either authority or power to bind the owner of an apartment complex, Toklas, the janitor, offers a resident manager job to Felix. The landlord learns of the offer and also hears that Felix is planning to quit his current job so he can become resident manager. The landlord says nothing to Felix, and Felix quits his current job. By this inaction, the landlord has ratified Toklas' offer. ◂

A purported principal can also ratify by accepting or retaining benefits while knowing that the benefits result from an unauthorized act. If the purported principal accepts benefits *without* the requisite knowledge, the third party may have an action in restitution or *quantum meruit*. Ratification is usually preferable for the third party, however, because ratification entitles the third party to the full benefit of the bargain. Restitution or *quantum meruit*, in contrast, entitles the third party only to the value of the benefit actually conferred.

Example

Toklas, the self-aggrandizing janitor, offers to rent an apartment to Mike for a year at $50 per month off the regular monthly rent if Mike agrees to keep the grass well-mowed. During his first month as a tenant, Mike mows the grass four times. If the landlord knew of the unauthorized offer, the landlord has ratified the agreement by accepting the services. Mike may therefore hold the landlord to the full bargain (i.e., to a lease and a rent reduction for a year). If, however, the landlord did not know of the offer, Mike has a right only to restitution or *quantum meruit* (i.e., only to be paid for the fair value of the mowing work he has already done).[97] ◂

The "All-or-Nothing" Rule Ratification occurs on an "all-or-nothing" basis. If a purported principal attempts to ratify only part of a single transaction, then either the entire transaction is ratified or there is no ratification at all.

Example

Acting without authority, Rebecca purports to sell Vladi's car to Michael for $500. Rebecca also purports to extend a 90-day warranty on the car. Vladi cannot ratify the sale without also ratifying the warranty. ◂

If a purported principal makes a "piecemeal" affirmance, whether ratification has occurred depends essentially on whether the purported principal has manifested:

- an intent to ratify and has sought to impose some exclusions or qualifications (in which case the entire transaction has been ratified and the sought-after exclusions and qualifications are ineffective); or
- an intent to be bound only if the exclusions or qualifications are part of the transaction (in which case there is no ratification and neither the purported principal nor the third party is bound, unless the third party manifests consent to the conditions).[98]

§2.7.3 Principal's Ignorance or Knowledge of Material Facts: Whose Burden of Proof?

According to the R.2d, "If, at the time of affirmance, the purported principal is ignorant of material facts involved in the original transaction, and is unaware of his ignorance, he can thereafter avoid the effect of the affirmance."[99] However, many courts and the R.3d treat the purported principal's knowledge of material information as a precondition to ratification. "A person is not bound by a ratification made without knowledge of material facts involved in the original act when the person was unaware of such lack of knowledge."[100] The difference is more than semantic; it determines the burden of proof.

Materiality Defined R.2d defines *material facts* as those that "so affect the existence and extent of the obligations involved in the transaction that knowledge of them is essential to an intelligent election to become a party to the transaction."[101] R.2d then confines this seemingly broad concept by specifically excluding knowledge:

- of the legal effect of ratification
- about the value of the transaction or the transaction's desirability, other than knowledge of important representations made by the agent or third party as they entered into the transaction.

R.3d uses a much briefer formulation, albeit one that is somewhat vaguer. The black letter refers to "material facts *involved in the original act*,"[102] and a comment to the black letter explains that "[t]he point of materiality…is the relevance of the fact to the principal's consent to have legal relations affected by the agent's act."[103]

The difference between the two Restatements could have substantial practical implications, depending on how a court interprets R.3d's language.

Example

Acting beyond her authority, *A* purports to bind *P* to a contract to sell frozen orange juice to *T*. Thinking the contract an excellent one for *P*, *A* immediately communicates with *P*, who affirms the contract. However, unbeknownst to *P* or *A*, a pest infestation in South America has eliminated a major source of frozen orange juice. The contract is therefore a very bad one for *P*. That information is certainly relevant to the principal's decision to

embrace the deal, but it is also "about the value of the transaction or the transaction's desirability." Under the R.2d approach, the information is not material to the decision to ratify. Under the R.3d, the issue is less clear.

Knowledge Requirement Not Purely Subjective At first glance, the knowledge requirement seems straightforward. Knowledge is a state of mind. What should matter, therefore, is whether the purported principal lacks subjective knowledge of material facts, not whether the purported principal has reason to know those facts.

However, both Restatements and the case law eschew this conceptually pure approach. According to the R.3d: "A factfinder may conclude that a principal has [assumed the risk of ignorance and ratified] when the principal is shown to have had knowledge of facts that would have led a reasonable person to investigate further, but the principal ratified without further investigation."[104]

Principal's Ignorance versus Third Party's Reliance The principal's ignorance ceases to be a factor if the third party has learned of and detrimentally relied on the principal's affirmance.[105]

§2.7.4 The Third Party's Right of Avoidance

Ordinarily, a purported principal's affirmance binds not only the purported principal but also the third party. As explained previously, a third party can *preclude* ratification by giving notice of withdrawal from the transaction *before* the purported principal affirms.[106] In two situations, the third party can also *avoid* an otherwise binding affirmance.

Changed Circumstances The third party may avoid a ratification if, before the purported principal ratifies, circumstances change so materially that holding the third party to the contract would be unfair. Obviously, at some point the third party will have to inform the purported principal of the changed circumstances. However, it is not necessary that the third party give notice before the affirmance.

Both Restatements use the same, classic example:

> Purporting to act for *P* but without power to bind *P*, *A* contracts to sell Blackacre with a house thereon to *T*. The next day the house burns. *P*'s later ratification does not bind *T*. *T* may elect to be

bound by the contract.[107]

Conflicting Arrangements A third party can also avoid ratification if the third party:

- learns that the purported agent acted without authority;
- relies on the apparent lack of authority; and
- makes substitute, conflicting arrangements or takes some other action that will cause prejudice to the third party if the original transaction is enforced.[108]

For the necessary reliance to exist, the third party must act before learning of the purported principal's affirmance.

§2.7.5 The Term "Ratification" in Other Contexts; Contrasted with Adoption and Novation

Generally In agency law, ratification is a term of art with a very specific and intricate meaning, but agency law has no monopoly on the use of the word. For example, "ratification" is often used to describe the final step in an approval process involving different sets of decision makers at each step.

Example

Article V of the U.S. Constitution states: "The Congress, whenever two thirds of both Houses shall deem it necessary, shall propose Amendments to this Constitution, or on the Application of the Legislatures of two thirds of the several States, shall call a Convention for proposing Amendments, which, in either Case, shall be valid to all Intents and Purposes, as Part of this Constitution, when ratified by the Legislatures of three fourths of the several States, or by Conventions in three fourths thereof, as the one or the other Mode of Ratification may be proposed by the Congress;…"

Ratification, Adoption, and Novation Even in the agency context, cases sometimes use "ratification" carelessly, usually by confusing and interchanging the terms *ratification, adoption*, and *novation*. Many of these cases involve contracts made by promoters on behalf of limited liability

companies, corporations, or other entities not in existence when the contract is made. To the extent that the three terms have separate meanings, those meanings are as follows.

Ratification is the retroactive approval of a previously unauthorized act. Subject to the conditions and exceptions discussed in this section, ratification binds both the purported principal and the third party to the original undertaking and discharges the purported agent from any liability on that undertaking.

Adoption occurs when:

- a purported agent has purported to bind a purported principal to an agreement while lacking the power to do so;
- the purported principal cannot ratify the purported agent's unauthorized act, typically because at the time of the act the purported principal either did not exist or lacked capacity to authorize the act;
- the original agreement made by the purported agent and the third party expressly or impliedly empowers the purported principal to choose to receive the benefits and assume the obligations of the agreement; and
- the purported principal manifests—either expressly or through a course of conduct—its desire to receive the benefits and assume the obligations of the agreement.

Like ratification, adoption binds both the principal and the third party to the original agreement. *Unlike* ratification, adoption does not relate back in time to the unauthorized act. So, if for any reason the starting date of the relationship between the adopting principal and the third party is important, that date is the date of the adoption, not the date of the unauthorized act. Moreover, adoption does not release the purported agent from any liability it may have to the third party on account of the original agreement, unless the original agreement provides that the principal's adoption will indeed release the agent.

Novation is a new, independent agreement between the principal and the third party. Novations arise from the same circumstances that give rise to adoptions, and it is often the original, unauthorized contract that causes the purported principal and the third party to consider doing business with each other. The terms of the novation may be and often are identical to the terms of the prior, unauthorized agreement.

Nonetheless, a novation reflects an entirely separate process of contract formation. Once formed, the novation contract completely displaces the original, unauthorized contract and relieves the purported agent from any liability it may have had to the third party on account of that prior contract.

Whether the new arrangement is an adoption (which does not release the purported agent) or a novation (which does) is a question of the parties' intent.

Example

Rachael decides to go into business with a 1950s-style hamburger joint. She plans to organize the business as a limited liability company under the name Sam's Place, LLC. She signs a lease for the restaurant, however, before actually forming the limited liability company. In signing the lease she purports to act as president of Sam's Place, LLC and neglects to inform the lessor that Sam's Place, LLC, has not yet come into existence.

Since a nonexistent limited liability company cannot authorize anyone to do anything, Rachael's act in signing the lease is unauthorized and does not bind the LLC. As of that moment, Rachael, not the LLC, is liable to the lessor on the lease.[109]

When Rachael does form the LLC, the LLC may decide to take responsibility for the lease. However, the LLC cannot by itself take Rachael off the hook. Ratification would release Rachael, but ratification is not possible: At the time of the lease signing the LLC did not exist, so one of the necessary preconditions to ratification is absent. The LLC can adopt the lease, but that adoption will not release Rachael. If the LLC later defaults, she will still be liable.

If the lessor agrees, the LLC and the lessor can make a novation. A new contractual relationship between the lessor and the LLC will replace the original lease, the LLC will be bound, and Rachael will no longer be liable.

§2.8 CHAINS OF AUTHORITY

§2.8.1 Multilevel Relationships

For the most part, the Examples used in this chapter so far have been "flat."

The principals act through a single agent, and agents draw their authority directly from manifestations made by the principal. Third parties claim apparent authority from manifestations made directly by a principal.

Real-life relationships tend to be more intricate.

Example

Marcia is the manager of an airport office of a rental car company. As part of her job, she hires, supervises, and, when necessary, fires the people who staff that office. Those people are agents of the rental car company, not of Marcia, even though: (i) it was Marcia who told each of them, "You're hired"; and (ii) the company itself has never made any direct manifestation to any of them. ◂

Example

Seeking to increase business, Marcia retains the services of Abitatruth, Inc., an advertising agency. Acting on behalf of the rental car company, Marcia authorizes the agency to spend $10,000 to rent advertising space around the airport on the company's behalf. The agency assigns the work of renting the advertising space to Alan, one of its employees. Alan has the power to bind the rental car company, even though: (i) Marcia has never made any manifestation to Alan; and (ii) Marcia does not even know that Alan exists. ◂

Each of these Examples involves a "concatenation" of responsibility. That is, in each situation a *chain* of relationships or events makes the rental car company the principal and gives the person at the bottom of the chain the power to bind. Thus, a person can be an agent without ever having met or communicated directly with the principal.

For instance, in the first Example (Marcia hires the staff), the employees are agents of the rental car company because another agent of the company (Marcia), acting within her actual authority, has made manifestations (attributable to the company) that the company (as principal) desires the employees to act on the company's behalf and subject to the company's control. See Figures 2-3 and 2-4.

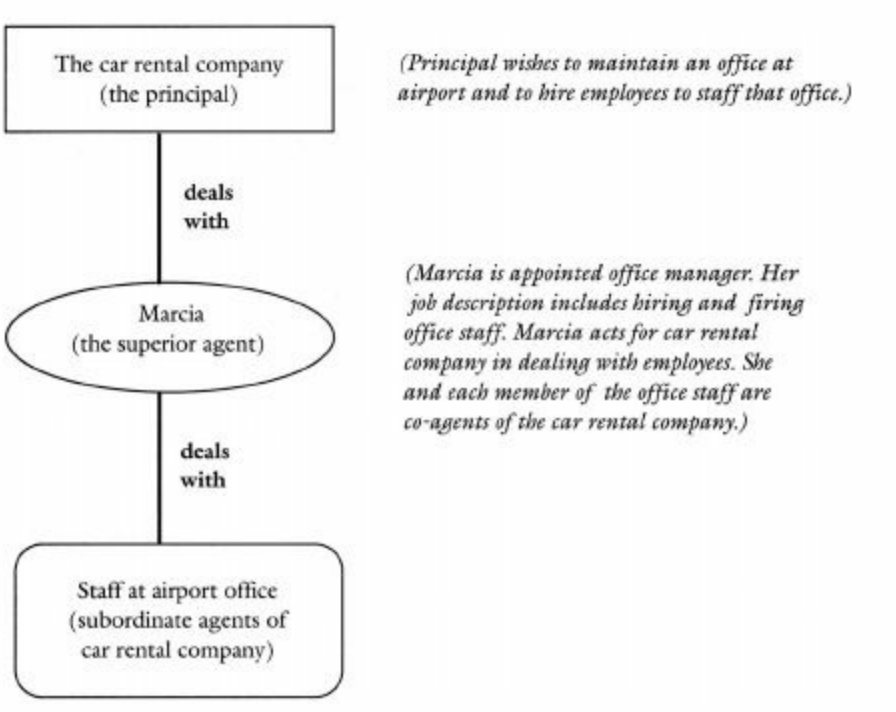


Figure 2-3. Concatenating Authority—The Practical Structure

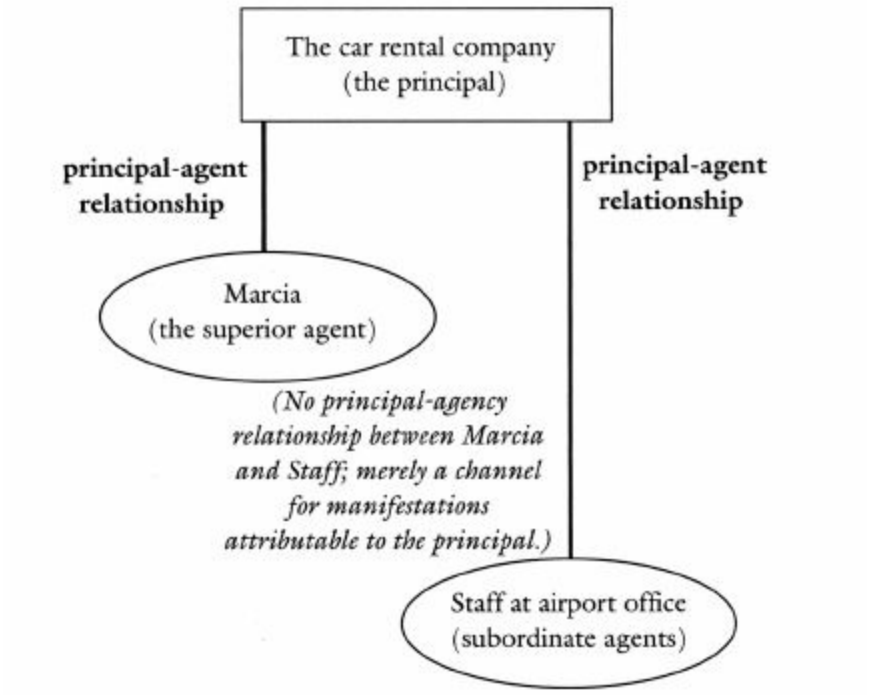


Figure 2-4. Concatenating Authority—The Agency Structure

Agency law handles such complexity in characteristic fashion. It establishes categories, labels the categories, and attaches consequences to the

categories. In matters of contract and communication, the key labels are *superior agents*, *subordinate agents*,[110] and *subagents*.

§2.8.2 Superior and Subordinate Agents

The Categories As section 2.8.1 illustrates, a principal can use one of its agents to appoint, direct, and discharge other agents of the principal. Using "superior agents" to deal with "subordinate agents" is merely a specific instance of a principal acting through its agents. The principal uses one (or more) of its agents to manifest its desires to the principal's other agents.

This concatenated, hierarchical structure is commonplace. Only the smallest of organizations can operate without the "top dog" delegating some responsibility to superior and subordinate agents. Moreover, the delegation often works through several levels (in military terms, the "chain of command"), with agents being simultaneously superior agents vis-à-vis those "below" them, and subordinate agents vis-à-vis those "above" them. Superior agents and subordinate agents are "co-agents" of the principal. A subordinate agent is never the agent of a superior agent.

Example

Marcia's actual authority to run the airport office might derive as follows: The car company's regional manager appointed her to the position, and generally described to her the duties and authority of the position. The regional manager obtained the actual authority to make such manifestations on behalf of the company when the Vice President for Leasing Operations appointed him to the regional manager position. The Vice President, in turn, obtained her actual authority to manifest the company's choice of regional managers (and to manifest the company's wishes as to the duties and authority of those managers) when the Chief Executive Officer appointed her as Vice President and outlined the duties and authority of that position. The company made the necessary manifestations to appoint and authorize the CEO when the company's Board of Directors elected the CEO.[111] See Figure 2-5. ◂

Most often, superior and subordinate agents are part of the same organization, but the concepts apply as well when the one agent is part of the organization comprising the principal and the other is not.

Example

International Diversified Operations, Inc. (“IDO”), does not have its own sales force, but instead relies on independent agents who work on commission and have specified authority to accept purchase orders on IDO’s behalf. IDO appoints Asif, one of IDO’s employees, as national sales director, with authority to issue instructions to the independent agents. Asif is a superior agent, and the independent agents are subordinate agents. ◂

Regardless of whether superior and subordinate agents are part of the same organization, and no matter how much authority and discretion a superior agent has, the superior agent acts on behalf of the principal and not on the agent’s own account. So long as a superior agent acts with actual authority, apparent authority, or inherent agency power, the superior agent’s manifestations—whether to the subordinate agents or to third parties—are attributable to the principal.

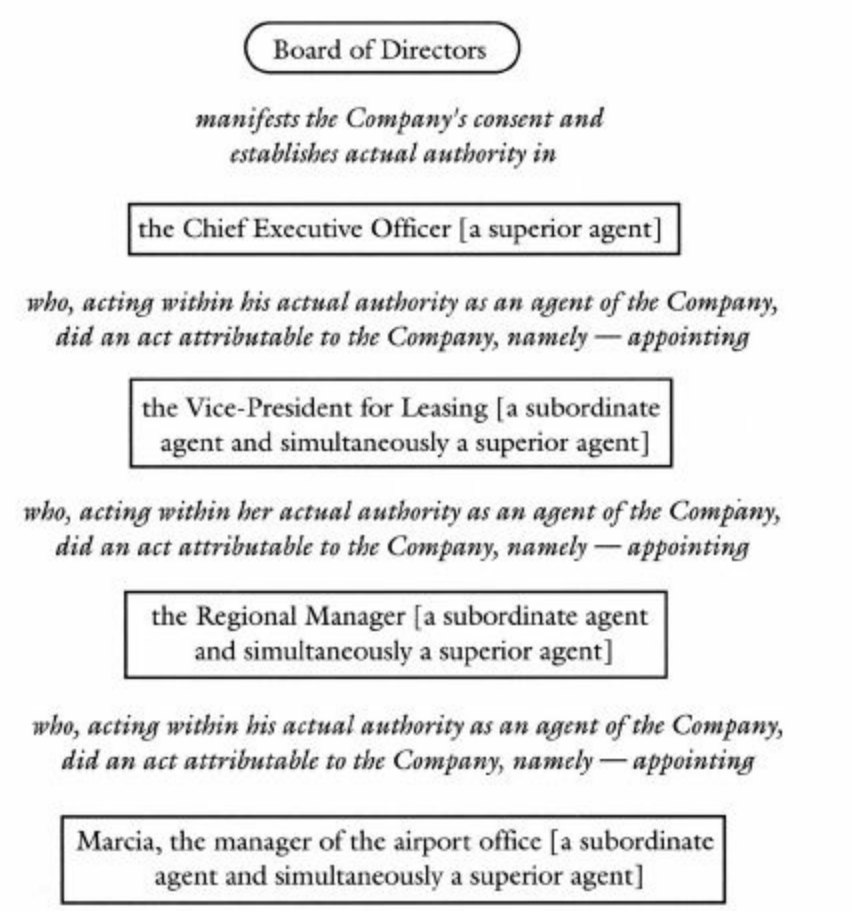


Figure 2-5. The Rental Car Company’s Chain of Command

A Subordinate Agent's Power to Bind the Principal A subordinate agent binds its principal under the same rules applicable to "plain" agents. The key questions are therefore the same; namely, did the subordinate agent act with actual authority, apparent authority, inherent agency power, under circumstances giving rise to estoppel? Answering these questions involves looking at the conduct attributable to the principal, including any manifestations made by superior agents within the scope of their actual authority, apparent authority, or inherent agency power.

Example

Marcia, the manager of the rental car company's airport office, has engaged Abitatruth, an ad agency, to develop advertising for the rental car company. Marcia brings along Sara, one of her assistants, to a series of conferences with Abitatruth. During these conferences Marcia repeatedly seeks Sara's opinion as to choices posed by the ad agency and occasionally defers to Sara's judgment. Later, when the ad agency cannot get in touch with Marcia, it asks Sara to approve the content of several advertising posters. Although Marcia has stated privately to Sara that Marcia plans to approve all posters, Sara tells the ad agency, "Go ahead." ◂

This approval binds the rental car company. Although Marcia's private statements to Sara preclude a claim based on actual authority, Sara did have apparent authority. Apparent authority presupposes a manifestation *of the rental car company*, which Marcia's conduct supplies. Consulting with and relying on subordinates—even in the presence of others—was certainly within Marcia's actual authority. That conduct is therefore, by attribution, the conduct of the rental car company. Coupled with the ad agency's resulting reasonable belief in Sara's authority, this attributed manifestation gave Sara apparent authority to approve the posters on the rental car company's behalf.

Superior Agent's Limited Responsibility for the Misconduct of Subordinate Agents All agents owe a duty of care to their principal,[112] and superior agents must exercise care in selecting, directing, and discharging subordinate agents. If a superior agent fails to do so and that breach of duty proximately causes injury to the principal, the superior agent is liable to the principal for resulting damages.

Example

Marcia hires Henry to drive the courtesy van that takes passengers between the airport and the car rental office. Marcia carelessly fails to check Henry's references and driving record. The references are false, and the record includes several drunk-driving convictions. One day Henry drives the van while drunk and causes an accident. Under the doctrine of *respondeat superior*, the car rental company is liable for any damage Henry caused to others.[113] Marcia is liable to the car rental company for its obligations to others, plus any damage to the company's courtesy van. She breached her duty of care in selecting and supervising a subordinate agent. ◂

A superior agent is not, however, the guarantor of the subordinate agent's performance.

Example

Same situation, except Henry's references are okay, his driving record is clean, and Marcia uses reasonable care in hiring and supervising Henry. The car rental company remains liable to others for harm caused by Henry's drunken driving, but Marcia is not liable to the car rental company. ◂

§2.8.3 Subagents

The Category When a principal engages an agent to perform a task, the principal has in effect delegated the task to the agent. If the agent, acting with authority, in turn delegates part or all of that task to an agent of its own, then the second agent becomes a subagent of the original principal.

Restatement on Point

P retains *A*, a real estate broker, to sell Blackacre. *P* knows that *A* employs salespeople to show property to prospective purchasers and to state the terms on which the property is for sale. The salespeople are *A*'s employees, not *P*'s employees. The salespeople are also *P*'s subagents.[114] ◂

The Agent's Authority to Further Delegate In theory, an agent has no authority to delegate its tasks to its own agents. However, a principal can authorize its agent to delegate, and, when the agent is a limited liability

company, corporation, or other legal entity, some authority to delegate is inescapably implied. Legal "persons" can act only through the endeavors of natural persons.

The general rules for creating actual authority apply to determine whether an agent has authority to re-delegate to its own agents.[115] Consistent with those rules, implied actual authority to delegate exists when: (i) the delegation relates merely to the mechanical aspects of the agent's tasks; (ii) the agent is a corporation, partnership, limited liability company, or other organization; or (iii) it is customary for agents in similar situations to delegate. The principal can of course override these implications with an express manifestation, but where the agent is an organization some delegation is inevitable.

Example

Sylvia, a rock singer, retains David, a well-known agent, to arrange on her behalf the facilities and amenities to be made available to Sylvia on an upcoming tour. David has several assistants, and they normally handle such "logistical details." Sylvia, however, says, "I want your personal touch on this. Don't let anyone else work on it." David has no actual authority to delegate the work. ◂

Example

Sylvia, a rock singer, retains Pauline's Representation, Inc. ("Pauline's"), to arrange bookings. Pauline's is a limited liability company, with the necessary right to delegate the task. Sylvia, however, imposes a restriction, saying, "Make sure whoever works on my account has been with you for at least five years." ◂

A Subagent's Power to Bind the Principal The R.2d and R.3d differ in their approach to this issue. The R.2d approach is more elaborate and more precise. Assuming that an agent has the authority to delegate tasks to a subagent, under the R.2d determining the scope of a subagent's power to bind the principal in contract involves a two-stage analysis:

1. What is the scope of the agent's power to bind the principal?
2. Of that scope, what has the agent authorized the subagent to perform?[116]

Example

The car rental company (acting via Marcia) gives Abitatruth actual authority to spend up to $10,000 in renting advertising space [stage 1]. Moe is a junior vice president of Abitatruth, with actual authority (from Abitatruth) to make leasing commitments of $1,000 or less [stage 2]. Moe has neither apparent authority nor inherent agency power to exceed the $1,000 limit while acting for Abitatruth [stage 2]. Moe purports to commit the car rental company to space Alpha for $800 and to space Beta for $1,250.

In each instance, Moe has acted as an agent for Abitatruth and subagent for the car rental company. The commitment on space Alpha binds the car rental company, because the commitment was within Abitatruth's authority vis-à-vis the company [stage 1] and within Moe's authority vis-à-vis Abitatruth [stage 2]. The commitment on space Beta does not bind the car rental company, because that commitment exceeded Moe's authority vis-à-vis Abitatruth [stage 2]. In sum, to bind the principal under the R.2d, a subagent's act must be both within the subagent's power to bind the agent and within the agent's power to bind the principal.

The R.3d approach has the virtue of simplicity:

> As between a principal and third parties, it is immaterial that an action was taken by a subagent as opposed to an agent directly appointed by the principal. In this respect, subagency is governed by a principle of transparency that looks from the subagent to the principal and through the appointing agent. As to third parties, an action taken by a subagent carries the legal consequences for the principal that would follow were the action instead taken by the appointing agent.[117]

Unfortunately, this approach also has the defect of indeterminacy. Surely not every act of a subagent binds the principal, especially not acts that would not bind the agent.

Agent as the Guarantor of the Subagent's Performance When an agent delegates all or part of its responsibilities to a subagent, the agent remains "on the hook" to the principal. Delegation does not relieve the agent of its responsibilities. If the subagent's performance satisfies the obligations the agent owes to the principal, then the agent, acting through the subagent, has performed its responsibilities as agent. If, however, the subagent's performance fails to satisfy the agent's obligations, then the agent is directly

responsible to the principal.[118]

§2.8.4 Distinguishing Subordinate Agents from Subagents

The concepts of subordinate agent and subagent both presuppose a hierarchy with:

- the principal at the top,
- the subordinate agent or subagent at the bottom, and
- an intermediary (either a superior agent or an agent) in between.

Nonetheless, the two concepts reflect very different relationships with very different legal consequences. It is therefore important to distinguish one relationship from the other.

The crucial point of distinction is the manifestation that the principal makes to the intermediary. Ideally at least, that manifestation, reasonably interpreted, will lead the intermediary reasonably to believe either that:

- the principal wishes the intermediary to retain or supervise another agent *of the principal*—in which case the intermediary is to be a superior agent, the other agent is to be a subordinate agent, and both the superior and subordinate agents are to be co-agents of the principal; or
- the principal wishes to retain the intermediary as the principal's agent and recognizes that the agent may delegate some or all of its responsibility to another person—in which case that other person is an agent of the agent and simultaneously a subagent of the principal.

Example

A landlord retains a management company to manage 150 separate apartment buildings owned by the landlord. The landlord wants a resident manager in each building and expects these caretakers to be employees of the management company. The managers will be agents of the management company and subagents of the landlord. ◂

Superior and subordinate agents are usually part of the same company,

as in the Examples in sections 2.8.1 and 2.8.2 involving Marcia and the car rental company. However, that circumstance is *not* an element of the superior/subordinate agent analysis.

Example

The management company's contract with the landlord has significantly increased the company's obligations, and the company needs interim help recruiting and supervising resident managers. On an interim basis, the management company retains Carolyn, an experienced real estate attorney, to interview applicants for caretaker positions, and gives her authority to hire applicants she considers appropriate. The management company also retains Carolyn to supervise the applicants she hires. Like her, the caretakers she hires will be agents of the management company.[119] When she supervises, she will be acting as a superior agent vis-à-vis subordinate agents. ◂

Problem 1

Captain Miles Standish loved the fair damsel Priscilla, but Standish's intense shyness prevented him from speaking to her. One day Standish lamented the situation to his friend John Alden, and Alden offered to speak to Priscilla and, on Standish's behalf, invite her to an upcoming community dance. Standish responded, stroking his beard reflectively, "I dunno. That might be a good idea." Alden took that comment as assent and rode off to see Priscilla. Actually, however, Standish did not intend to consent. Right after Alden rode off, Standish wrote in his diary, "Told Alden that I would think about his offer. Have done so and will reject it as soon as I next see him."

Before Standish saw Alden again, however, Alden saw Priscilla. Alden explained Standish's great love, and—purporting to act on Standish's behalf—invited Priscilla to accompany Standish to the dance. Priscilla accepted. Later, Standish saw Alden and told him not to talk to Priscilla. Alden told Standish, "Too late, fellow; you're going to the dance."

Assume that, as a matter of contract law, contracts to attend dances are valid and enforceable. Is Standish bound? ◂

Explanation

Standish is bound only if Alden had actual authority to extend the

invitation.[120] The creation of actual authority requires: (i) a manifestation by the principal; (ii) the agent's reasonable interpretation of that manifestation as a request that the agent acts for the principal; and (iii) the agent's manifestation of consent to act. The first and last certainly occurred. Standish's comment ("That might be a good idea") suffices as a manifestation. Alden's action reflects his consent. The question of the agent's interpretation, however, is more difficult. Although Standish's subjective intent is irrelevant, Standish's response was objectively ambiguous. Especially given what Alden knew of Standish's shyness, it was probably unreasonable for Alden to consider himself authorized without having first sought clarification. Therefore, no actual authority existed, and Standish is not bound on the contract.◂

Problem 2

A tenant rents her apartment on a month-to-month tenancy, with each term beginning on the first of the month. Under local law, the tenant can terminate the tenancy by giving a full calendar month's notice. For example, for the tenancy to end on March 31, the tenant must give notice before March 1. A resident manager, whom the landlord has authorized to receive notices from tenants, manages the building. On December 28, the tenant gives proper notice to the resident manager, stating that the tenant will vacate by January 31. Unfortunately, the resident manager fails to pass the notice on to the landlord until January 3. Will the tenancy end on January 31?◂

Explanation

Yes. When an agent has actual authority to receive a notice, receipt of that notice is attributable to the principal. The agent's failure to communicate the information to the principal may be a breach of the agent's duty to the principal[121] but has no effect on the attribution rule.◂

Problem 3

A gay man, well known as a gay rights advocate, seeks to buy a house for sale in a fashionable neighborhood, but fears that the owner, a well-known opponent of gay rights, will refuse to sell to him. The would-be buyer therefore secretly authorizes a friend to negotiate and consummate the

purchase, ostensibly in the friend's name. It never occurs to the seller that the ostensible purchaser might be a front, and the seller asks no questions to that effect. The friend of course makes no comment on the subject. At closing the seller learns that the gay man is the undisclosed principal. Is the seller obliged to go through with the sale?

Explanation

Yes. Although both the agent and the undisclosed principal had reason to know that the third party would have refused to deal with the principal, there was no affirmative misrepresentation.[122]

Problem 4

Mr. and Ms. Yup, high-power corporate lawyers, mesh their schedules and arrange a week's vacation hiking in the Andes Mountains. To babysit their offspring ("Little Yup") and to housesit their house, the Yups hire a babysitter ("Babysitter"). The Yups provide the babysitter, among other information, the name, office phone number, and office address of Little Yup's pediatrician. They also leave a health insurance card that indicates a health insurance account number for Little Yup. Unfortunately, while the Yups are away, Little Yup becomes seriously ill. The babysitter takes Little Yup to the hospital, where expensive medical procedures enable Little Yup to recover. In order to have the hospital provide the services, Babysitter shows the health insurance card and signs a contract with the hospital. Queried about the child's parents, Babysitter responds, "They're backpacking in the Andes. I am babysitting for their child for this week." Babysitter signs the hospitalization contract: "I.M. Babysitter, for Mr. and Ms. Yup." Are Mr. and Ms. Yup bound on that contract?

Explanation

The Yups are bound, certainly on actual authority and perhaps on apparent authority as well. Merely by entrusting the child to Babysitter for a week and leaving the country, the Yups manifested consent to have Babysitter arrange for necessary medical care. Providing the name of the pediatrician and the health insurance card reinforced that basic manifestation. The Yups did not specifically mention hospitalization and did not specifically authorize

Babysitter to sign hospital contracts on their behalf, but Babysitter certainly had implied actual authority to arrange hospitalization in an emergency and to sign all reasonably necessary documents for that purpose.

The argument for apparent authority is also strong. The hospital must be able to point to some manifestation of the Yups that, reasonably interpreted, led the hospital to believe that Babysitter was authorized to bind the Yups. The hospital can identify three manifestations: the Yups' entrusting of their child to Babysitter; the Babysitter's possession of the insurance card; the Babysitter's statement about her responsibilities. The first manifestation arguably establishes apparent authority by position, although babysitters do not customarily commit parents to large hospital bills. The possession of the insurance card made it more reasonable for the hospital to believe that the parents had given Babysitter authority to arrange for medical services. It is the third manifestation—Babysitter's statement—that is perhaps the strongest point. Had that statement been made directly by the Yups, there would have been no question of Babysitter's apparent authority. When Babysitter accurately described her authority, she was acting within her actual authority. As a consequence, her statement had the same effect as if the Yups had made it themselves. ◂

Problem 5

Pickwick owns an antique store that occupies the first three floors of a four-story brownstone. Pickwick lives on the fourth floor, has security cameras throughout the first three floors, and has a rather lackadaisical attitude toward maintaining personal surveillance over the store premises. He customarily leaves the store door unlocked even when he is upstairs having lunch or taking a nap. A large sign just inside the store entrance advises: "For assistance, pull on cord to ring bell."

One day, two newlyweds enter the store and are promptly approached by a respectable-looking lady who identifies herself as "Mrs. Pickwick." With Mrs. Pickwick's assistance, the newlyweds examine several large antiques and decide to purchase two of them. The newlyweds give Mrs. Pickwick $200 in cash as a down payment and arrange for a delivery day. Mrs. Pickwick takes from a rolltop desk a sheet of letterhead for "Pickwick & Company" and writes out a receipt.

"Mrs. Pickwick" is in fact an imposter. Is Mr. Pickwick bound to the

purported contract? If not, is Mr. Pickwick obliged to make good the $200?

Explanation

Although the imposter lacked actual and apparent authority,[123] Mr. Pickwick is probably liable via estoppel at least for the $200. The newlyweds "changed their position because of their belief that the transaction was entered into… for" Mr. Pickwick, and Mr. Pickwick "carelessly caused such belief" through his lackadaisical attitude toward security.[124] At minimum, the newlyweds are entitled to their reliance damages and perhaps to their expectation interest as well.

Problem 6

Henry comes to town one day looking for some land to purchase. He learns that Eleanor has a parcel of lakefront property that she wishes to sell. Henry meets Eleanor, explains that he is "in town acting for a group of investors who are looking for lakefront in this area," and goes with Eleanor to inspect the property. Henry appears impressed, but says to Eleanor, "I'm just the gofer. I'll have to check with the folks in charge." The next day Henry comes back and tells Eleanor that he is authorized to pay her $70,000 for the property. Eleanor thinks the price is a fair one, and together they go to a local stationery store and buy a legal form titled "Contract for the Sale of Land." They fill in all the blanks, Eleanor signs as seller, and Henry signs as "agent for the Aquitaine Corporation, Buyer." As completed and signed, the contract indicates that, on behalf of Aquitaine Corporation, Henry has put $100 down and that the corporation will deliver the rest of the purchase price within 30 days.

Two weeks after the contract is signed, Eleanor sees Henry walking down a street in town. Walking with Henry is a man whom Henry introduces as Richard, president of the Aquitaine Corporation. (This man is indeed Richard, and Richard is indeed president of Aquitaine.) After casual remarks about the weather, Eleanor asks, "Does Henry do a lot of work for your corporation, Richard?" Richard responds, "We've used him on a number of occasions. He's quite a go-getter."

Thirty days pass after the signing of the contract, and Eleanor receives no payment. When she contacts the Aquitaine Corporation, it denies that

Henry was authorized to act on its behalf. It truthfully states that: (i) it never made any manifestation to Henry regarding Eleanor's parcel, and (ii) Henry never had any ongoing responsibilities with Aquitaine but instead occasionally received specific assignments. Aquitaine denies any responsibility for the Eleanor—Henry transaction and flatly refuses to pay.

Henry being nowhere to be found, Eleanor brings suit on the contract against Aquitaine Corporation. Assume that the "equal dignities" rule does *not* apply in the jurisdiction. Assume also that Richard's comments to Eleanor are attributable to Aquitaine. What result in Eleanor's suit?

Explanation

Eleanor will lose. She will be unable to attribute Henry's actions to Aquitaine.

Since Aquitaine never made any manifestation to Henry regarding Eleanor's parcel, actual authority did not exist. Since Henry's role with Aquitaine never involved any "continuity of service," he was never a general agent. Consequently, he had no inherent agency power to enter into contracts on Aquitaine's behalf. The doctrines of apparent authority and estoppel are Eleanor's only hope, and that hope is forlorn.

The problem with apparent authority is one of timing: The apparent principal's manifestation came too late. To establish apparent authority, Eleanor must show some conduct attributable to Aquitaine that *as of the moment of contract formation* caused her to reasonably believe that Henry had authority. Until just prior to the execution of the form contract, Eleanor did not even know who the supposed principal was. Even when Henry disclosed Aquitaine's identity, Eleanor's inference that Henry had authority was based solely on Henry's remarks, not on any conduct of Aquitaine.

In some circumstances, an apparent principal's silence in the face of an apparent agent's known conduct will suffice as a manifestation. However, in this case there is no indication whatsoever that at the time of contract formation Aquitaine Corporation was aware of Henry's claim of agency status.

The conversation between Eleanor and Richard cannot salvage the situation for Eleanor. Even if Eleanor reasonably interpreted Richard's comments to mean that Henry had authority, there remains the problem of timing. Even under the Restatement view, the claimant must link the

manifestation to a reasonable belief that existed *as of the moment of the relevant act*. A post hoc manifestation cannot justify an ante hoc belief. By the time Eleanor spoke with Richard, Eleanor had already executed the contract.

The Eleanor—Richard conversation will be likewise unavailing for a claim of estoppel. Even assuming that Richard's casual remark "intentionally or carelessly" caused Eleanor to believe that Henry had acted with authority,[125] that belief did not cause any relevant harm. Eleanor had already signed the contract. Unless she can show that she suffered some additional prejudice subsequent to her conversation with Richard (e.g., turning down another potential buyer), she cannot establish estoppel.[126]

Problem 7

A small real estate company is planning to rent office space to an entrepreneur who needs "a place to hang my hat, pick up my mail, and get telephone calls." The real estate company's premises are small and its phone system very basic. The entrepreneur's calls will come through the main switchboard without a dedicated line, and her desk will be located in the same open space used by employees of the company. How can the real estate company minimize the chances that it will be held responsible for its tenant's dealings with third parties?

Explanation

Perhaps the most important safeguard is to expend the time and effort necessary to check into the *bona fides* of the would-be tenant. Problems will arise only if the entrepreneur cheats her customers or suppliers.

As for the agency law analysis, apparent authority is the key concept. Under that concept, the main risks would come from: (i) ambiguous manifestations by the real estate company; and (ii) reasonable misinterpretations by third parties. Due to the limitations of the phone system and the office setup, certain manifestations are inherent in the proposed arrangement. The key, therefore, is to preclude reasonable confusion. The safest approach is to make sure that an appropriate clarification accompanies each potentially confusing manifestation. For example, when the receptionist receives a call for the entrepreneur, the receptionist should use a greeting that

indicates that the real estate company does not employ the entrepreneur. As for the office setup, a sign on the office entrance should indicate the entrepreneur's independent, unassociated status.

Problem 8

For several years, a local band has played mostly for free at various local venues, seeking thereby to gain the experience and exposure and "break through" to paying opportunities. For the past two years, the band has relied on Oliver, its unpaid manager, to arrange its bookings.

Over the past several months, due to the band's increasing popularity, Oliver has been able to arrange modest fees for each performance. As is customary in the locality, payment is made immediately after each performance.

Last week, success created problems, as Oliver insisted on a percentage of future fees, the band told him no, he objected, and at 10 P.M. the band "fired" him. The next morning, at 10 A.M., Oliver went to a bar at which the band had previously played several times for free, as arranged by Oliver. On this occasion, Oliver: (i) purported still to be the band's manager; (ii) persuaded the bar to pay a performance fee of $500; (iii) insisted on collecting $100 in advance; (iv) succeeded with that insistence, due to the band's increasing popularity; (v) pocketed the money; and (vi) never told the band anything. Is the band obligated to perform? If the band does not perform, is the band obligated to "return" the $100 to the bar?

Explanation

As a matter of agency law and lingering apparent authority, the band probably is bound to the contract made by Oliver purportedly on its behalf. If so, (i) contract law determines the bar's remedy if the band breaches its obligation; and (ii) at minimum, the bar will have a claim for restitution of the $100 advance payment. If the band is not obligated to perform, the band is not liable for the $100.

Obviously, Oliver's actual authority ended when the band fired him. However, his apparent authority lingered as to the bar, which had previously dealt with the band through Oliver. By performing in the past as arranged by Oliver, the band manifested to the bar that Oliver was authorized to act on its behalf. Because the bar neither knew nor had reason to know of the split

between Oliver and the band, that manifestation supports a claim of lingering apparent authority.

Oliver's pocketing of the money is irrelevant to the claim; apparent authority applies to a faithless or even fraudulent apparent agent. However, the band might argue that both the fee and the requirement of an advance payment triggered a duty of inquiry.

The first of those arguments is make-weight. Except in unusual circumstances, the authority to arrange for free performances certainly suggests the authority to arrange for compensated performances.

The advance payment requires a more complex assessment. Although advance payments are not customary, the bar evidently considered it reasonable in these circumstances to make an advance payment. Why, then, would it be unreasonable for the bar to believe that the band had authorized its manager to collect the advance payment?

If Oliver had lingering apparent authority, the band is obligated on the contract. At minimum, restitution is available, because, given Oliver's apparent authority to collect the money, his receipt of the money is treated as if the band itself had received it.

However, if Oliver lacked apparent authority to bind the band to the contract, the band is also free of any responsibility for the $100. No apparent authority means no imputation to the band of Oliver's receipt of the money.[127]

Problem 9

Jeffrey is a buyer's broker in the recycled newspaper business. On behalf of various newsprint manufacturers, he locates and purchases recycled newspapers. Each time Jeffrey makes a purchase, he is acting on behalf of a particular customer. He nonetheless makes each purchase in his own name.

For the past five years, one of Jeffrey's customers has been Amalgamated Newsprint. During that time Jeffrey has made about four purchases per year for Amalgamated. On each occasion Jeffrey and Amalgamated have followed the same procedure: Amalgamated places an order with Jeffrey, stating a quantity and a maximum price. When Jeffrey finds the necessary newspapers, he purchases them in his own name and informs Amalgamated of the delivery date and price. Amalgamated then wires funds to Jeffrey, and Jeffrey pays the vendor. A commission structure

rewards Jeffrey for bringing in an order below the maximum allowed price. Jeffrey understands that he is not authorized to make any purchases for Amalgamated without first having an order in hand.

Nonetheless, after five years Jeffrey has begun to anticipate Amalgamated's needs. Last week he saw a great purchase opportunity and, expecting an order from Amalgamated, he agreed to make the purchase. Although, as always, Jeffrey made the purchase in his own name, he noted the purchase on his books as "for Amalgamated." If Jeffrey is unable to pay for the purchase, can the vendor enforce the contract against Amalgamated? ◂

Explanation

Probably not. Since Jeffrey lacked the right to purchase for Amalgamated without first having an order and since Amalgamated was an undisclosed principal, neither actual nor apparent authority apply. Also, since there is no evidence that Amalgamated knew of Jeffrey's conduct in this instance or was careless, there can be no estoppel.

The vendor's only hope is inherent agency power. The vendor must: (i) label Jeffrey as Amalgamated's general agent; (ii) delineate Jeffrey's agency function as acquiring newspaper for Amalgamated on an ongoing basis; and (iii) characterize the purchase contract as "usual or necessary" to Jeffrey's authorized activities.[128]

The vendor will likely fail in all three respects, because it will fail in the first. Jeffrey is not a general agent. He is not "authorized to conduct a series of transactions involving a continuity of service."[129] To the contrary, he receives and needs separate authorization for each individual transaction. As a result, Jeffrey has no "ongoing" authorized responsibilities and the unauthorized purchase was not "usual or necessary" to any authorized activity. ◂

Problem 10

Jeffrey makes the unauthorized purchase described in Problem 9, but in doing so tells the vendor that the purchase is being made on behalf of Amalgamated. Jeffrey then calls Amalgamated and reports his "great find." Amalgamated shocks Jeffrey by saying, "Nothing doing. No order with us, no deal from us."

Jeffrey immediately contacts the vendor, seeking a brief delay on delivery. “I bought this for a customer,” he explains, “and I didn’t exactly have their okay in advance. They’re balking a bit. I’ve got to make nice with them.” Jeffrey then calls Amalgamated again, apologizes profusely, and extols the benefits of this bargain. After a 45-minute conversation, Amalgamated relents and says, “All right. We’ll take it.”

Jeffrey immediately calls the vendor back and says, “No problem. We’re fine.” The vendor responds, “I’m fine anyhow. As soon as I learned that you were a go-between and had no authority, I went looking for another buyer. Just two minutes ago I sold the goods to somebody else.”

Can Amalgamated enforce the original agreement against the vendor? ◂

Explanation

No. Amalgamated did eventually affirm Jeffrey’s unauthorized act, and ordinarily that affirmance would bind both the vendor and Amalgamated to the contract. In this instance, however, the vendor can avoid the ratification. In reliance on Jeffrey’s lack of authority, the vendor changed its position and bound itself to another buyer. The fact that Amalgamated ratified before that change in position took place is irrelevant. What matters is that the vendor changed position before learning of the ratification. ◂

Problem 11

January 1, 2009	Elvira enters into an oral contract with three entrepreneurs who are founding a community theater. The contract calls for Elvira to begin work managing the theater on March 1, 2009, and to work in that capacity for one year. All parties understand that the entrepreneurs plan to form a corporation to own the business and that the corporation will take over Elvira’s contract.
March 1, 2009	Elvira begins work as manager.
May 1, 2009	The entrepreneurs form Community Theatre, Inc. (“CTI”), and elect themselves as the board of directors. Acting as the board, they appoint Roberta as chief executive officer and formally (albeit orally) agree to have CTI “take over the management contract with

	Elvira."
May 2, 2009	Roberta informs Elvira of CTI's formation, Roberta's appointment as CEO, and the board's action to take over Elvira's contract. Roberta says, "As of now, your management contract is with CTI."
May 31, 2009	Elvira receives her monthly salary check, this time drawn on a CTI checking account.
June 30, 2009	Elvira receives her monthly salary check, drawn on a CTI checking account.
July 10, 2009	Roberta terminates Elvira as manager.

Elvira subsequently sues CTI for breach of contract, asserting that under the contract CTI was obligated to continue her employment through February 29, 2010. CTI defends in part invoking the statute of frauds, noting that the original agreement contemplated performance that would extend more than one year beyond the making of the contract.

Elvira responds that: (a) the original agreement with the three entrepreneurs may have been within the statute, but she is not suing them; (b) when CTI "took over" the contract, the contract called for less than a year of performance; and therefore (c) the statute of frauds does not apply to CTI's obligations.

CTI rejoins that: (i) by "taking over" the contract, CTI ratified the original agreement; (ii) ratification relates back to the time of the action being ratified; and therefore (iii) CTI's ratification results in a contract that is within the statute of frauds.

Who is right? ◂

Explanation

Elvira. A party can ratify a prior act only if the party existed at the time of the act. A corporation can therefore never ratify an act taken on its behalf before the corporation came into existence. ◂

Problem 12

The board of directors of Rollerskating, Inc., adopts a resolution authorizing the CEO "to appoint such officers, managers, and employees of the corporation as the CEO deems appropriate, and to prescribe their respective duties, subject only to the numerical limits established by the board of directors from time to time." Aware of the resolution, Rollerskating's CEO appoints Rachael to be its purchasing agent. The CEO provides Rachael with a four-page memo outlining the internal approvals necessary before Rachael may place an order. For instance, orders costing less than $50,000 can be approved by the CEO; orders costing less than $25,000 may be approved by any vice president; orders costing less than $5,000 may be approved by any department manager. Rachael receives a request from a vice president to order a Model 5400 Wodget from Samuel Equipment Corporation ("Samuel Equipment") at a price of $15,000, and she places the order. Does the order bind Rollerskating?

Explanation

Yes. In placing the order, she is acting with the reasonable belief that she is authorized to do so. Her belief is based on manifestations from a superior agent (her appointment to the position of purchasing; the memo of internal procedures). Those manifestations are within the superior agent's actual authority and are therefore attributable to the principal. In short, Rachael has actual authority.

Problem 13

Over the next three months, Rachael places several more orders with Samuel Equipment Company, each properly requested by a Rollerskating vice president and each costing between $10,000 and $24,000. In due course Samuel Equipment delivers the equipment and bills Rollerskating. The bills come to the Rollerskating comptroller, whom the CEO has made responsible for reviewing and approving for payment all invoices over $1,000. The comptroller reviews the invoices, notes that each order was properly authorized and has been fulfilled, okays the payment, and signs and sends to Samuel Equipment a payment for the invoiced amount.

Subsequently, Rachael is promoted out of the purchasing department and is replaced by Herman. Rachael's last responsibility as purchasing agent is to brief Herman on his new responsibilities. Rachael does so, directing

Herman's attention to the CEO's memo on internal approvals. Herman reads the memo but promptly forgets its provisions.

The next day Herman receives a rush request to order another Model 5400 Wodget from Samuel Equipment Company at a price of $15,000. The request comes from a department manager, not a vice president, but Herman places the order anyway. Does Herman's order bind Rollerskating? ◂

Explanation

After having read the CEO's memo, Herman lacked actual authority to place the order. He could not *reasonably* have believed himself authorized. He did, however, have apparent authority. Rollerskating is therefore bound.

The apparent authority arises from manifestations attributable to Rollerskating, Herman's principal. Those manifestations were: (i) Herman's position as Rollerskating's purchasing agent; and (ii) Rollerskating's conduct on past orders placed with Samuel Equipment by a Rollerskating purchasing agent. On each prior occasion, Rollerskating's comptroller approved and sent payments. The comptroller was acting within her actual authority, so her actions are attributable to Rollerskating. The sequence of events—order from a purchasing agent followed by payment without protest—presumably led Samuel Equipment to believe that Rollerskating purchasing agents have authority to place such orders. In light of the past events, that belief was certainly reasonable.

Herman may also have had inherent agency power. He was a general agent, acting in his principal's interest. Ordering the Model 5400 could be seen as an act usual or necessary to serving Herman's authorized purpose.[130] ◂

Problem 14

A large corporation is facing a large number of product liability suits venued around the country but involving the same product. For efficiency's sake, the corporation hires a large firm of experienced and expensive lawyers ("Big Firm") to serve as national coordinating counsel to the corporation. In that capacity, Big Firm acts on the corporation's behalf to: (i) retain local counsel to represent the corporation in the various lawsuits; (ii) facilitate and coordinate the exchange of information and work product among the various local counsel; and (iii) to supervise the work of the local counsel.

Big Firm uses due care in carrying out its duties. Unfortunately, however, local counsel in one case commits discovery abuses that result in a $50,000 sanction being assessed against the corporation. Is Big Firm liable to the corporation for some or all of this amount?

Explanation

No, because local counsel is a subordinate agent of the corporation and not a subagent of Big Firm. Distinguishing between a subordinate agent and a subagent involves focusing on the manifestations of the principal. In this instance, the principal (the corporation) told the intermediary (Big Firm) to "retain local counsel to represent the corporation"; that is, to retain counsel to act as agents of the corporation. Therefore, Big Firm and local counsel are co-agents of the corporation, and Big Firm is a supervisory agent vis-à-vis local counsel. In that capacity, Big Firm is not the guarantor of local counsel's conduct and would be liable for local counsel's mistakes only if Big Firm had breached its duty of care in supervising local counsel.

Problem 15

The _____ Law School Exam Conflict and Make-Up Policy, printed in the Student Handbook, states in part:

> Students will take exams at the time and place announced in the exam schedule unless:
>
> 1. A student is prevented from taking the exams because of his or her illness or illness or death in the student's immediate family;
> 2. A student has two exams scheduled on the same day;
> 3. A student has three exams scheduled within a period of three calendar days;
> 4. A student has two exams scheduled to begin within 23 hours of each other;
> 5. A student has exceptional circumstances that, in the discretion of the Dean of Students, justify a rescheduling. Exceptional circumstances must relate to personal situations, not to a burdensome examination schedule.

No make-up exam will be given more than one week after the end of the regular exam period, except when such a delay is necessitated by illness or other exceptional circumstances.

No student shall take any exam before the regularly scheduled time for the exam.

On account of a serious illness in the immediate family, a student requests permission to reschedule an exam. Due to long-standing and significant employment responsibilities, the only practical time for the make-up exam is three days before the regularly scheduled time. The dean of students grants the request, and the student buys two nonrefundable airline tickets. The dean is aware that the student will be purchasing airline tickets but not that the tickets will be nonrefundable.

Subsequently, the professor whose exam is involved learns that an unidentified student will take a make-up in advance of the rest of the class. The professor objects and asserts that an advance make-up violates the policy quoted above. Has the action of the dean of students bound the law school to allow the advance make-up?

Explanation

The dean can bind the law school through some form of agency power (actual authority, apparent authority, inherent agency power) or through estoppel. In this matter, none of these attribution rules apply and the college is not bound.

For actual authority to exist, some manifestation of the principal must cause the agent to reasonably believe the agent has the right to bind the principal. The most salient manifestation given by the facts is the Student Handbook. That handbook expressly precludes the scheduling of advance make-ups. The dean's discretion, mentioned in item 5, relates to adequate cause for a make-up and does not override the subsequent, express prohibition on advance make-ups. The dean could not reasonably believe that he or she has the right to schedule advance make-ups.

For similar reasons, apparent authority will not help the student. For apparent authority to exist, some manifestation of the principal must cause the third party (here, the student) to reasonably believe the agent has the right to bind the principal. Arguably, at least, the dean's position constitutes a manifestation, as does the handbook's reference to the dean as the person who authorizes make-ups. However, those who rely on the appearance of authority have a duty of reasonable diligence. For a law student, that duty encompasses knowing the contents of the Student Handbook. Therefore, the

student could not *reasonably* believe that the dean has the authority to violate the policy.

Inherent authority also will not help the student, even though the dean is a general agent (i.e., authorized "to conduct a series of transactions involving a continuity of service"). In some circumstances a general agent has the inherent power to bind its principal even through an unauthorized act. However, the power does not exist when the third party has reason to know that the act is unauthorized.

Estoppel is likewise unavailing. The student may have believed the dean to be authorized to permit an advance make-up, but, given the clear statement in the Student Handbook, the law school cannot be said to have "intentionally or carelessly caused such belief."[131] Moreover, through the Student Handbook, the law school had taken "reasonable steps to notify [the student] of the facts."[132]

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1. R.2d, §6. R.3d does not include this general definition, but does use similar language in defining "power given as security." R.3d, §1.04(6).
2. See section 1.7.2.
3. This maxim translates as "who acts through another acts himself." *Black's Law Dictionary* 1249 (1990).
4. State v. Dalseg, 132 Wash.App. 854, 857, 865 (2006).
5. Inherent power is actually a collection of attribution rules, or a rule with several different facets. See section 2.6. R.3d excludes from its "black letter" the concept of inherent power, relying instead on concepts of apparent authority, estoppel, and restitution. R.3d, Chapter 2, Introductory Note.
6. Chapter 3 considers the attribution rules relevant to tort claims. In that context, the most important attribution rule is *respondeat superior*, an aspect of inherent power. Apparent authority can be relevant for some types of torts, either instead of or in addition to *respondeat superior*.
7. Ratification occurs when a principal affirms a previously unauthorized act, and, consequently, ratification analysis has a dual temporal focus: the moment at which the unauthorized act occurs and the moment at which the principal affirms. Section 2.7 discusses ratification in detail.
8. R.2d, R.3d and the case law call this *authorized* power "actual authority." For a detailed discussion of actual authority, see section 2.2.
9. See sections 2.3 and 2.6.2. R.3d would treat this situation as involving only apparent authority.
10. As explained by the R.3d., §1.01, comment *c*, "An agent who has actual authority holds power as a result of a voluntary conferral by the principal and is privileged, in relation to the principal, to exercise that power." Some cases refer to actual authority as "true authority."
11. R.3d, §2.02, comment *e*. See also R.2d, §33 ("An agent is authorized to do, and to do only, what it is reasonable for him to infer that the principal desires him to do in the light of the principal's manifestations and the facts as he [i.e., the agent] knows or should know them at the time he acts").
12. R.2d, §34, comment *a*. The text of §34 provides the following nonexhaustive list of factors that figure into determining the reasonableness of the agent's interpretation:

> (a) the situation of the parties, their relations to one another, and the business in which they are engaged;

(b) the general usages of business, the usages of trades or employments of the kind to which the authorization [i.e., the principal's manifestation] relates, and the business methods of the principal;

(c) facts of which the agent has notice respecting the objects which the principal desires to accomplish;

(d) the nature of the subject matter, the circumstances under which the act is to be performed and the legality or illegality of the act; and

(e) the formality or informality, and the care, or lack of it, with which an instrument evidencing the authority is drawn.

13. R.3d, §2.02(3).
14. See section 1.4.3.
15. R.3d, §2.02(2).
16. R.3d, §1.01, comment *e*.
17. See sections 1.4.7, 4.1.3, and 4.1.6.
18. See sections 2.6.2 (inherent power) and 2.3 (apparent authority).
19. R.3d, §1.04(2)(a); R.2d, §4(1).
20. In contrast, the third party's view is pivotal to the existence of apparent authority. See section 2.3.5.
21. R.3d §1.04(2)(c). In the R.2d, the corresponding term is "partially disclosed," R.2d, §4(2), which, according to R.3d, §1.04, comment *b*, "misleadingly suggests that a portion of the principal's identity is known to the third party."
22. Whether a principal is disclosed, partially disclosed, or undisclosed matters substantially as to the agent's liability on a contract. See section 4.2.1.
23. R.2d, §35; R.3d, Ch. 2, Introductory Note, and §2.01, comment *b*.
24. R.3d, §2.01, comment *b*.
25. R.3d, §2.02, Reporter's Notes to comment *d* ("Implied actual authority may also serve as a device to address gaps in the principal's explicit statement of authority.").
26. Dweck v. Nasser, 959 A.2d 29, 31, 43 (2008) (footnote omitted), vacated and remanded after consideration of the Appellees' Motion to Withdraw Opposition to Appeal, 966 A.2d 348 (Table), 2009 WL 378447 (Del. 2009).
27. In some states, the "equal dignities rule" would require Sartre to put the authorization in a signed writing. See section 1.4.6.
28. Agency law here closely parallels contract law. See Restatement (Second) Contracts, §317(2)(a) (stating that a party to a contract may not assign its rights when "the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him").
29. For a more extensive explanation of the doctrine's rationale, see section 2.3.8.
30. R.2d, §27 is to the same effect: "Apparent authority to do an act is created as to a third person by written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him."
31. R.3d, §2.03; R.2d §8, comment *d*. The word "traceable" does not appear in R.2d but is part of the black letter of R.3d.
32. The Restatements also contemplate agency by estoppel, but the Restatement concept of estoppel is subtly different from the doctrine of apparent authority. See section 2.5 (authority by estoppel).
33. Conduct by the apparent agent may be relevant to the reasonableness of the third party's belief, but that belief must ultimately rest on some manifestation attributable to the apparent principal. In contrast, a manifestation by one agent of a principal can give rise to apparent authority for another agent of the principal—if the first agent's manifestation is legally attributable to the principal. For a simple illustration of this phenomenon, see the first Example in section 2.3.4. See also section 2.8.

34. R.2d, §27, comment *c*. The principal can remove this authority by directing the agent not to represent her authority. R.3d does not address this issue, making instead only the more general point that "an agent's own statements about the nature or extent of the agent's authority to act on behalf of the principal do not create apparent authority by themselves." R.3d, §6.11, comment *b*.
35. For a more detailed discussion of this type of attribution, see section 2.8.
36. As a "general agent," Ralph may also have bound the owner through inherent agency power. See section 2.6.2. R.3d relies exclusively on apparent authority. R.3d, ch. 2, Introductory Note, §2.01, comment *b* (explaining that Restatement (Third) does not use the concept of inherent agency power).
37. Some courts hold otherwise, but the Example reflects the majority view. The situation is different when a lawsuit is ongoing and a party's attorney of record agrees to a settlement. See, e.g., Navajo Tribe of Indians v. Hanosh Chevrolet–Buick, Inc., 749 P.2d 90, 92 (NM 1988)("While an attorney's authority to settle must be expressly conferred, it is presumed that an attorney of record who settles his client's claim in open court has authority to do so unless rebutted by affirmative evidence to the contrary.") (citation omitted).
38. R.3d, §1.03, comment *b*.
39. R.3d, §1.03, comment c.
40. Under the "presumption" rule stated above in note 37, each party's acquiescence would prevent that party from overcoming the presumption, as well as constituting a manifestation creating the appearance of authority for the party's lawyer. In addition, the acquiescence would constitute a manifestation of actual authority from each party to that party's lawyer. See section 2.2.2 (manifestation by principal to agent via inaction).
41. If this element is missing, the closely related doctrine of "estoppel" may help the third party. See section 2.5.
42. Contract law has a comparable rule on "acceptance [of an offer] by silence." Restatement (Second) of Contracts, §69(1)(c).
43. Azur v. Chase Bank, USA, Nat. Ass'n, 601 F.3d 212, 214, 221 (3d Cir. 2010) (footnotes, internal quotation, and citations omitted). The facts also support a claim of agency by estoppel. See section 2.5.
44. See section 2.2.2.
45. R.3d, §2.03, comment *c*.
46. Streetman v. Benchmark Bank, 890 S.W.2d 212, 216 (1994).
47. In this context, the word "duty" is somewhat misleading. Typically, a duty is an obligation the nonperformance of which entitles the obligee to a remedy. In contrast, nonperformance of the duty of inquiry precludes the third party from using apparent authority to support a substantive law claim for a remedy. (This duty of inquiry thus resembles contract law's "duty" to mitigate damages.)
48. Truck Crane Service Co. v. Barr-Nelson, 329 N.W. 2d 824, 827 (Minn. 1983).
49. Having decided to embezzle from the bank, the teller could no longer reasonably believe himself authorized to accept funds on behalf of the bank.
50. Or, for those who majored in the humanities, "The song has ended/but the melody lingers on." (Irving Berlin).
51. R.3d, §3.11, comment *c*.
52. In a perfect world this question would perhaps be moot, because the apparent agent would "make good" any harm done. For the relevant legal theories, see sections 4.2.2 (warranty of authority) and 4.1.2 (duty to act within authority). In the real world, however, holding the apparent agent accountable costs time, effort, and money. Moreover, the apparent agent may be judgment-proof, beyond the jurisdiction of the court, or simply nowhere to be found.
53. *A fortiori*, the third party cannot trace that appearance to a manifestation attributable to the principal.
54. This Example is taken from R.3d, §2.03, Illustration 15, which, according to the Reporter's Notes, is in turn based on Old Republic Ins. Co. v. Hansa World Cargo Serv. Inc., 51 F. Supp. 2d 457, 495 (S.D.N.Y. 1999).

55. The exception for undisclosed principals, discussed at section 2.2.6 does not apply, because apparent authority cannot apply to an undisclosed principal.
56. See section 2.4.1.
57. According to Senator Howard H. Baker, Jr., the pivotal question in the Watergate crisis was, "What did the President know, and when did he know it?" Fred Shapiro, ed., *Oxford Dictionary of American Legal Quotations* (1993) at 13 (citing Sam J. Ervin, Jr., *The Whole Truth: The Watergate Conspiracy* at 174).
58. Other law determines what the effect will be. See section 2.4.1.
59. See section 2.4.2.
60. NCP Litigation Trust v. KPMG LLP, 901 A.2d 871, 873 (NJ 2006).
61. See section 4.1.5.
62. Engen v. Mitch's Bar & Grill, No. C7-95-78, 1995 WL 387738 (Minn. Ct. App. July 3, 1995), petition for review denied, (Minn. Aug. 30, 1995).The *Engen* court decided *against* attribution. For criticism of *Engen* and a detailed discussion of the issue, see Daniel S. Kleinberger, "Guilty Knowledge," 22 WM. MITCHELL L. REV. 953 (1996). For the correct rule, see R.3d, §5.03, cmt. e (stating that "notice is imputed to the principal of material facts that an agent learns casually or through experiences in the agent's life separate from work").
63. R.2d, §277 provides:

> The principal is not affected by the knowledge that an agent should have acquired in the performance of the agent's duties to the principal or to others, except where the principal or master has a duty to others that care shall be exercised in obtaining information.

64. This Example comes verbatim from R.2d, §277, Illustration 1.
65. R.3d, §5.03. In support of this position, the Reporter's Notes cite Southport Little League v. Vaugh, 734 N.E. 2d 261, 275 (Ind. Ct. App. 2000) as holding that "a principal is charged with the knowledge of that which his agent by ordinary care could have known where the agent has received sufficient information to awaken inquiry.
66. Not all promises are enforceable, even if made directly by a principal. Agency law only attributes the agent's promise to the principal; contract law determines whether the promise is enforceable.
67. How can an agent have actual authority to make misrepresentations? Having actual authority to make accurate statements, that agent might make a misstatement innocently, reasonably believing the misstatement to be true. According to Restatement §162, comment *b*, that misstatement would come within the agent's actual authority. Other instances are also possible. A nefarious principal might indeed authorize fraud, and an innocent principal might authorize statements that turn out to be misrepresentations. In any event, where actual authority leaves off, inherent agency power takes over. An agent of a disclosed or partially disclosed principal has inherent power to make an inaccurate statement that, if accurate, would have been within the agent's actual authority. For other instances of interest power, see section 2.6.
68. The impact under tort law is subtly different. See section 3.4.2.
69. R.3d, §5.01, comment *g*.
70. Knox-Tenn Rental Co. v. Home Ins. Co., 2 F.3d 678, 682 (6th Cir. 1993), cited in R.3d, §5.02, Reporter's Notes b to comment *c*.
71. Specialized Tours, Inc. v. Hagen, 392 N.W.2d 520, 531 (Minn. 1986).
72. This Example is based on R.3d, §5.03, Illustration 12.
73. See section 2.3.4 (manifestation by inaction).
74. R.3d, §2.05. R.2d, §8B(1) was generally to the same effect. The R.3d makes explicit a point left implicit by R.2d—namely, that to successfully claim estoppel the third party must show that its reliance was justifiable.
75. For jurisdictions that follow the pure Restatement view of apparent authority, there is another distinction: Apparent authority can exist without a showing of detrimental reliance. See section 2.3.2

for a discussion of the Restatements' view of apparent authority. As noted in that section, many jurisdictions differ with the Restatements on this point.
76. The quoted language is from R.2d, §8B(1)(a).
77. For an explanation of this point, see section 2.3.9.
78. The doctrine of *respondeat superior*, discussed in Chapter 3, is another major example of inherent agency power.
79. Some courts call the doctrine "inherent agency authority." R.3d eschews the concept of inherent power, relying instead on concepts of apparent authority, estoppel, and restitution. R.3d, Chapter 2, Introductory Note, §2.01.
80. R.2d, §8A, comment *a*.
81. In a perfect world, free of transaction costs, both parties could look to the agent. The world, however, is not perfect. See above, note 52. If the principal is at fault (e.g., has negligently hired an agent with a background of misbehavior), other doctrines will place the loss on the principal. For a discussion of a principal's liability for direct negligence, see sections 4.4.1 and 4.4.2.
82. R.2d, §3(1).
83. R.2d, §§161 (unauthorized acts of general agents); 194 (acts of general agents); and 195 (acts of manager appearing to be owner).
84. R.2d, §195.
85. Recall from section 2.6.1 that inherent agency power functions to allocate the risk between two relatively blameless parties.
86. R.3d, §2.06, comment *b*.
87. R.3d, §2.06(2).
88. R.3d, §4.01(1) states: "Ratification is the affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority."
89. R.2d, §84, comment *a*.
90. There are indeed a *few* cases that cite ratification as the reason for holding one party liable for another's tort. Most of those cases seem to involve the ratification of a course of conduct that happened to include a tort, rather than a purposeful embracing of the tort and its attendant liability. Some of the cases involve facts that support a "scope of employment"/*respondeat superior* determination (Chapter 3) as much as a holding of ratification.
91. R.3d, §4.01, comment *b*.
92. R.3d, Ch. 4, Intro. Note.
93. R.3d, §4.03, comment *b*.
94. This precondition explains why a corporation cannot ratify a contract made on the corporation's behalf before the corporation came into existence. See section 2.7.5, which contrasts ratification with novation and assumption.
95. This rule parallels the rule governing an agent's consent to act on behalf of a principal. See section 1.4.2. In that case also, the manifestation is viewed objectively and need not reach the other relevant party to be effective.
96. R.2d, §94, comment *a*. In gender-neutral and less ornate language, R.3d, comment *d* states that a "person may ratify the act through conduct justifiable only on the assumption that the person consents to be bound by the act's legal consequences."
97. If a third party has fully performed an unauthorized contract, the difference may well be immaterial. In theory, the measure of recovery will be different—benefit of the bargain versus value of services conferred—but in practice, courts often use the contract price to measure the benefit.
98. This fact determination resembles the determination made under §2-207(1) of the Uniform Commercial Code. That "battle of the forms" provision distinguishes between "a definite…expression of acceptance…which…states terms additional to or different from those offered" and an expression in which "acceptance is…made conditional on assent to the additional or different terms."
99. R.2d, §91(1).

100. R.3d, §4.06.
101. R.2d, §91, comment *d*.
102. R.3d, §4.06.
103. R.3d, §4.06, comment *c* (stating, "[f]or definitions of materiality, see Restatement (Second), Torts, §538(2)(a); Principles of Corporate Governance: Analysis and Recommendations, §1.25").
104. R.3d, §4.06, comment *d*.
105. R.3d, §4.08; R.2d §91, comment *b*.
106. See section 2.7.2.
107. R.3d, §4.05, Ill. 2, which is taken almost verbatim from R.2d, §89, Ill. 1.
108. R.3d, §4.05(2); R.2d, §95, comment *b*.
109. See section 4.2.2.
110. Neither the R.2d nor the case law provides any names for these important links in the chain of agency authority. For the first edition of this book, the author coined the terms "intermediary" and "subordinate." R.3d uses the terms "superior and subordinate co-agents"; §1.04(9) and this edition follows that usage.
111. As to the conduct of a corporation's day-to-day affairs, the board of directors has the ultimate authority and power. See, e.g., Revised Model Business Corporation Act, §8.01(b) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors.…").
112. See section 4.1.4.
113. See section 3.2.
114. This example is taken verbatim from R.3d, §1.04, Ill. 4.
115. Recall that if the delegation is to another agent of the principal (rather than to an agent of the agent), subagency is not involved. Instead, the "redelegator" is a superior agent, delegating to a subordinate agent.
116. R.2d, §5, comment *d*.
117. R.3d, §3.15, comment *d*.
118. The rule stated here closely parallels a rule of contract law: When an obligor delegates its performance obligations to another, that delegation does not by itself discharge the obligor's duties to the obligee.
119. Unlike Carolyn, the resident managers will probably also be servants of the management company. See section 3.2.2. However, that distinction is immaterial here.
120. Since there is no indication of Priscilla's being aware of any manifestation by Standish, there can be no apparent authority. Since Alden is not a general agent, there can be no inherent power. Since Priscilla has not changed position to her detriment, there can be no estoppel. (The facts do not indicate that she has bought a new dress or rejected other invitations.)
121. See sections 4.1.4 and 4.1.5.
122. This Example assumes the transaction is not subject to a law prohibiting discrimination on account of sexual orientation.
123. No manifestation attributable to Mr. Pickwick, the principal.
124. R.2d, §8B(1)(a), discussed in section 2.5. See also R.3d, Ch. 2, Topic 4, Introduction.
125. Restatement, §8B(1)(a), discussed at section 2.5.
126. To assert that Richard's comments caused ratification is too much of a stretch. Ratification requires a manifestation of affirmance, and the purported principal's manifestation must relate specifically to the unauthorized act being ratified.
127. The facts do not support a claim for agency by estoppel. There are no facts to suggest that the band had reason to suspect that Oliver would respond to his firing by acting dishonestly, and the short time between the firing and Oliver's dishonesty negates any suggestion that the band was dilatory in informing the past customers of the change in Oliver's status.
128. R.2d, §194 (inherent agency power of general agent of undisclosed principal), discussed at section

2.6.2.
129. R.2d, §3(1) (general agent defined), discussed at section 2.6.2.
130. In one respect, this explanation is unrealistically "flat." The third party, Samuel Equipment, has no mind in which to form or harbor beliefs and therefore cannot *directly* believe anything about Herman's authority. The relevant beliefs are those of Samuel Equipment's agents, which are attributable to their principal according to agency law. Whether those attributed beliefs are reasonable depends in part on what Samuel Equipment knows or has reason to know. Since Samuel Equipment cannot *directly* know anything, what it knows or has reason to know likewise depends on the attribution rules of agency law.
131. R.2d, §8B(1)(a), discussed in section 2.5.
132. R.2d, §8B(1)(b), discussed in section 2.5.

§3.1 OVERVIEW

In a modern economy, most principals work through agents, and most tortious conduct is committed by agents.

Example

A delivery company uses appropriate care in selecting, training, and scheduling its drivers. On the way to make a delivery, one of the company's drivers drives negligently and injures a third party. The driver's conduct is directly tortious, but the company's is not. ◂

Example

The owner of an office building hires a real estate broker to sell the building. The broker finds a prospect and, in extolling the building's virtues, purposely misrepresents several material matters. The owner is unaware of the misrepresentations and certainly has not authorized them. The broker's conduct is fraudulent, but the building owner's is not. ◂

In the two circumstances just described, and in many others, the principal will be responsible for the agent's tort. Agency law contains rules

for attributing an agent's tort to its principal, even though the principal has not itself engaged in any wrongful conduct.[1]

These attribution rules divide roughly into two categories, according to the nature of the agent's conduct and the nature of the third party's injury. If an agent's physical conduct causes physical harm to a third party's person or property, then the concepts discussed in Chapter Two are largely irrelevant, and the applicable doctrine is *respondeat superior*. This rule of inherent agency power applies only to a subcategory of agents known for centuries as "servants" and relabeled by the R.3d as "employees."[2] A principal is generally not responsible for the physical torts of its non-servant (or "nonemployee") agents.[3]

In contrast, if the agent's misconduct consists solely of words and the third party suffers harm only to its emotions, reputation, or pocketbook, the servant/non-servant (or, in R.3d terminology, employee *vel non*) distinction is rarely relevant. *Respondeat superior* is largely inapposite,[4] and attribution occurs according to the same rules of actual authority, apparent authority, and inherent agency power that apply to contractual matters.

§3.2 RESPONDEAT SUPERIOR

§3.2.1 The Rule Defined

Respondeat superior is a venerable doctrine that imposes strict, vicarious liability on a principal when:

- an agent's tort has caused physical injury to a person or property,
- the tortfeasor agent meets the criteria to be considered a "servant" (or, under the R.3d, "employee") of the principal; and
- the tortious conduct occurred within the servant's/employee's "scope of employment."[5]

When triggered, *respondeat superior* automatically renders the principal (referred to as "the master" or, per the R.3d, "employer") liable for the servant/employee's misconduct regardless of whether the master/employer: (i) authorized the misconduct; (ii) forbade the misconduct; or (iii) even used

all reasonable means to prevent the misconduct. Most *respondeat superior* cases involve claims that the tortfeasor employee (or servant) has been negligent, but the doctrine also applies to intentional torts involving physical harm.

The scope of *respondeat superior* thus depends on the definition and application of two key concepts: *servant (employee) status* and *scope of employment*. The more expansively each is defined, the broader the scope of the rule. As a result, disputes between an injured third party and an alleged master/employer typically involve battles over characterization. Was the tortfeasor a servant/employee? Was the tortious conduct within the scope of employment?

§3.2.2 The Nomenclature Question

Agency law is in transition concerning a crucial aspect of *respondeat superior* terminology. The R.2d and most cases use "master-servant," while the R.3d uses "employer-employee." A few cases use both.

Case in Point—Dias v. Brigham Medical Associates, Inc.

"Broadly speaking, *respondeat superior* is the proposition that an employer, or master, should be held vicariously liable for the torts of its employee, or servant, committed within the scope of employment."[6]

Case in Point—Butera & Andrews v. IBM, Corp.

"Under District of Columbia law, an employer cannot be held liable for its employees' intentional conduct solely on the basis of an employer-employee relationship. See *Haddon v. United States*, 68 F.3d 1420, 1424 (D.C. Cir. 1995) (holding that '[i]t is not enough that an employee's job provides an 'opportunity' to commit an intentional tort'); see also *Keys v. Wash. Metro. Area Transit Auth.*, 408 F. Supp. 2d 1, 4 (D.D.C. 2005) (stating that '[t]he mere existence of [a] master and servant relationship is not enough to impose liability on the master.')…."[7]

As the following definitions show, the difference is a matter of semantics, not substance.

R.2d, §220(1)	A servant is a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control.
R.3, §7.07(3)(a)	[A]n employee is an agent whose principal controls or has the right to control the manner and means of the agent's performance of work.…

The R.3d rejects the older terminology because: "The connotation that household service is the prototype for employment is dated, as is its suggestion that an employer has an all-pervasive right of control over most dimensions of the employee's life."[8]

Certainly, this assessment is correct. In the agency law sense, the term *servant* has nothing to do with servile status, menial tasks, or connection to a household. Servants are everywhere in modern society: A maid may be a servant, but so too are the top executives in any large corporation. Neither the exercise of responsibility nor the possession of professional skills suffices to negate servant status.[9] A master plumber employed by a plumbing contractor is likely a servant, as is the skilled staff physician employed by a hospital. The modern employee is, in agency parlance, a servant, and the modern employer is a master.

Unfortunately, "employer" and "employee" are not perfect replacements as agency law terms of art, because the terms have a well-established ordinary (or "lay") meaning. The resulting connotation is that the agency law meaning corresponds to the ordinary meaning, and that connotation is inaccurate. While all employees in the lay sense may well be employees in the R.3d sense, not all R.3d employees are necessarily employees in the lay sense.

Most importantly, an organization can be a "servant" of another organization, and that characterization is crucial for attributing to the second organization torts ascribed to the first organization.[10] Using "employee" as an agency law term of art can distract from this analysis, because the lay meaning of the word conjures up the image of an individual, not an organization. The same has not been true of the word "servant," because for at least a century agency law has applied that term of art far beyond its lay meaning. Ironically, it is the dissonance between the lay and technical

meanings of "servant" that makes the word a better term of art in the context of what might be called "organizational *respondeat superior*."[11]

More generally, the overlap between lay and technical meanings may cause some people (especially but not exclusively law students) to assume that, because a person is an employee in the ordinary sense of the word, the person can be treated as an employee in the R.3d sense ***without need for any supporting analysis*. That would be a serious mistake.**

Nonetheless, future cases will likely follow R.3d usage, because the ALI's latest pronouncements are always influential and the overwhelming majority of *respondeat superior* cases will involve tortfeasors who are, in fact, individuals. This book will generally follow the R.3d, while occasionally using the old and the new terminology in tandem.

§3.2.3 The Rule's Rationale

The doctrine of *respondeat superior* rests on three rationales: enterprise liability, risk avoidance, and risk spreading. It sometimes seems, however, that the doctrine's real purpose is to "find the deep pocket."

Enterprise Liability As explained in more detail in Chapter Two, this rationale attempts to link risks to benefits and hold accountable for risk-creating activities the enterprise that stands to benefit from those activities.[12] As explained in detail below:

- an "employee" (or, in the older nomenclature, a servant) is subject to detailed control as to means as well as ends and is thus integrally connected to the employer's (or "master's") enterprise; and
- an employee's (or servant's) scope of employment comprises those activities that are fairly considered part of the employer's (or master's) enterprise.

Risk Spreading According to this rationale, the employer/master should strictly and vicariously bear the risk of its employees'/servants' misconduct because the employer/master can: (i) anticipate the risks inherent in its enterprise; (ii) spread the risk through insurance; (iii) take into account the cost of insurance in setting the price for its goods or services; and (iv) thereby

spread the risk among those who benefit from the goods or services.

Risk Avoidance According to this rationale, *respondeat superior* serves to protect society from dangerous occurrences. Since the existence of employee/servant status means that the employer/master has the right to control the employee/servant's physical performance, the employer/master is well positioned to prevent the employee/servant from engaging in careless or otherwise improper conduct. Imposing strict liability creates a strong incentive for the employer/master to use its position of control to achieve "risk avoidance."

Viewed from this perspective, the rule may seem overbroad. If we are looking to encourage "safety-producing" conduct by employers, why impose liability even if the employer has taken reasonable care in selecting, training, and supervising its servants? Why, that is, have strict liability? Why not impose liability only when the master has failed to properly select, train, or supervise?[13]

In part, the answer is that both the *enterprise liability* and *risk spreading* rationales support a broad approach. Expediency is also involved. A narrowly tailored rule would present significant problems of proof, and those problems of proof would make a narrowly tailored rule ineffective. The difficulty of proving direct negligence on the part of the master warrants a rule of vicarious, strict liability.[14]

The Deep Pocket Theory The overwhelming majority of employees have fewer resources than do their employer. It may be tempting to look to this economic reality and characterize the doctrine of *respondeat superio*r as a mere guise for reaching nonnegligent defendants with convenient deep pockets.

Indeed, a few cases have expressly sought to justify *respondeat superior* as a mechanism for assuring victim compensation, and the rule does owe its practical importance to the deep pockets of masters.

Case in Point—Harbury v. Hayden

"Many states and D.C. apply the scope-of-employment test very expansively, in part because doing so usually allows an injured tort plaintiff a chance to recover from a deep-pocket employer rather than a judgment-proof

employee."[15] ◂

Restatement on Point

In addition to other rationales, "Respondeat superior also reflects the likelihood that an employer will be more likely to satisfy a judgment."[16] ◂

However, as discussed above, the doctrine has independent theoretical justification.

§3.2.4 Employee/Servant Status

Employee (Servant) Further Defined: A Factor Analysis Like many legal questions, the issue of employee status is a *vel non* ("or not") question.[17] Either the alleged tortfeasor fits within the category or does not. Like most legal issues, this one applies to a wide range of possible facts. At the far ends of the range, the determination is (by hypothesis) clear cut.

Example

Dennis works as a baker's assistant in Marcia's bakery. Marcia provides all the necessary equipment, sets Dennis's hours, assigns his particular tasks, and supervises his performance. Dennis is Marcia's employee, and Marcia is the employer. ◂

Example

Dennis decides to quit work and hires Eli, an attorney, to work out a "severance package" with Marcia. Dennis tells Eli what kind of package he wants, but the details of the negotiations are up to Eli. Eli is Dennis's nonemployee agent. ◂

Both Restatements include a set of factors for making the employee/servant *vel non* determination. A comment to R.3d provides the following list, which is drawn essentially verbatim from a black letter list in R.2d. Brackets are the author's, indicating which way each factor "cuts." [E] means that the factor cuts in favor of employee status. [N-E] means that the factor cuts against that status.

1. The extent of control that the agent and the principal have agreed the principal may exercise over details of the work [E];
2. whether the agent is engaged in a distinct occupation or business [N-E];
3. whether the type of work done by the agent is customarily done under a principal's direction [E] or without supervision [N-E];
4. the skill required in the agent's occupation [N-E if great skill required; E if unskilled work][18];
5. whether the agent [N-E] or the principal [N] supplies the tools and other instrumentalities required for the work and the place in which to perform it;
6. the length of time during which the agent is engaged by a principal [the longer time, the more E];
7. whether the agent is paid by the job [N-E] or by the time worked [E];
8. whether the agent's work is part of the principal's regular business [E];
9. whether the principal and the agent believe that they are creating an employment relationship [E]; and
10. whether the principal is or is not in business [E, although here "business" means any ongoing enterprise that deals in the commercial world, including nonprofit enterprises].[19]

Example

Big Scale Construction, LLC ("BSC") employs a doctor full time to attend to on-the-job injuries suffered by BSC employees while on remote locations. BSC pays the doctor a regular salary, which is reported to the IRS on a W-2 form (the form used for "employees" as that term is understood as a matter of tax law). BSC also provides the doctor lodging and meals while she is stationed at remote locations and requires that she stay on-site 24/7, except for approved "days away."

The doctor is responsible for supplying her own "black bag," [factor 5] and her occupation requires great skill [factor 4]. In addition, BSC does not interfere with her exercise of medical judgment [factor 1].

Nonetheless, she is an "employee" for *respondeat superior* purposes. Almost all the factors so indicate:

1. the extent of control that the agent and the principal have agreed the

principal may exercise over details of the work—BSC *does not interfere with the doctor's medical judgment, but does determine where she goes to work and requires her to be on site and away from home for long periods of time*

2. whether the agent is engaged in a distinct occupation or business—*she is not; her work is part of* BSC's *business*
3. whether the type of work done by the agent is customarily done under a principal's direction or without supervision—*many doctors now work as parts of large organizations, although the principal purpose of most such organizations is the delivery of health care services*
4. the skill required in the agent's occupation—*this one factor "cuts the other way"*
5. whether the agent or the principal supplies the tools and other instrumentalities required for the work and the place in which to perform it—*she supplies her black bag, but BCS "supplies" the place in which to perform her work (the various remote locations)*
6. the length of time during which the agent is engaged by a principal—*this is long-term engagement*
7. whether the agent is paid by the job or by the time worked—*she is paid by salary; i.e., by time worked*
8. whether the agent's work is part of the principal's regular business—*it is, albeit in an ancillary way*
9. whether the principal and the agent believe that they are creating an employment relationship—*the only relevant fact (the W-2) suggests that they do*
10. whether the principal is or is not in business—*BCS is in business*

No single factor is determinative, and the language of an agreement will not prevail over the reality of the relationship. Moreover, formal independence will be discounted if the master's right to fire results in practical control. As the R.3d explains: "Also relevant is the extent of control that the principal has exercised in practice over the details of the agent's work."[20]

Example

A pizza shop contracts with a driver to provide home delivery. A written

agreement between the shop and the driver:

- labels the driver an “independent contractor”;
- permits the pizza shop to terminate the contract at any time without cause;
- requires the driver to provide his own car, car insurance, and uniform;
- requires the driver to know the streets of the delivery area and to choose his own route on each delivery;
- provides for payment by delivery, not by the hour; and
- permits the driver to have other jobs;
- provides that each Friday the pizza shop will communicate to the driver a proposed schedule for the following week and requires that the driver notify the pizza shop within 24 hours if the driver has any objections to the schedule.

The driver, however, has no other employment. Moreover, it is well known that drivers who do not regularly accept the proposed weekly schedule are terminated.

One evening, while making a delivery for the pizza shop, the driver has an auto accident. The other driver sues the pizza shop, successfully invoking *respondeat superior*. Despite the driver’s formal freedom of action and the contract’s label of “independent contractor,” the pizza shop’s right to terminate at any time gave the shop effective control of the driver’s performance. Given the driver’s dependence on the job, the driver was likely to obey any “suggestions” the shop happened to make and to accept each proposed work schedule. Given the unskilled nature of the work, the shop had whatever expertise was necessary to actually make suggestions or give orders. Moreover, the driver has no distinct occupation and the work is an integral part of the pizza shop’s business.

The right to terminate is not by itself dispositive. It carries weight only to the extent that it creates the practical ability to control the agent’s performance.

Example

Marcia, the baker, hires Joe, a carpenter, to remodel the front of the bakery. Marcia provides a detailed plan for the remodeling and agrees that Joe will

work on a “time and materials” basis. That is, Joe will charge her for the materials he uses, plus an hourly fee for the time he spends working. Joe agrees that Marcia can end the job at any time for any reason. Despite Marcia’s right to terminate, Joe is an independent contractor (in the language of the R.2d and many cases), not Marcia’s employee (in the language of the R.3d). Carpentry is a skilled occupation, and Marcia lacks the expertise to control the details of the work. Moreover, Joe supplies his own tools, the work is not part of Marcia’s regular business, and Joe is engaged in a distinct occupation. ◂

Example

Joe wants to speed up the remodeling, so he hires Dorothy to work on the project. Like Joe, Dorothy is a skilled carpenter. Joe agrees to pay Dorothy an hourly wage, and Dorothy understands that Joe can fire her at any time. Despite Dorothy’s skill, she is Joe’s employee. His right to fire her gives him effective control over her performance. His expertise will allow him to exercise that control. (The hourly wage also argues in favor of employee status.) ◂

Almost all *respondeat superior* cases deal with tortfeasors who are paid in some way, but the doctrine can apply to unpaid volunteers. Many recent volunteer cases involve sexual misconduct.[21]

Case in Point—Doe v. Boys Clubs of Greater Dallas, Inc.

Individual who volunteered due to community-service requirement of court-imposed sentence for driving under the influence had the status of an employee for purposes of *respondeat superior* when the employer had the right to direct the volunteer’s duties, has an interest in the work to be accomplished, accepted direct or indirect benefit from the work, and had right to fire or replace volunteer..[22] ◂

Applying *respondeat superior* makes sense when the employer is an enterprise of some sort (e.g., a nonprofit organization), but is questionable as a matter of policy when the alleged “employee” is merely a friend or relative of the alleged employer and is merely helping with some household or home improvement task. *Respondeat superior* is a theory of enterprise liability that seeks to encourage risk avoidance. In the “help with a chore” situation, there

is no enterprise involved and risk avoidance is irrelevant.

The risk spreading rationale might apply, given the prevalence of homeowner's insurance. In any event, the R.2d expressly contemplates the "help with a chore" situation, although the stated rationale has little to do with the policies underlying the *respondeat superior* doctrine:

> One who volunteers services without an agreement for or expectation of reward may be a servant of the one accepting such services.…Consideration is not necessary to create the relation of principal and agent, and it is not necessary in the case of master and servant.
>
> Illustration:
> 1. *A*, a social guest at *P*'s house, not skilled in repairing, volunteers to assist *P* in the repair of *P*'s house. During the execution of such repair, *A* negligently drops a board upon a person passing upon the street. *A* may be found to be a servant of *P*.[23]

The Relationship of Employee Status to Agent Status The R.3d treats "employee" as an integral part of agency law and a subcategory of agent status. The R.2d does the same with "servant." In theory, therefore, any *respondeat superior* case should begin with a threshold question: Is the alleged tortfeasor an agent of the person sought to be held accountable via *respondeat superior*?

In practice, however, cases litigating employee/servant status rarely, if ever, consider the agent *vel non* issue. Instead, they proceed directly to the subcategory; that is, employee *vel non*.

History may explain the omission. The law of master-servant predates the modern law of agency. At some point, the former was subsumed (more or less freestanding) into the latter. Moreover, *respondeat superior* has to do with the employer's right of control and the employee's integration into the master's enterprise. There are circumstances in which the elements of servant status exist but without it being clear that the alleged employee was asked or manifested assent to act as the alleged employer's fiduciary. In those circumstances, it makes sense to apply *respondeat superior* without regard to the agent *vel non* analysis. As Oliver Wendell Holmes explained, "The life of law has not been logic; it has been experience."[24]

The Impact of Employee/Servant Status on Other Areas of Law Agency law's employee/servant concept helps set the scope for a wide range of statutes designed to regulate or tax the modern employment relationship. In areas ranging from civil rights to payroll taxes, these statutes typically cover "employees" but neglect to define the term. Courts must therefore develop a

definition, and many have turned to the agency notion of servant. Some decisions make explicit reference to the law of agency; others use its concepts without attribution.

The agency law concepts have influenced the reach of statutes in the following areas, among others:

- discrimination in employment
- unemployment compensation
- workers' compensation
- social security
- payroll taxes

Case in Point—Clackamas Gastroenterology Assocs., P.C. v. Wells

"[W]hen Congress has used the term 'employee' without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine."[25]

Case in Point—CBS Corp. v. F.C.C

In the aftermath of the infamous "wardrobe malfunction" during a Superbowl halftime show,[26] the FCC fined CBS, asserting *inter alia respondeat superior*. The Third Circuit disagreed: "Jackson and Timberlake were independent contractors, who are outside the scope of *respondeat superior*, rather than employees as the FCC found."

§3.2.5 Scope of Employment

The Rationale and Reach of the Concept *Scope of employment* is the other main *respondeat superior* battleground. Even if the tortfeasor is an employee, vicarious liability results only if the tort occurred within the scope of employment.[27] This restriction arises from the rationale of the rule. *Respondeat superior* is a doctrine of inherent authority, and the "scope of employment" element seeks to confine the master's liability to risks that

inhere in the employee's assigned tasks.

The R.2d sets four preconditions to finding a person's conduct within the scope of employment:

> (a) it is of the kind he is employed[28] 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.[29]

The R.3d is less formulaic:

> 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.[30]

Note particularly that R.3d has revised the R.2d's third condition—substituting "an independent course of conduct not intended by the employee to serve any purpose of the employer" for "actuated, at least in part, by a purpose to serve the master." This issue is relevant when an employee commits a tort of negligence while deviating from the tasks of his or her employment[31] and also when *respondeat superior* is invoked to hold the employer liable for intentional torts.[32]

As to the R.2d's second condition—"substantially within the authorized time and space limits"—the R.3d rejects it entirely as antiquated:

> This formulation does not naturally encompass the working circumstances of many managerial and professional employees and others whose work is not so readily cabined by temporal or spatial limitations. Many employees in contemporary workforces interact on an employer's behalf with third parties although the employee is neither situated on the employer's premises nor continuously or exclusively engaged in performing assigned work.[33]

The concept of "authorized place and time" may still be helpful to courts in interpreting old-fashioned situations, while the R.3d's more open-ended language can help courts deal with contemporary situations—for example, employees who telecommute or use cell phones to mix personal and business activities.

Example

Early one morning, Dennis, the baker's assistant, is at his job kneading dough in the bakery. He notices that a stray cat has wandered in and is about to jump on a counter that is covered with freshly baked cookies. Dennis scoops the cat up and gently tosses it out the door into the alley. Unfortunately, the cat lands atop a crate packed with cut glass that belongs to the china shop next door. The crate falls over and the glass breaks. Dennis has acted within the scope of his employment. He was doing the kind of work he was employed to perform, in his usual (and therefore authorized) place and during the usual (and therefore authorized) time. He acted to serve his master's interests.[34] ◂

Example

After work one day Dennis stops by a bookstore, looking for a book on baking techniques. He wishes to improve his own skills so that he can do a better job at the bakery. While browsing through the aisles he trips over a step stool and bumps another customer. This accident was not within the scope of his employment. Although he was "actuated, at least in part, by a purpose to serve the master," he was not doing the type of work for which he was hired. Moreover, he was outside the authorized time and far from his authorized place of work. ◂

Example

Renee is a regional sales manager. She spends most of her work time at her company's office. The company has a policy that forbids employees from making or receiving work-related phone calls while driving. However, one evening, while driving home from work, Renee decides to telephone one of "her" sales reps. Making the phone call distracts her from her driving, and she negligently causes an accident. At the time of the accident, she was within the scope of her employment. Although she was not "substantially within the authorized time and space limits," R.2d, §228(1)(b), she was both "performing work assigned by the employer [and] engaging in a course of conduct subject to the employer's control." R.3d, §7.07(2). ◂

Factor Analysis The R.2d lists 10 factors to be considered in determining whether a servant's conduct is within the scope of employment:

> (a) whether or not the act is one commonly done by such servants;

(b) the time, place, and purpose of the act;
(c) the previous relations between the master and the servant;
(d) the extent to which the business of the master is apportioned between different servants;
(e) whether or not the act is outside the enterprise of the master or, if within the enterprise, has not been entrusted to any servant;
(f) whether or not the master has reason to expect that such an act will be done;
(g) the similarity in quality of the act done to the act authorized;
(h) whether or not the instrumentality by which the harm is done has been furnished by the master to the servant;
(i) the extent of departure from the normal method of accomplishing an authorized result; and
(j) whether or not the act is seriously criminal.[35]

"[T]he formulation of the scope-of-employment doctrine in [the R.3d] differs from its counterparts in Restatement Second, Agency §§228 and 229 because it is phrased in more general terms."[36] However, courts like detailed guidance, and the R.2d factors are likely to remain influential.

As those factors indicate, scope of employment is not limited to the servant's proper or authorized conduct. To be within the scope of employment, "conduct must be of the same general nature as that [actually] authorized, or incidental to the conduct authorized."[37] However, the notion of "incidental" goes a long way. It is foreseeable that employees will on occasion transgress and that some of the misconduct will occur on the periphery of the employee's authorized work. An act can therefore be within the scope of employment even though: (i) the employer has expressly forbidden the act; (ii) the act is tortious[38]; or (iii) the act constitutes a minor crime. (On these points, the R.3d is in accord.)

Example

A bar owner instructs a bouncer never to use a certain chokehold in restraining obstreperous customers. One night the bouncer overreacts to an especially troublesome patron and uses the hold. The patron subsequently files a civil suit against the bar owner and seeks to press criminal charges against the bouncer. Nonetheless, the bouncer acted within the scope of employment; the relevant conduct fits within the general guidelines of R.2d, §228(1).[39]

The alleged tort does not change the outcome. *Respondeat superior* exists to attribute the torts of servants. The use of a forbidden tactic also is immaterial;. unauthorized conduct can be within the scope of employment. Likewise, the alleged simple assault does not matter. "The master can

reasonably anticipate that servants may commit minor crimes in the prosecution of the business."[40]

The Relationship of the Scope of the Employer's Control to the Scope of Employment Whether the "principal controls or has the right to control the manner and means of the agent's performance of work" determines whether an agent is an employee,[41] but an employee's scope of employment can extend beyond the range of the principal's effective control. That is, the principal must have a certain amount of control over the agent's physical performance in order for employee status to exist, but that control will not necessarily extend to every aspect of the employee's tasks. It is therefore possible for a servant's scope of employment to include areas in which the master does not exercise control.[42]

Example

Marcia, the baker, employs Sarah, an expert wedding cake designer. Marcia pays Sarah a weekly salary and provides the location and all necessary equipment and materials for Sarah's efforts. Marcia determines Sarah's working hours and working conditions and assigns Sarah particular cake orders to fill. In short, Sarah is Marcia's employee. Nonetheless, Marcia and Sarah both expect Sarah to use her own judgment, discretion, and expertise in designing, baking, and constructing wedding cakes. Marcia does not supervise Sarah's work.

On one occasion, Sarah leaves a small metal wire inside an apparently edible portion of a cake, and a customer is injured. Sarah's negligence is within the scope of her employment. Even though the negligence occurred outside the master's zone of control, the conduct was nonetheless "of the same general nature as that [actually] authorized, or incidental to the conduct authorized."[43]

§3.2.6 Scope of Employment and an Employee's "Peregrinations"

Travel as Part of Work Distinguished from Commuting; "Special Errand" Exception As the R.3d explains:[44] "In general, travel required to perform work, such as travel from an employer's office to a job site or from one job

site to another, is within the scope of an employee's employment, while traveling to and from work is not."[45] While commuting may be a precondition to the employee performing his or her tasks, the commute itself is not normally part of those tasks.

In R.2d terms:

- the commute may seem to be "actuated, at least in part, by a purpose to serve the master"[46]

Jeeze, why else would I get out of bed before daybreak and spend an hour in traffic?

- but, in fact, the commuter's purpose is merely to position herself to be able to serve the master

that is, merely to get to work

- in sum, the commuting is:
  - — neither "the kind [of task the commuter] is employed to perform"[47]
  - — nor does "it occur[] substantially within the authorized time and space limits"[48]

However, if an employee undertakes an errand at the employer's request, the entire trip is part of the scope of employment, even if the employee does the errand while traveling to or from work.

Example

As the company's receptionist is leaving work at the end of the day, the office manager asks him to "drop off this bottle of Scotch" at the house of one of the company's major customers. The receptionist agrees, delivers the Scotch without incident, and is driving straight home from the customer's house when an accident occurs. The drive home (and the accident) are within the receptionist's scope of employment.[49]

A few cases hold that an employee is within the scope of employment while driving home from a work-related social event if: (i) attendance at the event was required or otherwise part of the employee's job; (ii) the employee became intoxicated at the social event and remained so while driving home; and (iii) the employee caused an accident while driving home intoxicated.

Tangential Acts: Frolic and Detour Even when the scope of employment

includes travel on the employer's behalf, "[a]n 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."[50] However, a mere "incidental deviation from [the] performance of assigned work" remains within the scope of employment,[51] even when the deviation is exclusively to serve the employee's own purposes. In contrast, a substantial deviation puts the employee outside the scope of employment.

Agency law has a pair of labels to distinguish small-scale deviations from substantial ones. During a mere "detour," the employee remains within scope of employment (and consequently *respondeat superior* still applies). Not so when the employee is on a "frolic" of his or her own. The labels date from 1834 and the famous case of Joel v. Morrison.[52]

Example

Nick and Nora drive a delivery van for Acme Delivery Company. During their lunch break, they take the company truck and drive across town to the opera house to buy tickets to *La Boheme* for their own use. Buying opera tickets is not incidental to making deliveries. During this trip, Nick and Nora are not acting within the scope of their employment. They are on a frolic of their own. ◂

Example

On their way to make a delivery for Acme, Nick and Nora realize that they are hungry and that the city's best deli is just two blocks off their direct route. They are entitled to a full lunch break but know that the customer is anxiously awaiting delivery. They decide just to get something "to go" at the deli. On their brief trip to the deli, they remain within the scope of their employment. Although they are temporarily on business of their own, they remain "actuated, at least in part, by a purpose to serve the master." In traditional terms, they are merely on a "detour." ◂

Frolic and *detour* are powerful labels. They determine whether *respondeat superior* applies. Unfortunately, neither the cases nor the commentators provide coherent, specific guidance for determining when which label applies. One famous case requires the conduct to be at least "incidental" to the servant's duties.[53] But how to determine whether a detour

is incidental enough to avoid being a frolic? One prominent commentator has suggested, "A temporary deviation from one's work can be incidental to one's task; a temporary abandonment cannot be."[54] But how does one distinguish between a deviation and a temporary abandonment?

There are no simple answers to these questions. The cases sometimes refer to the distinction being "a matter of degree," or to the determination necessarily being made on a "case-by-case basis." Such expressions are really a code for "we know the difference when we see it (maybe), but we cannot articulate any rule to allow lawyers (or law students) to easily predict outcomes."

In the face of this uncertainty, those seeking to predict outcomes should read a range of "frolic or detour" cases, try to develop a sense of their "flavor," and keep in mind the following themes:

- Employees predictably engage in small-scale deviations from single-minded concentration on the master's interests. Ordinary, expectable deviations are likely to be considered mere detours. "De minimis departures from assigned routes are not 'frolics.' "[55]
- Deviations that pose risks of harm of a type significantly different than the types inherent in the servant's task are more likely to be considered frolics.[56]
- If the employee's deviating conduct occurs far outside the "time and space" authorized by the employer, the deviation is more likely to be a frolic.
- Cases decided under workers compensation statutes often tilt in favor of classifying activity as within the scope of employment. This tilt reflects a policy judgment and typically traces to specific statutory language.

Ending the Frolic Frolics rarely last forever. At some point, the employee "reenters employment"[57] and *respondeat superior* again applies. Reentry has certainly occurred once the employee is fully back in the employer's service —that is, once the servant is:

- again actuated at least in part (or in some jurisdictions, predominantly) by a desire to serve the master's interest;
- again within the authorized space and time limits; and
- actually is taking (or has taken) some action in the master's interests

not necessitated by the frolic itself.

Example

After purchasing their opera tickets, Nick and Nora get back into the Acme delivery van, drive to their next delivery stop, and begin unloading packages. One of the packages falls and lands on the toe of a passerby. Assuming that Nick and Nora have been negligent, *respondeat superior* will apply. Nick and Nora's frolic has ended, and they have reentered employment. ◂

The analysis is murkier, however, if a servant negligently causes harm while merely "on the way back" to employment. Indeed, the law here is as difficult to pin down as the law distinguishing frolic from detour. The following themes provide some guidance:

- An employee has not reentered the scope of employment merely by deciding to return to serving the employer's interest.
- An employee does not necessarily have to return to the point the frolic began in order to reenter the scope of employment.
- Views differ as to how complete the employee's return must be for reentry to occur.
  - — According to the R.2d, the employee must be at least "reasonably near the authorized space and time limits" for reentry to occur.[58]
  - — In some jurisdictions, merely starting back toward a place where servant duties are to be performed suffices to reenter the scope of employment.
  - — In other jurisdictions, the employee must have actually returned to the authorized "time and space."
  - — The R.3d rule is vague: "When a frolic consists of a physical journey away from the workplace or a material departure from an assigned route of travel, an employee reenters employment when the employee has taken action consistent with once again resuming work."[59]

Example

Nick and Nora's trip to the opera house has taken them a half-hour off their regular delivery route. After purchasing their tickets, they get back into the Acme delivery van and head for their next stop. As they are pulling away from the curb, they negligently hit another car. In some jurisdictions, *respondeat superior* will apply, because the employees have started back to their authorized work location (i.e., the next delivery stop). In other jurisdictions, the distance between that location and the accident site will preclude a finding of reentry into employment.

Personal/Business Multitasking: On-Site Frolics and Negligent Self-Distraction The frolic label most often applies to employees whose personal agenda takes them away physically from a location appropriate to their business task. However, in the modern world of telephones and computers, a person can be on a frolic while still at his or her desk.

Restatement on Point

P Insurance Co. furnishes telephones to its office staff with the direction that they may be used only when necessary to an employee's work. *A*, a claims processor, uses the telephone P Insurance Co. provides to make statements defamatory of *T*, a personal enemy of *A*'s. The recipients of *A*'s defamatory statements are unrelated to P Insurance Co.'s business. P Insurance Co. is not subject to liability to T. *A*'s conduct in defaming *T* was not within the scope of *A*'s employment. *A* acted only for *A*'s own purposes.[60]

In contrast, if an employee undertakes personal matters simultaneously with business tasks, the business task remains within the scope of employment. Indeed, the employee's self-distraction may constitute negligence in performing the business task.

Example

Leighton is a housing inspector whose job requires him to drive from inspection site to inspection site. One afternoon, while en route from one site to another, Leighton uses his personal cell phone to make a personal call. During the call, Leighton negligently collides with another car. The collision is within the scope of Leighton's employment.

§3.2.7 Intentional Torts

The Purpose Test Although most *respondeat superior* cases involve torts of negligence, the doctrine's rationale and reach also extend to some intentional torts. When an employee, acting within the scope of employment, commits an intentional tort causing physical harm, the employer is vicariously liable. The intentional nature of the tort does not preclude vicarious liability, and even an expressly forbidden or criminal act can be within the scope of employment.

Overly aggressive barroom employees provide prime examples.

Example

Seeking to remove an unruly patron, a bar's bouncer applies an overly aggressive wristlock. The bar's owner is vicariously liable for the intentional tort of battery.

In most cases asserting *respondeat superior* for an intentional tort, employee status is clear and scope of employment is therefore the crucial issue. On that issue, under the R.2d and the overwhelming majority of cases, the pivotal inquiry is whether:

- the employee
- in engaging in the conduct that constituted the intentional tort
- was motivated at least in part by a desire to serve the master.[61]

The R.2d also focuses attention on "the similarity in quality of the act done to the act authorized."[62]

The R.3d uses a different formulation—namely, whether the tortious act "occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer."[63] The newer formulation is intended to clarify rather than revise the older one.

Example

An employee of a finance company is lawfully using "self help" to repossess a car. When the owner happens to come home and see the repossession in progress, he loudly voices his objections and places himself in the path of the

car to block its departure. The employee drives the repossessed car straight at the owner, causing him great fear of injury and also causing him to drop into the mud a friend's dress that he had just picked up from the dry cleaner.

Assuming that the employee is liable for the tort of assault, the finance company is liable in *respondeat superior*. Although the employee's conduct may well have been forbidden by the finance company, the tort occurred as the employee was trying to effect the repossession. The assault-via-vehicle was not "a departure from [but rather merely] an escalation of conduct involved in performing assigned work."[64]

Example

Throughout a lengthy bus ride, a passenger is noisy and disruptive. After the bus arrives at the terminal and the passenger has disembarked, the bus driver grabs the passenger and punches him. The bus company is not vicariously liable.[65] Since the trip is over and the passenger's misbehavior no longer affects the master's interest, the "servant" (bus driver) could not be actuated by a desire to serve the "master" (the bus company). By the time the tort occurs, the employee has embarked on "an independent course of conduct not intended by the employee to serve any purpose of the employer."[66]

The "purpose rule" has always been pliable. "Judge Learned Hand concluded that a drunken boatswain who routed the plaintiff out of his bunk with a blow, saying, 'Get up, you big son of a bitch, and turn to,' and then continued to fight, might have thought he was acting in the interest of the ship."[67] One court even found the necessary "purpose to serve the master" when a police trainee, practicing his quick draw inside the police station, accidentally shot a fellow officer. The court held that the trainee was trying to improve his firearms techniques, to the benefit of his employer.[68] Courts have also applied the purpose rule to include an employee's intentionally violent conduct when that conduct closely relates to a dispute that at least initially concerned the interests of the employer.

Example

A customer in a bar refuses to pay for a drink. Outraged, and seeking to collect on the debt owed the bar's owner, the bartender strikes the customer. The bar's owner is vicariously liable for the intentional tort of battery.

The Incidental/Foreseeable Test Some recent cases abandon the purpose test and instead ask "whether [the] conduct [constituting the intentional tort] should fairly have been foreseen from the nature of the employment and the duties relating to it,"[69] or "whether the risk [of such conduct] was one that may fairly be regarded as typical of or broadly incidental to the enterprise undertaken by the employer."[70]

In the most well-reasoned of these "incidental/foreseeable" cases, the courts identify some special characteristic of the employee's assigned task as facilitating or at least occasioning the abusive conduct.

Case in Point—Marston v. Minneapolis Clinic of Psychiatry and Neurology, Ltd.

A psychologist employed by a clinic engages in sexual relations with a patient. The patient later asserts that the psychologist's emotional control over her vitiated any apparent consent and that the psychologist's conduct constituted an intentional tort. She sues both the psychologist and the clinic. The clinic may well be liable vicariously, because the psychologist's conduct was both foreseeable and incidental to his job. "[S]exual relations between a psychologist and a patient is a well-known hazard and thus, to a degree, foreseeable and a risk of employment. In addition, the…situation would not have occurred but for [the psychologist's] employment; it was only through his relation to [the patient] as a therapist that [the psychologist] was able to commit the acts in question."[71]

In *Marston*, the therapist's employment did more than create a happenstance opportunity for sexual assault. The proper performance of the therapist's assigned task involved exploring, developing, and using the patient's vulnerability for therapeutic purposes.

Unfortunately, in many other incidental/foreseeable cases the holdings are far broader and more troublesome. In one jurisdiction, for example, courts have held that:

- sexual harassment of a waitress by a coworker is arguably "foreseeable" (and therefore arguably within the scope of employment) because the restaurant had a policy prohibiting sexual harassment[72]

- when a day-care worker sexually assaults a little child, a *respondeat superior* claim against the day-care center can survive a motion for summary judgment on the strength of a single expert affidavit stating that in the day-care industry "sexual abuse of children is a paramount concern"[73]
- an individual's alleged violations of the Uniform Trade Secrets Act while attempting to switch customers from his old employer to his new employer did *not* support a *respondeat superior* claim by the former against the latter, because:
  — although the individual's tortious conduct clearly benefited and was intended to benefit the new employer's business;
  — the scope of employment question turned on "foreseeability;" and
  — the old employer failed to introduce any evidence that trade secret violations were a "well-known hazard" in the particular industry at issue.[74]

The R.3d has criticized and rejected the incidental/foreseeable test:

> [F]ormulations based on assessments of "foreseeability" are potentially confusing and may generate outcomes that are less predictable than intent-based formulations. "Foreseeability" has a well-developed meaning in connection with negligence and to use it, additionally, to define a different boundary for *respondeat superior* risks confusion.…[T]he possibility that the work may lead to or somehow provide the occasion for intentional misconduct that is distinct from an employee's actions in performing assigned work…is indeed always "foreseeable," given human frailty, but its occurrence is not a risk that an employer can effectively control and its occurrence may be related causally to employment no more than to other relationships and circumstances in an errant employee's life more generally. Moreover, a "foreseeability" formulation for imposing vicarious liability may penalize an employer who has taken reasonable precautions against employee misconduct to the extent it enables a plaintiff to demonstrate that the employer did indeed foresee the risk of misconduct.[75]

Scope of Employment and Seriously Criminal Behavior The incidental/foreseeable cases often involve seriously criminal behavior. Given the proper facts, victims can hold the employer directly liable for negligence in hiring, training, or supervising the employee; the greater the foreseeable vulnerability of the victim, the more exacting is the standard of ordinary care.[76]

Nonetheless, many of the incidental/foreseeable cases bend the concept of *respondeat superior* to hold the employer liable *without fault* so as to access the deep pocket.

> In many of these cases, the plaintiffs are victims of an employee's sexual misconduct. In one case, the victims were only three and four years old. It is difficult to criticize decisions that stretch a concept to succor such victims, but [law reflected in many of the incidental/foreseeable cases] has gone beyond stretching. It has been recast in an extraordinary and fundamentally unfair way.[77]

Fortunately, in most jurisdictions and the overwhelming majority of cases, the purpose test remains key to establishing *respondeat superior* enterprise liability. When an employee chooses to commit a serious crime on the employer's premises and against a customer or patron of the employer, it is unlikely that the employee is seeking to serve the employer's interest.[78] Or, in R.3d terms, the "extreme quality" of "a serious crime…may indicate that [the employee] has launched upon an independent course of action,"[79] which ousts the conduct from the scope of employment if the "independent course" is "not intended by the employee to serve any purpose of the employer."[80]

§3.3 LIABILITY FOR PHYSICAL HARM BEYOND *RESPONDEAT SUPERIOR*

In general, a principal is not vicariously liable for physical harm caused by the torts of a nonemployee agent (in R.2d terms, an "independent contract agent"). *Respondeat superior* controls most such cases, and it applies only to employees (servants). In a few situations, however, other rules apply, and these rules impose liability for the torts of nonemployee agents.

§3.3.1 Principal's Direct Duty to a Third Party

If a principal owes a direct duty of care to a third party and relies on an agent for the necessary performance, the agent's conduct may result in liability for the principal. Section 4.4 discusses such situations.

§3.3.2 Intentional Torts of Nonemployee Agents

When a nonemployee agent commits an intentional tort and causes physical injury, the relevant law is muddy. According to some authorities, the principal is not liable unless: (i) the principal intended or authorized the result or the manner of performance[81]; or (ii) the principal owed a duty to the

injured party to have the agent's task performed with due care.

Notable exceptions exist to this rule. For example, store owners often face liability when a hired guard service falsely arrests or imprisons a customer of the store. The liability comes despite the store owner's protestation that the guard service acted as an independent contractor. Some of the cases that impose liability rest on a finding of control by the store of the guard service. Others assert that the principal ratified the guard service's wrongful act (e.g., by not terminating services of the independent tortfeasor). Other cases hold the store liable for breaching its duty to protect its customers from unwarranted attack.[82] Still other cases simply hold that independent contractor status does not bar vicarious liability for an agent's *intentional* (as distinguished from negligent) torts.

§3.3.3 Misrepresentation by an Agent or Apparent Agent

If: (i) a person has actual or apparent authority to make statements concerning a particular subject; (ii) the person makes a misstatement of fact concerning that subject; (iii) a third party relies on that misstatement; and (iv) the third party suffers physical harm as a result, then the actual or apparent principal is liable to the third party.[83]

Example

Office Realty, Inc. ("Realty") is substantially remodeling an office building that it owns and wishes to allow prospective tenants to see the work in progress. Realty has hired a construction manager to supervise the remodeling work and instructs that manager to tell prospective tenants which sites within the building are safe to view. One day, the construction manager makes a mistake and sends Bill, a prospective tenant, into an unsafe stairwell. Bill is injured. Realty is liable, regardless of whether the construction manager is an employee or independent contractor. Realty's agent had actual authority to identify the safe locations, and the agent's misstatement on that subject caused Bill physical harm.[84]

Example

Realty tells Alice, another prospective tenant, "If you want to see how the

place will look, go over to the building. It's under construction, but one of our people will tell you where it's okay to go." Alice goes over to the building and meets a security guard, who is employed by a guard service hired by Realty. Neither the guard service nor its employees have actual authority to direct prospective tenants. However, when Alice asks, "How do I get to look at some redone offices?" the guard responds by directing Alice into the unsafe stairwell. If Alice is injured as a result, she can hold Realty vicariously liable. The guard's statement was made with apparent authority.[85]

§3.3.4 Negligence of Apparent Servants

In one area, the doctrine of *respondeat superior* meshes with the law of apparent authority and produces vicarious liability for those who merely appear to be masters. In the words of the R.2d:

> One who represents that another is his servant or other agent and thereby causes a third person justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.[86]

The R.3d states an even broader rule:

> A principal is subject to vicarious liability for a tort committed by an agent in dealing…with a third party on or purportedly on behalf of the principal when actions taken by the agent with apparent authority constitute the tort.[87]

Regardless of which formulation applies, the rule is important. In our modern economy, many businesses present themselves to the marketplace as economically integrated enterprises while substituting independent contractors for traditional employees.

Case in Point—Gizzi v. Texaco, Inc.

An oil company conducts a national advertising campaign, encouraging customers to have their cars serviced at service stations carrying the company's logo. In the words of the ad campaign: "You can trust your car to the man who wears the star." Some of the service stations are, in fact, independently owned and operated. These stations are not the oil company's agents, let alone the company's employees. In agency parlance, the

independent operations are independent contractors

One such independent contractor negligently repairs a car, and the customer suffers injury as a result. The injured customer may well have a claim against the oil company. In R.2d terms, the ad campaign may have created an appearance of servant status, and the customer may indeed have "trusted" that relationship in choosing the service station. If so, the oil company will be vicariously liable.[88]

Case in Point—Jones v. HealthSouth Treasure Valley Hosp.

Family members of patient who died during surgery filed medical malpractice and wrongful-death claims against the surgery center, alleging that it was vicariously liable, under a theory of apparent agency, for the negligence of two anesthesiologists and a cell-saver technician who attended the surgery as independent contractors. The trial court granted summary judgment for the surgery center. This court reversed and remanded, holding, *inter alia*, that a hospital could be found liable under Idaho's doctrine of apparent authority for the negligence of independent personnel assigned by the hospital to perform support services, where a patient accepting the services of the hospital's agent did so in the reasonable belief that the services were rendered on behalf of the hospital.[89]

§3.4 TORTS NOT INVOLVING PHYSICAL HARM

§3.4.1 The Basic Paradigm: Closer to Contracts Than to Physical Torts

If an agent's misconduct consists solely of words and the third party suffers harm only to its emotions, reputation, or pocketbook, the agency analysis resembles the approach used for contractual matters. The key rules are those of actual authority, apparent authority, and inherent agency power.[90] Except for the borderline areas of malicious prosecution and intentional interference with business relations, *respondeat superior* is largely irrelevant.

§3.4.2 The Tort of Misrepresentation

The Attribution Rule It is commonplace for agents negotiating or communicating on behalf of principals to make statements concerning the subject matter of a potential transaction. If an agent makes a misstatement within the scope of the agent's actual authority, apparent authority, or inherent power, the misstatement itself is attributable to the principal for contract law purposes. If the misstatement is tortious in and of itself, the principal will be vicariously liable if the agent acted with actual[91] or apparent authority.[92]

Case in Point—Rodi v. S. New England Sch. Of Law

A law school graduate who could not take the bar examination because his school was unaccredited sued the school (and other defendants) for fraudulent misrepresentation. The graduate claimed that he had relied on the dean's recruitment letter, which stated that the American Bar Association's accreditation committee had voted to recommend the school for provisional accreditation and that the dean was highly confident of receiving requisite ratification. The graduate also alleged that, after negative ABA action after his enrollment, he decided not to transfer from the law school because the school's acting dean assured him that there was no cause for pessimism about accreditation. The court held that, because deans were high-ranking school employees, their misrepresentations were attributable to the law school.[93]

Example

Rebecca retains Michael to sell a plot of land she owns near the river and makes his authority generally known. Michael shows the land to Samantha, who seems quite interested. She asks, "Has there ever been any trouble with flooding from the river?" Michael knows that, in fact, almost every spring the river floods at least a little and that often the water temporarily covers a quarter of Rebecca's plot. However, fearful of losing the sale, he responds, "Oh no. Not at all." Samantha agrees to buy the land and signs a purchase agreement. Planning to build a house near the river, she hires and pays an architect to do preliminary plans. She then learns the truth about the flooding and, pursuant to contract law, rescinds the purchase agreement.[94] The architect's plans are now worthless to Samantha, and she may recover their cost from Rebecca. Michael, Rebecca's agent, made a material misstatement

with intent to deceive and thereby committed the tort of intentional misrepresentation.[95] Michael lacked the actual authority to falsely describe the flooding situation, but his false description came within his apparent authority. Samantha relied on the false statement and as a consequence suffered injury. Rebecca is therefore vicariously liable for Michael's tort.

When a misrepresentation is made with apparent authority, the principal is liable even if the person making the misrepresentation "acts entirely for his [sic] own purposes, unless the [third party] has notice of this."[96] In general, "A principal who puts a servant or other agent in a position which enables the agent, while apparently acting within his authority, to commit a fraud upon third persons is subject to liability to such third persons for the fraud."[97]

Tort Attribution Contrasted with Contract Attribution Besides saddling a principal with tort liability, as the Example above illustrates, an agent's misstatements can also give rise to contractual claims against the principal, particularly claims for breach of warranty and rescission. The tort attribution rules differ from the contract rules, however, with regard to what is being attributed and, consequently, with regard to the role of innocent misstatements.

For tort law purposes, the principal's liability is vicarious, and the attribution involves a complete tort: a material misstatement made by an agent with the requisite state of mind (e.g., intent, negligence), followed by a third party's injurious reliance. Establishing the principal's liability involves two steps: tort law recognizes a tort as committed by the agent; agency law attributes that completed tort to the principal. Therefore, since innocent misstatements do not constitute torts, an agent's innocent misstatements do not trigger the tort attribution rules.

The process works differently with contractual claims. Unless the principal is undisclosed, no contractual claim is complete at the agent's level and no complete claim exists to be attributed.[98] Instead, agency law attributes the agent's statement, and contract law then imposes liability as if the principal had itself made the statement. The principal's liability is direct ("on the contract"), even though one of the elements creating liability (the misstatement) is satisfied only by attribution. For contract law purposes, therefore, an agent's misstatement is attributed regardless of whether the misstatement was innocent, negligent, reckless, or intentional. Indeed, the attribution occurs essentially as if the statement were accurate.[99] For a

graphic explanation, see Figure 3-1.

Often, the same situation supports both contract and tort claims. Whether the third party prefers one claim over another often depends on issues outside of agency law, such as which remedy is the most desirable or whether the statute of limitations has run on one claim but not on the other.

	Agent's Level	What Is Being Attributed	Principal's Level
Tort	Agent commits a tort of misrepresentation (which necessarily involves a non-innocent misstatement).	Agent's tort	Vicarious Liability for the attributed tort of Agent
Contract	Agent makes a statement which may be a misstatement, which in turn may be innocent.	Agent's (mis)statement	Direct Liability (if provided by applicable substantive law), in part due to the attributed (mis)statement of Agent

Figure 3-1 Comparison of Tort and Contract Attribution Paradigms

§3.4.3 Defamation

A principal is liable for an agent's defamation if the agent acted with actual or apparent authority in making the defamatory statement. It is not necessary that the agent be actually or apparently authorized to commit defamation, but rather that the agent be actually or apparently authorized to make the statement. For apparent authority to be relevant, the agent must have appeared authorized to "those hearing or reading the statement."[100]

Example

A credit bureau authorizes its employees to report information contained in the bureau's database to subscribers. A bureau employee receives a call from a subscriber who is seeking information about James Hobbs. The employee consults the database and reports, "Two convictions for larceny, and 12 bounced checks." In fact, the database is completely wrong, and, up to this moment, Mr. Hobbs' reputation has been unblemished. The credit bureau is liable for defamation. The employee had actual authority to make the report that turned out to be defamatory. ◂

Example

A newspaper columnist has written a series of columns harshly criticizing the city's parking commissioner. The newspaper's publisher becomes concerned that the columns are getting perilously close to the "actual malice" necessary to allow a public figure to recover for defamation. The publisher therefore orders the columnist to cease writing about the commissioner. Assuming that the columnist will obey, the publisher neglects to mention the order to the paper's managing editor. The columnist disobeys the publisher's order, and another column appears that contains scurrilous statements that are clearly defamatory. The newspaper is liable to the commissioner for defamation. Although the columnist lacked actual authority to write on the subject, to the newspaper's readers the columnist appeared to be authorized.[101] ◂

The example of the columnist highlights the policy behind using apparent authority as an attribution rule for defamation. In the words of the R.2d:

> [D]efamation is effective, in part at least, because of the personality of the one publishing it. Thus, one who appears to have authority to make statements for the employer gives to his statements the weight of the employer's reputation.[102]

§3.4.4 Malicious Prosecution and Interference with Business Relations

These torts often involve both words and actions, and in this borderline area *respondeat superior* is the chief rule.

Example

Todd is a salaried sales rep for the Nickel Surgical Products Company ("Nickel"). Nickel trains its sales reps to pursue business aggressively. Todd persuades Ace Hospital to stop buying its surgical drapes from Amalgamated Hospital Supply ("Amalgamated") and buy instead from Nickel. Ace's decision and subsequent purchases from Nickel breach a contract with Amalgamated. Todd has tortiously induced that breach of contract, and Nickel is vicariously liable.[103] ◂

§3.5 ATTRIBUTING TORTS IN COMPLEX OR MULTILEVEL RELATIONSHIPS

Respondeat superior attributes an employee's (servant's) tort to the principal on the grounds that the principal has the right to control the tortfeasor's performance. In some situations, however, it may be difficult to identify the principal who controls the conduct giving rise to the tort. For example, one party's employee may come under the temporary control of another party, as when an equipment leasing company lends an equipment operator to a construction company or when a surgeon conducts an operation with the assistance of nurses employed by a hospital. Agency law analyzes such situations using the *borrowed servant* doctrine.[104]

Another type of problem arises when: (i) the employee of one party commits a tort; (ii) the employer itself is subject to substantial control or influence by another party; and (iii) the tort victim seeks to recover from that other party. Situations involving *distant masters* arise most often in franchise relationships, although they also occur frequently in the construction industry. Agency case law and the R.2d offer several different views on that subject. The R.3d does not address this issue.

Borrowed Servant This concept is best introduced by example.

Example

Hoister Crane Company ("Hoister") owns and leases out large cranes used in major construction projects. Operating such a crane requires considerable skill, so Hoister employs a staff of trained, full-time operators and assigns an operator to run each leased crane. Hoister charges its customer a single fee that includes both the use of the crane and the services of the operator.

Hoister rents a crane to General Contractor, Inc. ("General Contractor"), a construction company building a large office building. At the worksite, Hoister's operator runs the crane, but General Contractor's site supervisor tells the operator what tasks to do and when to do them. When the crane is in operation, the site supervisor uses hand signals to direct the operator. While lifting a load of steel bars, the operator negligently allows three bars to fall, injuring a passerby. Whether *respondeat superior* implicates Hoister or General Contractor depends on whether, at the time of the accident, the crane

operator was General Contractor's borrowed servant. ◂

Example

Jeff Couteau, a surgeon, has operating privileges at Morgan Hospital ("the hospital") but is not a hospital employee. When he performs surgery at the hospital, he is assisted by operating room nurses who are hospital employees. During the course of an operation these nurses take orders from whatever physician is in charge.

At the end of one of Couteau's operations, a nurse neglects to make a proper sponge count and the patient is closed with one sponge still inside. In the subsequent malpractice action, the patient asserts that *respondeat superior* makes Couteau liable for the nurse's negligence. Whether this claim succeeds depends on whether, during the operation (and more particularly, at the time of the negligent sponge count), the nurse was Couteau's borrowed servant. ◂

The precise contours of the borrowed servant doctrine vary from jurisdiction to jurisdiction. In most jurisdictions a party invoking the rule must show that:

- the regular master (sometimes called "the general employer") assigned or allowed its servant to work for and under the supervision of another party (sometimes called "the special employer");
- at the time of the servant's tortious conduct:
  — the special employer had the right to control in detail the performance of the servant's work; and
  — the general employer retained no significant right of control over the servant, including the right to reassign the servant to other tasks.

The doctrine is relevant only when a servant is alleged to have committed a tort, so "the important question is not whether or not [the servant] remains the servant of the general employer as to matters generally, but whether or not, as to the act in question, [the servant] is acting in the business of and under the direction of [the general employer] or [the special employer.]"[105] The inquiry is always very fact intensive, and "[e]ven within the same jurisdiction, it may be difficult to predict whether a given set of

indicia will demonstrate that a special employer has assumed the right of control."[106]

Although the borrowed servant doctrine can be described as an exception to *respondeat superior*, the doctrine is better understood as an application of *respondeat superior* principles. *Respondeat superior* attributes a servant's negligence to the servant's master, and the borrowed servant doctrine redirects that attribution away from the regular master ("the general employer") to a temporary master ("the special employer"). The redirection is appropriate because the special employer has a transitory but substantial right to control the servant. Since *respondeat superior* rests on the master's right to control, vicarious liability should follow the control. When the general employer allows the special employer to control the servant's performance, the "borrowed" servant's torts should be attributed to the special employer.

As for the case of the crane operator, courts have gone both ways.[107] Some have looked to the general contractor's detailed control over the operator (e.g., the hand signals) and have found the operator to be the general contractor's borrowed servant. Other courts have held to the contrary, following a R.2d comment that "a continuation of the general employment is indicated by the fact that the general employer can properly substitute another servant at any time, that the time of the new employment is short, and that the lent servant has the skill of a specialist."[108]

As for the medical malpractice case, if the hospital lacked the right to reassign the nurse during the operation, the borrowed servant doctrine probably applies.

Distant Masters Like the issue with borrowed servants, the issues in this area are best introduced with examples.[109]

Example

A franchisor licenses a local company to run a hotel using the franchisor's name, logo, business practices, and national reservation system. The franchise agreement requires the franchisee to abide by a thick book of regulations on topics ranging from style of linen to lawn care. One winter a custodial employee of the *franchisee* carelessly shovels a sidewalk and leaves behind a thin sheet of ice. A customer of the franchisee slips and falls. The customer sues not only the franchisee but also the franchisor.

Example

A construction company ("the general contractor") wins a bid to build a new apartment building. The general contractor subcontracts the electrical work to an electrical subcontractor and the plumbing work to a plumbing subcontractor.[110] Concerned about workplace safety, the general contractor has its own site supervisor regularly check on the work of all the subcontractors. An electrician, employed by the electrical subcontractor, negligently leaves some equipment lying around, and an employee of the plumbing subcontractor trips and suffers injury. The injured employee sues not only the electrical subcontractor but also the general contractor. ◂

The outcome of each of these situations depends on whether the plaintiff can find a chain of attribution that links the tortfeasor (in the above Examples, the custodian and the electrician) to the distant party (the franchisor and the general contractor). Unfortunately, many of the cases in this area fail to articulate a complete analysis. For example, courts in franchise cases often: (i) note that the tortfeasor is the servant of the franchisee; (ii) determine that the franchisee is the servant of the franchisor; and (iii) on that basis alone hold the franchisor liable for the tortfeasor's misconduct. These courts neglect to explain why the franchisor is responsible for the torts of its servant's servant.

At least three different theories could apply. First, the tortfeasor could be deemed the subservant of the distant party. According to the R.2d, if a master's servant engages servants of its own to conduct the master's business, then the servant's servants are subservants of the master.[111] In that event, *respondeat superior* attributes the subservant's torts (if within the scope of employment) directly to the master.[112] Under this approach, the franchisor and the general contractor would be masters, the franchisee and the electrical contractor would be servants, and the custodian and the electrician would be subservants. See Figure 3-2.

The problem with this analysis is that, for a subservant to exist, the master must have expressly or impliedly authorized the servant to engage servants of its own to do the master's business. Moreover, the master will have the "prerogative of overriding his servant in giving directions [to] the subservant."[113] In the situations under discussion, neither of these elements is present. The distant party (i.e., the franchisor and the general contractor) does not consider the intermediate party (i.e., the franchisee and the electrical

contractor) to be its servant. To the contrary, the typical franchise agreement and the typical construction subcontract expressly disclaim any agency status whatsoever. It is therefore unlikely that the distant party has consented to having the intermediate party engage *subservants*. Likewise, the intermediate parties see themselves as independent contractors, especially when it comes to control of their employees. They would hardly view the distant party as having the "prerogative" to directly control their employees.

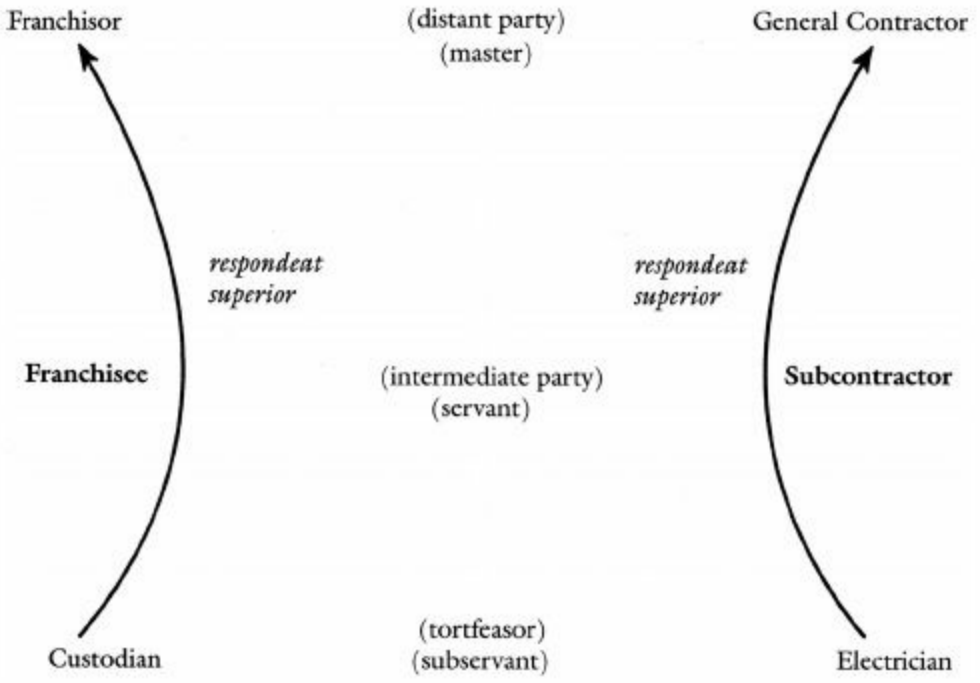

Figure 3-2. Subservant Analysis

The second approach follows more closely the actual business relationships and involves two steps of attribution. Under this approach, the tortfeasor (i.e., the custodian and the electrician) is seen simply as the servant of the intermediate party (i.e., the franchisee and the electrical contractor), and the intermediate party is seen as the servant of the distant party (i.e., the franchisor and the general contractor). *Respondeat superior* then operates twice: The tortfeasor's negligence is attributed to the intermediate party, and the intermediate party's (attributed) negligence is attributed to the distant party. See Figure 3-3.

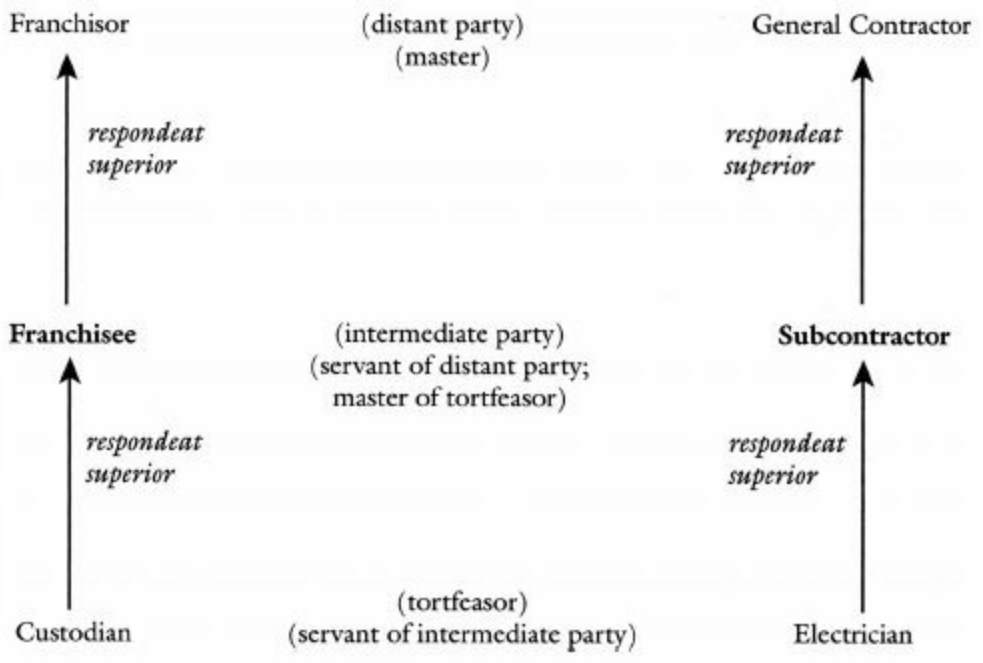

Figure 3-3. Master of Master Analysis

Case in Point—Estate of Miller v. Thrifty Rent-A-Car Sys., Inc.

The estate and family of a rental-car passenger who died following an accident, in which the car's brake system allegedly seized, brought action for negligence, strict liability, and breach of warranty against franchisor of rental-car franchisee that provided the car. Granting summary judgment for defendant, the court held, *inter alia*, that defendant was not vicariously liable for franchisee's provision of the allegedly defective vehicle under theories of agency or *respondeat superior*. The court reasoned, in part, that only one factor potentially weighed in favor of finding franchisee to be an employee of franchisor rather than an independent contractor—namely, whether the work was part of the regular business of the employer. The most important factor, control, weighed heavily against employee status, because the agreement between franchisor and franchisee was oriented toward "results" rather than "means."[114]

The third approach is the most direct, holding that the distant party has retained or exercised a direct right to control the intermediate party's employees and is accordingly the tortfeasor's master. *Respondeat superior* therefore applies directly. See Figure 3-4. In most circumstances, there will be no express evidence of the distant party's right of control. Indeed, the

typical franchise agreement and the typical construction subcontract will state to the contrary. However, the parties' conduct may belie their formal manifestations. If, for example, the general contractor's site supervisor regularly issues orders to the employees of the electrical subcontractor and those employees obey, then the right to control is present and *respondeat superior* may well apply. Similarly, if the franchisor regularly sends out inspectors, these inspectors give orders directly to the franchisee's employees, and the employees obey, then the franchisor may well find itself at the receiving end of *respondeat superior* liability.

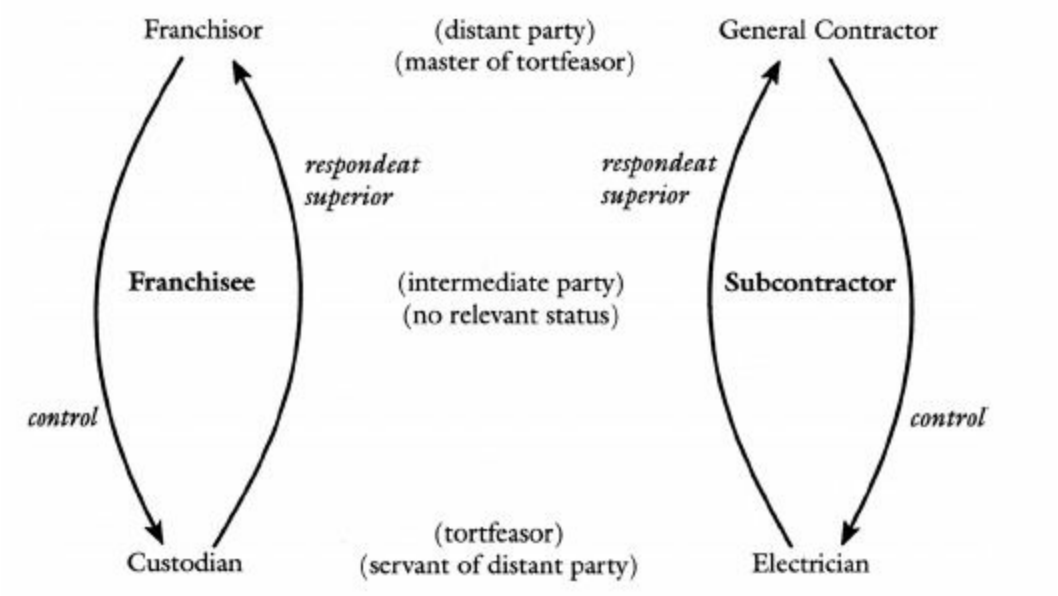

Figure 3-4. Direct Control Analysis

Problem 16

Rachael hires Jan, an experienced attorney, to represent her in a commercial dispute. Driving to a settlement conference, Jan negligently hits a pedestrian. The pedestrian sues Rachael, asserting *respondeat superior*. What result?

Explanation

The pedestrian's claim will fail. For *respondeat superior* to apply, the tortfeasor must be a servant. For servant status to exist, the principal must have the right to exercise detailed control of the agent's manner of performance. A lawyer's client does not have that right. The client sets the goal and may make major strategy decisions. Tactics, however, are the

lawyer's domain.

Problem 17

Athos buys new vinyl tile for his kitchen floor from Porthos Floor Coverings Unlimited ("Porthos"), a discount retailer of carpet, linoleum, tile, and other floor coverings. Porthos does not have any installers on staff, but tells Athos that it will arrange to have the tile installed by one of the "licensed, bonded contractors who do this sort of work for us." Porthos arranges for Michael Planchet to install Athos's tile. Planchet runs his own small contractor business and does jobs for various retailers and directly for homeowners. Porthos does not guarantee him any regular work and pays him a flat fee per square yard on each installation. (The fee does vary depending on the floor covering being installed.)

In due course, Planchet arrives at Athos's kitchen with the tile and the installment materials. Those materials include an effective but highly volatile adhesive for securing the tiles to the subfloor. Unfortunately, Planchet fails to read or follow the instructions on the adhesive can, and a fire breaks out. Athos sues Porthos, asserting *respondeat superior*. What result?

Explanation

Athos will lose. Planchet is an independent contractor, not Athos's servant.

Virtually all the factors listed in R.3d, §7.07, comment *f* indicate Planchet's independence. Porthos, the alleged master, has no control "over the details of the work." Planchet, the alleged servant, is skilled, "is engaged in a distinct occupation or business," and supplies his own tools. The employment is episodic, not sustained, and payment is by the job. Moreover, Porthos and Planchet do not consider themselves employer and employee.[115]

Problem 18

A newspaper provides its customers home delivery through a network of "independent delivery agents." A written contract between the newspaper and each agent: (i) assigns each agent a particular route; (ii) provides the agent a percentage commission based on the subscription price of papers delivered; (iii) allows the newspaper to terminate the relationship at any time without

cause; and (iv) expressly disclaims any master-servant relationship. The newspaper conducts training programs on how to make deliveries and increase sales. Although the contract does not mention these programs, the newspaper considers regular attendance to be mandatory. Each delivery agent supplies his or her own car or van to make the deliveries. Many of the routes are quite large, and many of the agents have no other gainful employment. The newspaper does not withhold social security taxes from the commission checks and does not pay the employer's portion of social security on the commission amounts.

While delivering papers one morning, one of the agents loses control of the car and crashes into a building. The building owner sues the newspaper, asserting *respondeat superior*. What result?

Explanation

The building owner may well prevail, although several factors from the R.2d and R.3d point the other way.

The parties apparently did not consider themselves master and servant. The contract expressly disclaimed that relationship, and the principal did not withhold or pay social security taxes on account of the commissions.[116] The newspaper did not pay a set wage or salary,[117] and the delivery agent supplied the key instrumentality (i.e., the car).[118]

The key question, however, is the right to exercise control. The newspaper's right to terminate without cause and without advance notice suggests that, practically speaking, the newspaper had considerable control over the agents' performance. The fact that few of the agents were "engaged in a distinct occupation or business"[119] made each especially susceptible to the threat of termination. That the threat carried weight is evidenced by the required attendance policy.

Although the R.3d/R.2d factors may thus point in opposite directions, the policies underlying *respondeat superior* clearly favor a finding of servant status. Home delivery is an integral part of the newspaper's enterprise, and that enterprise should bear the costs of accidents foreseeable in that phase of the business. As for risk avoidance, the training sessions demonstrate that the newspaper can and already does influence the agents' manner of performance. Moreover, as for risk spreading, the newspaper is far better able to anticipate, calculate, and spread the cost than are the individual agents.

Problem 19

A manufacturing company employs a staff of full-time research scientists. Each scientist receives a salary, a well-equipped laboratory, and necessary materials. Each scientist reports to the company's director of research, who assigns research projects and keeps tabs on research progress. According to company policy, however, all scientists are to spend at least 20 percent of their time on projects they have conceived. The company believes that this "bootleg research" will spur creativity and innovation. The director of research does not review the bootleg projects in any detail, but instead merely inquires on occasion as to their subject matter.

One afternoon, a company research scientist leaves the lab and goes to a city park. As part of a bootleg project, the scientist wishes to test a new waterproofing substance in the brook that runs through the park. (It's also a nice day for a walk.)

Although the scientist is certain that the substance is stable and nontoxic, the substance disintegrates in and pollutes the brook. Cleanup costs total $35,000. The city sues the manufacturing company, alleging *respondeat superior*. What result?

Explanation

The city will prevail. The scientist is the company's employee and was acting within the scope of employment.

Employee status is evident. The only possible contrary factor is the great degree of "skill required in the particular occupation."[120] That skill does not, however, undercut either the employer's right or ability to control. The director of research, who acts for the master,[121] has ample expertise to supervise the scientist.

The scope of employment issue is almost as clear. Although the scientist was away from the authorized workplace,[122] the work was within the authorized time,[123] "of the kind [the scientist was] employed to perform,"[124] and "actuated at least in part by a purpose to serve the master."[125] The bootleg nature of the project is immaterial. Although the master did not exert active control over the project, the master certainly retained the right to do so. Nothing prevented the company from changing or eliminating the bootleg policy. Moreover, in determining the scope of employment, what matters is

the zone of the employee's endeavors, not the zone of active control.

Problem 20

Sandpit Gravel Company ("Sandpit") is excavating a deposit of gravel from a large open pit. Among the Sandpit employees working in the pit is a group of dump truck drivers. There are two ways to drive out of the pit: one safe but very time-consuming, the other quick and quite dangerous. Sandpit has repeatedly instructed the drivers to take the safe route and has repeatedly forbidden them to use the dangerous one. The drivers are generally happy to comply, because the company pays them by the hour. At closing time, however, the drivers have a different attitude. When the closing whistle blows, the drivers are "off the clock" and want to get themselves home as soon as possible. Nonetheless, they obey the rules and take the slow way out, until one day, when a driver in a big rush tries the fast route. The truck slides off and rolls over, crushing the leg of an OSHA inspector. The OSHA inspector sues Sandpit, alleging *respondeat superior*. What result?

Explanation

Sandpit is liable. An employee's act can come within the scope of employment even though forbidden by the employer. In this case, the driver was conducting the employer's business, with an "instrumentality…furnished by the master;"[126] the act was quite similar "in quality…to the act authorized;"[127] "the departure from the normal method of accomplishing an authorized result"[128] was moderate; and "the master [had] reason to expect that such an act [would] be done."[129]

Problem 21

A shopping mall employs its own staff of private security guards. These guards receive regular wages, wear uniforms supplied by the mall, report to the mall's director of security, and work shifts assigned by the director. The mall, through the director, has forbidden the security guards to carry guns.

One day a guard disobeys that policy and brings an unlicensed gun to work. While at work, the guard has a scuffle with an unruly patron, and the gun inadvertently discharges and wounds a patron in the leg. The patron sues

the mall, alleging *respondeat superior*.[130] What result?

Explanation

Assuming that the patron can establish the guard's underlying tort, vicarious liability will probably exist. Dealing with unruly patrons is central to the guard's responsibilities, and as shown in Problem 20, a forbidden act can be within the scope of employment. The servant's illegal act—carrying an unlicensed weapon—will undercut the patron's claim only if that act is considered "seriously criminal" and even then only if the act is considered unforeseeable.

Problem 22

A major league pitcher is having a bad day on the mound. Not only are the opposing batters doing well, but there is also a heckler in the stands who is increasingly obnoxious. Finally, distracted beyond endurance, the pitcher whirls and fires the ball straight at the heckler. This pitch is right on target, hitting the heckler on the head. The heckler sues the pitcher's employer, the ball club. What result?

Explanation

This intentional tort may be one instance in which the incidental/foreseeable test is worse for the plaintiff than the more traditional purpose test. Beaning a spectator is hardly incidental to pitching a ball game, and there is nothing in the nature of a pitcher's task that makes the assault foreseeable. It might be established, however, that the pitcher's purpose was in part to serve the master. The heckling was distracting the pitcher and interfering with his ability to perform well for his employer. To silence the heckler therefore was to advance the master's interests. The result will thus depend on whether the court uses the purpose test and, if so, how malleable the court considers that test to be.[131]

Problem 23

A large school district, serving tens of thousands of students and with thousands of employees, assigns a custodian to work at a high school.

Subsequently, the custodian sexually assaults a student at the high school. The student sues the school district, asserting *respondeat superior*.[132] What result?

Explanation

If the jurisdiction uses the purpose test, the student will inevitably lose. By no stretch of the imagination can a sexual assault be said to serve the school district's interests.

Even if the jurisdiction uses some form of the incidental/foreseeable test, the student's chances are slim. Abstractly, it may be foreseeable that an organization that has a large enough number of employees will inevitably employ some "bad apples." However, for an intentional tort to be foreseeable in the sense of *respondeat superior*, there must be something about the nature of the employee's job or the employer's enterprise that facilitates or specially occasions the harm. Unlike the psychologist-patient relationship discussed previously,[133] a custodian's role does not make the victim especially vulnerable to sexual assault. Sexual assault is not incidental to custodial work.

Problem 24

Same facts as in Problem 23, except: (i) the employee is a teacher and coach of the high school debate team; (ii) the victim is a minor and a member of the debate team; (iii) the sexual activity develops in the context of one-on-one coaching by the teacher of the victim, initially at the school but eventually at the teacher's apartment; (iv) the victim initially gives actual (but of course legally ineffective) consent to the relationship. Is the school district liable per *respondeat superior*?

Explanation

Most likely not. When coaching morphs into predatory sexual behavior, the employee has embarked on "an independent course of conduct not intended by the employee to serve any purpose of the employer."[134] Moreover, the teacher's conduct is "seriously criminal," and there is zero "similarity in quality of the act done to the act authorized."[135]

The plaintiff would have more room to argue under the

incidental/foreseeable test. If the jurisdiction misequates foreseeability with the notion of "a well-known hazard," the plaintiff might survive a summary judgment motion simply by submitting press clippings about notorious teacher-student sex scandals.

Problem 25

Your adult son, though employed, is mentally handicapped. Ordinarily, you drive him to and from work, but over the next several weeks you will be out of town for a number of days. You decide to have a particular taxicab company fill in for you, and you make the necessary arrangements through a telephone call to the company's dispatcher.

You believe the cab company employs cab drivers as well as dispatchers, and your belief comes from the company's trade name, trade dress, advertisements, signage, and published telephone numbers. This appearance plays a role in your decision to have this particular company dispatch drivers to transport your son.

In due course, you leave town and the cab company dispatches cabs to transport your son. Unfortunately, one of these cabs is involved in an accident, the driver is at fault, and your son is injured. Only when you seek compensation for your son from the taxicab company do you discover that the company does not in fact employ the drivers. Contrary to appearances, the drivers in those distinctively marked cabs are all independent contractors. The taxicab company denies any legal responsibility for the driver's negligence and for your son's injuries. Is the taxicab company correct?

Explanation

No. Under the stated facts, the drivers are the apparent servants of the taxicab company. Through its "trade name, trade dress, advertisements, signage, and published telephone numbers," the taxicab company "represent[ed] that another [was] his servant," and that representation justifiably caused you to "rely upon the care or skill of such apparent agent."[136] According to R.2d, §267, therefore, the taxicab company "is subject to liability…for harm caused by the lack of care or skill of the one appearing to be a servant…as if he were such."[137]

Problem 26

A hotel franchisor is concerned about apparent servant liability, but still wants its franchisees to make abundant use of the franchise name, logo, and trademarks. Consistent with that business purpose, how can the franchisor reduce its exposure to apparent servant liability?

Explanation

The core of apparent servant liability is the appearance of servant status. Therefore, the simplest solution, at least in concept, would be to eliminate the appearance at its source. The legal problem would disappear if the franchisees were to remove all insignia that make their hotels appear to belong to the franchisor and that make their employees appear to be the franchisor's servants. This would be legally perfect treatment—after which the patient (i.e., the business) would unfortunately die.

A less pure but more practical solution would be to leave the insignia in place but act affirmatively to avoid the misapprehension. For example, the franchisor could require all its franchisees to prominently indicate that their hotel, although part of the national chain, is "independently owned and operated." The proclamation might appear on all significant signage, the hotel's stationery, and on all check-in and checkout documents.

Problem 27

An air conditioning manufacturer is about to ship a valuable load of equipment to a developer that is constructing a new office building. The manufacturer is, however, concerned about the developer's ability to pay for the equipment. The developer assures the manufacturer, "No problem. We've got a loan commitment from First National Bank that will cover the entire cost of construction. Why don't you call the bank's vice president for commercial loans and get that confirmed?"

The manufacturer takes the suggestion and calls the vice president. The vice president confirms that the bank has committed to a loan up to $10 million and that current cost projections total only $8.5 million. Satisfied, the manufacturer ships the equipment.

Unfortunately for the manufacturer, the bank had made no loan commitment. The vice president lied in return for a $5,000 bribe from the developer. The office-building project eventually folds, the manufacturer's equipment is nowhere to be found, and the developer is bankrupt. Can the

manufacturer recover from the bank?

Explanation

Yes. The bank's agent, its vice president for commercial loans, committed the tort of intentional misrepresentation. That tort will be attributed to the bank if the agent had actual authority, apparent authority, or inherent agency power to make the statement in question. The vice president had apparent authority by position. It is customary for bank officers to provide the type of information the vice president provided, so it was reasonable for the manufacturer to believe the vice president was speaking for the bank. The vice president's ulterior motive is immaterial. Apparent authority can exist even though the apparent agent does not intend to serve the interests of the apparent principal.[138]

Problem 28

Morgan Hospital has an in-patient psychiatric ward that is run under the direction of Dr. Stanley, a board-certified psychiatrist who is a full-time employee of the hospital. Dr. Stanley has become increasingly frustrated with Medical Indemnity Company, an insurance company that provides health insurance coverage to many people in Morgan's vicinity. Medical Indemnity has been disallowing a large number of claims made by patients treated in Morgan's in-patient psychiatric ward. Dr. Stanley believes that most of these disallowances are unjustified, and he faults two psychologists who review patient claims for Medical Indemnity. Dr. Stanley's job has never involved public relations, but he decides "enough is enough." In a fit of frustration and without discussing the matter with any of Morgan's higher-ups, he fires off a letter to the local medical association, the local association of clinical psychologists, and the president of Medical Indemnity. The letter, written on Morgan Hospital letterhead and signed by Stanley as "Director, In-Patient Psychiatry Unit, Morgan Hospital," scathingly criticizes the two psychologists. Embarrassed and humiliated, the two psychologists sue both Dr. Stanley and Morgan Hospital for defamation. Assuming that Dr. Stanley's letter defamed the plaintiffs, is Morgan Hospital liable to them?

Explanation

Probably. An agent's defamatory statement is attributable to the principal if the agent had actual or apparent authority to make the statement. Dr. Stanley probably lacked actual authority. Nothing in his job implied the authority to speak for Morgan Hospital on matters of public concern, and Dr. Stanley did not receive any specific authorization before sending the letter. To those who received the letter, however, Dr. Stanley likely appeared to be speaking on Morgan Hospital's behalf. Morgan arguably manifested as much when it clothed Dr. Stanley with an impressive title. Certainly, Dr. Stanley's use of the title and the Morgan's letterhead added weight to the comments and power to the defamation. ◂

Problem 29

Ziegler Limo Leasing and Sales, Inc. ("Ziegler") sells and leases limousines and also provides limousine service on an hourly, daily, and weekly basis. Newly wealthy, Irv is considering buying a limousine from Ziegler. Selma, Ziegler's owner, says, "Tell you what, I'll let you use a limo and a driver for a week for free. It's kinda slow for us right now, and you'll get a feel for what it's like to have a limo at your beck and call. Then you can decide. Just one thing, though—if business heats up I'll have to take the limo back."

Irv happily agrees to the arrangement, and Selma assigns Jeffrey, one of her best drivers, to drive a stretch limo for Irv. Selma tells Jeffrey, "Listen. Show him our best red carpet service. That way, if he decides not to buy, he'll know we're the only place to rent from. But also—you know how new millionaires sometimes get aggressive. Remember our safe driving policy."

Two days later, Jeffrey is driving Irv to a party when a sports car cuts them off. Enraged, Irv yells to Jeffrey, "That [expletive deleted] can't do that to us. Catch him and pass him." Ziegler's operating rules require all Ziegler drivers to obey speed limits and strictly prohibit "aggressive driving." Irv is insistent, however, and Jeffrey gives in. In the rush to catch the sports car, the limo sideswipes another car. Assuming that Jeffrey has been negligent, can the driver of the other car successfully invoke *respondeat superior* against Irv? ◂

Explanation

Probably not. At the time of the accident, Jeffrey probably was not Irv's borrowed servant. Although Jeffrey's general employer (Ziegler) had

assigned Jeffrey to work for Irv, Ziegler retained considerable control over Jeffrey's conduct. Selma had reminded Jeffrey that Ziegler's safe driving rules still applied. Moreover, Ziegler had retained the right to reassign Jeffrey at any time. When Irv successfully urged Jeffrey to speed up, Irv was merely persuading Jeffrey to violate the general employer's rules. Irv was not establishing the type of total, temporary control that establishes a special employer.

Problem 30

A city hires an electrical contractor to remove above-ground electrical lines that had once served a trolley system. The contract gives the contractor total control and responsibility for the work, provided only that the contractor minimizes interference with traffic. However, the city's manager of public works worries incessantly about safety on the job. The manager repeatedly makes surprise visits to the worksites and often speaks directly to the contractor's employees. The employees report these contacts to the contractor. The contractor is fearful of losing the contract by offending the public works manager and instructs its employees to take the manager's suggestions "unless they're dangerous, expensive, or off the wall."

Midway through the project, a live line falls on a passing car. Fortunately, no one is injured, but the car is severely damaged. Assuming the conduct of the public works manager binds the city[139] and that the accident resulted from the negligence of an employee of the contractor, does the car owner have a claim against the city?

Explanation

Yes. The city's interference in the performance of the work demonstrates a right to control the employees of the contractor. Those employees are therefore servants of the city, and *respondeat superior* accordingly applies.

Problem 31

When a business contracts out work, for quality control and safety reasons, the business may wish to closely supervise the contracted work. If an accident occurs, however, the injured party will point to the close supervision and seek to invoke *respondeat superior*. By acting on its concern for quality

and safety, the delegating party will have risked vicarious liability. Propose a solution to this conundrum.

Explanation

The Problem cannot be totally resolved, because a tension will always exist between the amount of control and the amount of risk. The key is to find ways to influence performance that stop short of actionable control. The first step, whenever possible, is to reduce the risk by avoiding mishaps. The delegating party should therefore find contractors that have good safety records and justified reputations for quality work. Second, the delegating party should limit its review of the work to inspection and suggestion. This step will, perhaps, prevent the delegating party from being deemed the master of the contractor. Third, the delegating party should avoid any direct instructions to the contractor's employees. This step will, perhaps, prevent those employees from being deemed servants of the delegating party.

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1. If a principal does engage in wrongful conduct, direct liability results. For a discussion of the direct duties of principals to third parties, see section 4.4.
2. R.3d, §2.04, comment *a*.
3. Liability may exist when the work involved is inherently dangerous.
4. *Respondeat superior* is relevant in certain borderline areas, such as malicious prosecution and intentional interference with business relations. See section 3.4.4.
5. The injured party may also assert claims of direct responsibility against the principal. See section 4.4. In any event, the tortfeasor agent will be directly liable. See section 4.2.3.
6. Dias v. Brigham Medical Associates, Inc., 780 N.E. 2d 447, 449 (Mass. 2002).
7. Butera & Andrews v. IBM, Corp., 456 F. Supp. 2d 104, 112 (D.D.C. 2006) (internal quotation marks and citations omitted in the original).
8. R.3d, Introduction.
9. However, in some circumstances an alleged servant's skills can argue against servant status, especially when the alleged master lacks the necessary expertise to effectively exercise control.
10. Ascribing a tort to the first organization also involves agency law analysis, typically *respondeat superior*. For a detailed discussion of "organizational *respondeat superior*," see section 3.5. That section also discusses a theory under which employees of the first organization can be treated directly as employees of the second organization.
11. For further discussion, see section 3.5
12. See section 2.6.1 (discussing enterprise liability as a rationale for inherent agency power).
13. A employer/master (or other principal) can be directly liable on this basis. See section 4.4.1.
14. In this regard, this rationale for *respondeat superior* parallels one of the rationales for strict product liability. See, e.g., Phipps v. General Motors Corp., 363 A.2d 955, 958 (Md. 1976) (strict liability warranted in part due to the difficulty of proving producer negligence).
15. *Harbury v. Hayden*, 522 F.3d 413, 422, n.4 (D.C. Cir. 2008). Despite this expansive approach, the court ruled against the plaintiff, the widow of a fighter killed during the Guatemalan civil war, who

"sued various U.S. Government officials, claiming they were legally responsible for the physical abuse and death of her husband. The District Court long ago dismissed most of Harbury's claims." *Id*. at 415. The court dismissed the lawsuit for reasons unrelated to the *respondeat superior* issue. For a discussion of *respondeat superior* for intentional torts, see section 3.2.7.

16. R.3d, §2.04, cmt. b.

17. The R.2d uses the term "independent contractor" to describe the "or not" category. The R.3d rejects that usage as confusing, noting that the R.2d applies the phrase both to describe nonagent service providers (independent contractors *simpliciter*) and nonservant agents (independent contractor agents). R.3d, §1.01, comment *c*.

18. Modern circumstances have weakened the power of this factor. At least through the pre-industrial era, a person who possessed special vocational skills was likely to be outside any effective or nuanced supervision by the principal, who typically lacked sufficient knowledge to have any detailed insight into the work. Also, artisans and, even more so, professionals tended to work for themselves—that is, to have "a distinct occupation or business." In the modern world, in contrast, principals that are organizations often employ skilled individuals who, on the principal's behalf, can exercise the necessary skill and judgment to effectively supervise even a "professional."

19. R.3d, §7.07, comment *f*, relying on R.2d, §220(2). Numbering not present in original.

20. R.3d, §7.07, comment *f*.

21. In addition to the "employee" *vel non* question, these cases raise the difficult "scope of employment" issues discussed in section 3.2.7.

22. 868 S.W.2d 942, 949–950 (Tex.App.1994), aff'd, 907 S.W.2d 472 (Tex.1995). However, the sexual misconduct was outside the "scope of employment." *Id*. at 950.

23. R.2d, §225, comment *a* and Ill. 1.

24. Oliver Wendell Holmes, *The Common Law* (1881) at 5.

25. Clackamas Gastroenterology Assocs., P.C. v. Wells, 123 S. Ct. 1673, 1678 (2003) (quoting Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322-323 (1992); internal quotation marks omitted).

26. CBS Corp. v. F.C.C., 535 F.3d 167, 189 (3d Cir. 2008) *cert*. granted, judgment vacated, 129 S. Ct. 2176, 173 L. Ed. 2d 1153 (U.S. 2009).

27. An employer may nonetheless face direct liability. For example, if a resident manager rapes an apartment tenant, that conduct is probably outside the scope of employment. See section 3.2.7 (discussing *respondeat superior* and intentional torts). However, if the manager had an extensive criminal record involving violence toward women and the landlord overlooked that record, the landlord may be directly liable on a claim of negligent hiring or for failure to provide safe premises. See sections 4.4.1-4.4.2.

28. In ordinary parlance, the word "employment" describes a business relationship that agency law classifies as master-servant. In contrast, the R.2d uses "employment" as a term of art, to mean a principal's engagement of an agent to accomplish some task or provide some service. Thus, in R.2d terms, a principal can "employ" a nonservant agent.

29. R.2d, §228(1). Some jurisdictions omit the "actuated in part" element when considering intentional torts. See section 3.2.7.

30. R.3d, §7.07(2).

31. See section 3.2.6.

32. See section 3.2.7.

33. R.3d, §7.07, comment *b*.

34. As for R.2d, §228(1)(d) (intentionally use force "against another"), using force against a cat is not, in R.2d terms, using force "against another." Although this Example involves an employee acting within the scope of his employment, for *respondeat superior* to apply, the china shop must also demonstrate that Dennis's act was tortious.

35. R.2d, §229(2).

36. R.3d, §7.07, comment *b*.

37. R.2d, §229(1).
38. If tortious acts were necessarily outside the scope of employment, *respondeat superior* would never impose vicarious liability. The doctrine operates to attribute the servant's tort to the master.
39. Quoted at note 29. Restraining patrons is the kind of work a bouncer is "employed to perform." The bouncer's purpose was to serve the bar owner (by quieting a disruption), and the actions occurred when and where they were supposed to. A bouncer's use of force should come as no surprise to a bar owner.
40. R.2d, §231, comment *a*.
41. R.3d, §7.07(3)(a).
42. R.3d, §7.07, comment *b* (stating that "although an employer's ability to exercise control is an important element in justifying *respondeat superior*, the range of an employer's effective control is not the limit that *respondeat superior* imposes on the circumstances under which an employer is subject to liability").
43. R.2d, §229(1).
44. R.3d, §7.07, cmt. *e* uses this term.
45. R.3d, §7.07, comment 3.
46. R.2d, §228(1)(c).
47. R.2d, §228(1)(a).
48. R.2d, §228(1)(b).
49. This Example is based on Trejo v. Maciel, 48 Cal. Rptr. 765 (Cal. Ct. App. 1966).
50. R.3d, §7.07(2). See also R.2d, §228(1)(c) (for conduct to be within the scope of employment, the servant must be "actuated, at least in part, by a purpose to serve the master").
51. R.3d, §7.07, Ill. 14.
52. Joel v. Morrison, England, Nisi Prius (Exchequer), 6 Car. & P. 501, 172 Eng. Rep. 1338 (1834).
53. Fiocco v. Carver, 137 N.E. 309, 311 (N.Y. 1922).
54. J. Hynes, *Teacher's Manual to Agency and Partnership: Cases, Materials, Problems* 3rd ed. (1989) 41.
55. R.3d, §7.07, comment *e*.
56. *Respondeat superior* is a doctrine of inherent agency power, and this theme is consistent with that doctrine's rationale; that is, imposing liability on the principal only for risks inherent in the enterprise. See section 3.2.3.
57. R.3d, §7.07, comment *e*. See also R.2d, §237, comment *a* ("reenter the employment").
58. R.2d, §237.
59. R.3d, §7.07, comment *e*.
60. R.3d, §7.07, Ill. 10.
61. R.2d, §228(1)(c), discussed in section 3.2.5, makes this an entrance criterion to scope of employment.
62. R.2d, §229(2)(g). For further discussion of this issue, see the discussion below of "scope of employment and seriously criminal behavior."
63. R.3d, §7.07(2).
64. R.3d, §7.07, comment i.
65. If the bus company owns the terminal, it may be directly liable for failing to provide safe premises to business invitees.
66. R.3d, §7.07(2).
67. Ira S. Bushey & Sons v. United States, 398 F.2d 167, 170 (2d Cir. 1968), citing Nelson v. American-West African Line, 86 F.2d 730 (2d Cir. 1936), *cert. denied*, 300 U.S. 665 (1937).
68. Thompson v. United States, 504 F. Supp. 1087 (D.S.D. 1980).
69. Marston v. Minneapolis Clinic of Psychiatry and Neurology, Ltd., 329 N.W. 2d 306, 311 (Minn. 1983).
70. Whitson v. Oakland Unified School District, 123 Cal. App. 3d 133, 142 (1981) (citations and internal quotations omitted).

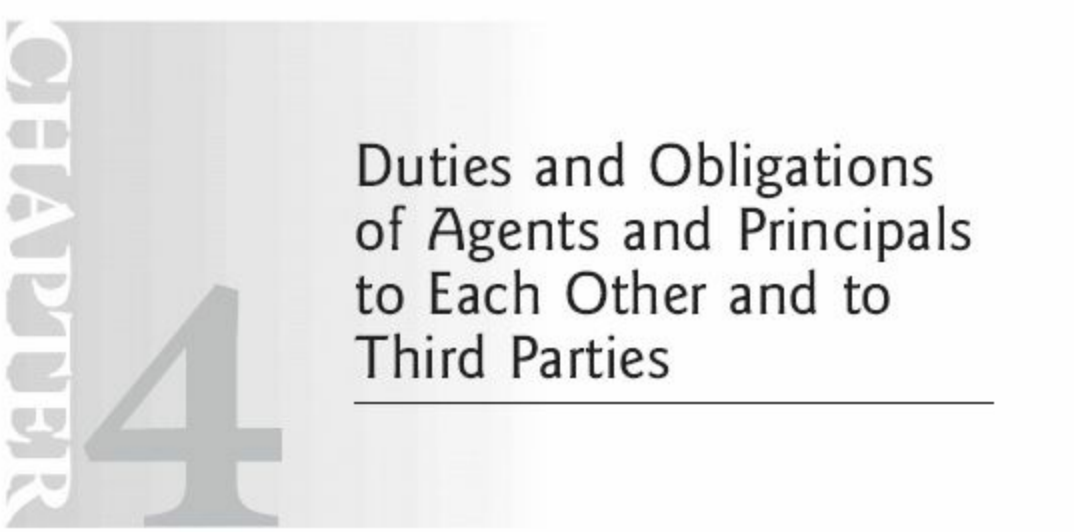
71. Marston, *supra* note 69, at 311. This analysis comports with R.2d, §229(2)(h), which refers to "whether or not the instrumentality by which the harm is done has been furnished by the master to the servant."
72. Boykin v. Perkins Family Restaurant, C9-01-1100, 2002 WL 4548 (Minn. App. 2002).
73. L.M. v. Karlson, 646 N.W. 2d 537, 539 (Minn. App. 2002). Remember that *respondeat superior* imposes automatically liability on the employer regardless of how careful the employer has been in hiring, training, and supervising its employees.
74. Hagen v. Burmeister & Associates, Inc., 633 N.W. 2d 497, 505 (Minn. 2001).
75. R.3d, §7.07, comment *b*.
76. See section 4.4.1. In this context, "foreseeability" is an appropriate concept, because the direct claims are negligence claims.
77. Daniel S. Kleinberger, "Respondeat Superior Run Amok," 59-Nov BENCH & B. MINN. 16 (Westlaw) (November 2002) (footnote omitted).
78. Moreover, under the R.2d's approach to scope of employment:

- "whether or not the act is seriously criminal" is itself a factor in making the scope of employment determination, as is "the similarity in quality of the act done to the act authorized," R.2d, §229(2)(g) and (j), and
- a serious crime is unlikely to meet the requirements that the tortious act be "of the kind [the servant] is employed to perform" and that "if force is intentionally used by the servant against another, the use of force is not unexpectable by the master." R.2d, §228(1)(a) and (d).

79. R.3d, §7.07, comment *c*.
80. R.3d, §7.07(2).
81. In such circumstances, an employer would also be liable for the intentional tort of its employee. The employer's intent would bring the employee's act within the scope of employment.
82. Under this theory, the store is not vicariously liable for the guard service's intentional tort. Rather, the store is directly liable for having breached its duty to provide safe premises for its business invitee. See section 4.4.2.
83. R.3d, §§7.04 (actual authority) and 7.08 (apparent authority). See also R.2d §§251(b) (actual authority) and 266 (apparent authority).
84. Bill may also have another theory of recovery: Realty's direct liability for failure to use reasonable care to protect business invitees. See section 4.4.2.
85. For the rules for establishing apparent authority, see section 2.3.
86. R.2d, §267.
87. R.3d, §7.08. According to the Reporter's Notes to R.3d, §7.07, comment *a*, section 7.07 "is a consolidated treatment of topics covered in several separate sections of Restatement Second, Agency, including §…267." However, R.3d, §7.07 does not address the appearance of employee status. See also *Restatement (Second) of Torts* 429 (1965) ("One who employs an independent contractor to perform services for another which are accepted in the reasonable belief that the services are being rendered by the employer or by his servants, is subject to liability for physical harm caused by the negligence of the contractor in supplying such services, to the same extent as though the employer were supplying them himself or by his servants.").
88. Gizzi v. Texaco, Inc., 437 F.2d 308 (3d Cir. 1971) (directed verdict for defendant reversed; jury question as to whether ad campaign induced reasonable reliance).

89. *206 P.3d 473 (Idaho 2009)*.
90. For a detailed discussion of these rules, see Chapter 2.
91. R.3d, §7.03, comment *b*.
92. R.3d, §7.08. See also R.2d, §257.
93. 389 F.3d 5 (1st Cir. 2004). The court invoked *respondeat superior* rather than actual or apparent authority.
94. Michael's misstatement as to the flooding is attributed to Rebecca, so Samantha can rescind for fraud in the inducement. See section 2.4.6.
95. Michael is also liable. See section 4.2.3.
96. R.2d, §262.
97. R.2d, §261. See also R.3d, §7.08, comment *b* ("When an agent acts with apparent authority, the agent's motivation is immaterial to the legal consequences that the agent's action carries for the principal. Likewise, the fact that an agent's conduct is not in fact beneficial to the principal does not shield the principal from legal consequences.").
98. If the principal is undisclosed, the agent is a party to the contract and the third party's claim will be valid against the agent as well as the undisclosed principal. See section 4.2.1.
99. Assume, for example, that a principal authorizes an agent to sell the principal's car and to describe the car's characteristics to prospective purchasers. The agent says to a third party, "This car will get at least 25 miles per gallon on the highway," and in reliance the third party agrees to buy the car. Agency law attributes the mpg statement to the principal, and under contract law the statement creates a warranty that binds the principal. If the statement happens to be true, contract law gives the buyer no claim against the principal. If the statement happens to be false, contract law will provide the buyer several remedies (e.g., rejection, revocation of acceptance, action for damages for breach of warranty). The distinction drawn in the text parallels a distinction between contract law and tort law. Under contract law, innocent misstatements by a party can be actionable. Under tort law, they are not.
100. R.2d, §247.
101. The newspaper's manifestation was, of course, the running of the column.
102. R.2d, §247, comment *c*. See also R.3d, §7.08, comment *d* ("The effectiveness of the defamation—its credibility to those to whom it is published and its propensity to harm the person defamed—is often tied to the reputation and thus the personality of its publisher.").
103. For a discussion of the factors used to determine scope of employment, see section 3.2.5.
104. A comment to the R.3d suggests the term "lent employees" while acknowledging "borrowed servants" as the prevalent term of art. R.3d, §7.03, comment *d*(2).
105. R.2d, §227, comment *a*.
106. R.3d, §7.03, comment *d*(2).
107. Compare DePratt v. Sergio, 306 N.W. 2d 62 (Wis. 1981) (holding crane operator who obeyed hand signals to be a borrowed servant) and Gulf, Colorado & Santa Fe Co. v. Harry Newton, Inc., 430 S.W. 2d 223 (Tex. Civ. App. 1968) (holding crane operator not to be a borrowed servant even though operator was following instructions of the special employer).
108. R.2d, §227, comment *c*. Presumably the operator's skill makes it less practical for the special employer to assert effective control. See section 3.2.4 (when agent possesses special skills that principal lacks, principal is less able to exert control and less likely to be a master).
109. Unlike "borrowed servant," this phrase does not appear in the Restatements or case law. The phrase is instead the author's shorthand.
110. Sometimes a business that is providing services or producing a product will delegate or "subcontract" part of the work to another business. The reasons for this practice vary. The delegating party may lack the necessary in-house expertise; it may have the expertise, but its own employees may be busy on other projects; it may be able to save money by delegating work to a company that is more efficient or that pays its employees lower wages. Subcontracting is characteristic of the construction industry and increasingly prevalent in the manufacturing sector.

111. R.2d, §5(2). The R.3d does not use the term "subservant" and does not consider how *respondeat superior* might apply to a distant master. See R.3d, §7.03, comment *d*(1) (stating that, "[w]hen a subagent is an employee…of the appointing agent, the *appointing agent* is subject to vicarious liability for torts committed by the subagent within the scope of employment" but only contemplating "the appointing agent and the principal [being] subject to vicarious liability when a subagent acts with *apparent authority* in committing a tort") (citation omitted; emphasis added).
112. R.2d, §5(2), comment *e*.
113. Id.
114. 637 F. Supp. 2d 1029 (M.D. Fla. 2009).
115. Alexander may have a successful contract claim, however, if he can establish that his contract with Porthos included installation. See section 4.4.3. Porthos's reference to "contractors" probably negates an apparent servant claim. See section 3.3.4.
116. R.2d, §220(2)(i); R.3d, §7.07, comment *f*.
117. R.2d, §220(2)(g); R.3d, §7.07, comment *f*.
118. R.2d, §220(2)(e); R.3d, §7.07, comment *f*.
119. R.2d, §220(2)(b); R.3d, §7.07, comment *f*.
120. R.3d, 7.07, comment *f*; R.2d §220(2)(d).
121. Under the terminology developed in Chapter Two, the director of research is the employer's superior agent. See section 2.8.2.
122. R.2d, §228(1)(b).
123. *Id*.
124. *Id*. §228(1)(a).
125. *Id*. §228(1)(c). The scientist was also actuated in part by a personal desire to take a walk in the park. However, the scientist was not engaged in "an independent course of conduct not intended by the employee to serve any purpose of the employer." R.3d, §7.07(2).
126. R.2d, §229(2)(h).
127. R.2d, §229(2)(g).
128. *Id*. §229(2)(i).
129. *Id*. §229(2)(f). The master saw a need to repeat the prohibition, suggesting that the master considered the prohibited conduct to be at least somewhat attractive to the drivers.
130. The patron would probably also assert direct claims, such as failure to provide reasonably safe premises to customers and negligent hiring. See section 4.4.2.
131. In any event, the heckler may have a direct claim against the owner of the ballpark for failing to provide reasonably safe premises to a customer (see section 4.4.2) and can certainly sue the pitcher for battery. See section 4.2.3.
132. The student would probably assert direct claims as well, such as failure to provide safe premises and negligent hiring and supervision. See sections 4.4.1-4.4.2.
133. *See* section 3.2.7.
134. R.3d, §7.07(2).
135. R.2d, §229(2)(g) and (j).
136. R.2d, §267.
137. Id. This Problem is based on Daniel S. Kleinberger and Peter Knapp, "Apparent Servants and Making Appearances Matter: A Critique of Bagot v. Airport & Airline Taxi Cab Corp.," 28 WM. MITCHELL L. REV. 1527 (2002).
138. See section 2.3.5 (apparent agent can bind apparent principal even though apparent agent intends to take for itself the benefits of the transaction).
139. For a discussion of this type of question, see Chapter 2.



§4.1 DUTIES AND OBLIGATIONS OF THE AGENT TO THE PRINCIPAL

§4.1.1 Duty of Loyalty: Hallmark of Agent Status

Agency is emphatically not an arm's-length relationship. In its very first line of black letter, R.3d labels agency a "fiduciary relationship,"[1] and the duty of loyalty is a hallmark characteristic of agent status. The agent's role is a selfless one, and the principal's objectives and wishes are dominant. The agent is important merely as a means to accomplish the principal's ends.[2] Except when the principal has knowingly agreed to the contrary or when extraordinary circumstances exist,[3] the agent is obliged to prefer the principal's interests over the agent's own and to act "solely for the benefit of the principal in all matters connected with [the] agency."[4]

The duty of loyalty is so deeply ingrained into agency law that few cases address the rationale underlying the duty. Some modern commentators speak in terms of economic efficiency. It would certainly be woefully inefficient if agent and principal had to negotiate their expectations in detail prior to the formation of each agency relationship. Having a standard set of loyalty rules thus reduces transaction costs. In addition, a strict regime of selflessness

probably reduces the principal's monitoring costs.[5]

However, this perspective finds little voice in the case law. When judges explain the duty of loyalty, they do so with a decidedly moralistic tone. When a principal engages an agent, the principal reposes trust and confidence in that agent and the agent accepts a position of trust and confidence. To allow an agent to violate that confidence, betray that trust, and then profit from the abuse is simply unacceptable.[6]

The duty of loyalty applies regardless of how grand or menial an agent's role may be and unquestionably encompasses all modern-day employees:

> As agents, all employees owe duties of loyalty to their employers. The specific implications vary with the position the employee occupies, the nature of the employer's assets to which the employee has access, and the degree of discretion that the employee's work requires. However ministerial or routinized a work assignment may be, no agent, whether or not an employee, is simply a pair of hands, legs, or eyes. All are sentient and, capable of disloyal action, all have the duty to act loyally.[7]

An agent's duty of loyalty includes a number of specific duties of selflessness, all serving to protect the principal's economic interests.

Unapproved Benefits Unless otherwise agreed, an agent may not benefit from its efforts on behalf of the principal. This rule applies regardless of whether the benefit is received from the principal or from a third party.

Of course, in most agency relationships the principal agrees to compensate the agent for the agent's efforts, so the agent has the right to receive and retain those benefits. An agreement to allow the agent to profit may be express or implied.

Confidential Information An agent has a duty to safeguard the principal's confidential information and not to use that information for the agent's own benefit or the benefit of others. Confidential information includes any information that is not generally known and that either carries an economic benefit for the principal, or could, if disclosed, otherwise damage or embarrass the principal. Trade secrets, customer lists, unique business methods, and business plans are examples of confidential information.

The duty of nondisclosure and nonuse applies to any confidential information the agent acquires or develops during the course of the agency relationship. The duty applies even if the confidential information does not relate to the subject matter of the agency. The duty does *not* encompass any

special skills that the agent develops while performing agency tasks.

Example

Ralph works as a waiter in an upscale restaurant. None of Ralph's duties involve preparing food. One day, while standing in the kitchen waiting for an order, Ralph sees and reads the restaurant's secret recipe for stuffed mushrooms. Ralph may not use the recipe or disclose it to others. Even though his role as an agent does not involve preparing food, Ralph must keep the recipe confidential. ◂

Example

Bernice works as an assistant cook in the same restaurant. She learns all of the restaurant's special recipes and also learns how to make *pâte brisée* (a type of pastry that is standard in upscale cooking but very difficult to make well). Bernice may not use the recipes outside her job, because they are confidential information. Bernice's knowledge of how to make *pâte brisée*, however, is an expertise, not confidential information. Subject to her duty not to compete (discussed below), Bernice may make *pâte brisée* wherever she likes. ◂

The duty to respect confidential information continues even after the agency ends. Confidential information belongs to the principal, and the end of the agency relationship does nothing to alter the principal's property rights in the information.[8]

No Competition Unless otherwise agreed, the agent has a duty not to compete with the principal in any matter within the scope of the agency relationship. This noncompetition duty follows from the theme of selflessness and applies regardless of whether:

- the agent uses the principal's facilities, property, or confidential information to find or pursue an opportunity;
- the agent finds or pursues an opportunity "on its own time."

Case in Point—Huong Que, Inc. v. Luu

The defendants sold a company to plaintiff and agreed not to compete "as owners" and also to act as the company's managing agents. The defendants allegedly stole the company's customer list and used the list to solicit business for a competing enterprise, which they did not own. The trial court granted a temporary injunction against the defendants. The court of appeals affirmed due to the defendants' duty of loyalty as managing agents.[9] ◂

The noncompetition aspect of the duty of loyalty runs counter to a strong public policy in favor of open competition. Once the agency relationship ends, that public policy reasserts itself. As a matter of agency law, the noncompetition duty ends. The duty to respect the principal's confidential information remains, but otherwise, subject to the duty to "get out clean," agency law allows a former agent to compete with its former principal.[10]

No Acting for Others with Conflicting Interests Unless otherwise agreed, an agent may not act for anyone whose interests might conflict with the interests of the principal. The mere existence of a dual agency violates the duty of undivided loyalty. Moreover, the dual agent risks specific conflicts of duty as to a myriad of individual issues. The fact that these individual conflicts may be irreconcilable does not justify the agent ignoring one duty or the other. Rather, if any such specific conflict materializes, the agent is destined to be liable to one principal, the other, or both.

Example

A real estate broker agrees to help Sam locate and purchase a new house. The broker knows that Rachael is interested in selling her house. The broker contacts Rachael and agrees to help sell her house to Sam. Since Rachael's and Sam's interests are in some ways conflicting, the broker has breached a duty of loyalty to both Sam and Rachael merely by acting for both simultaneously. ◂

Example

Same situation as above, plus Rachael wishes not to disclose to Sam certain information which in an arm's-length transaction it is lawful to withhold. Rachael mentions the information to the broker, but instructs the broker not to tell Sam. The broker's duty of obedience to Rachael compels

compliance,[11] while the broker's duty to provide information to Sam requires disclosure.[12]

If an agent arranges a transaction in violation of the dual agency rule:

- if neither principal knows about the dual agency, either principal may rescind;
- if one principal knows, the other principal may either: (i) affirm the transaction and seek damages from the agent and the knowing principal; or (ii) rescind.[13]

Dealing with the Principal An agent may not become the other party to a transaction with the principal, unless the agent discloses its role and the principal consents. In R.2d terminology, without the principal's consent the agent may not be "the adverse party" and may not "act on his own account."[14] The R.3d states: "An agent has a duty not to deal with the principal as…an adverse party in a transaction connected with the agency relationship."[15]

Example

Horace wishes to go into the restaurant business and retains Elizabeth to locate a restaurant that Horace can purchase. Elizabeth happens to own a restaurant and wishes to sell it to Horace. She may do so only if she discloses her ownership to Horace and he consents. She may not hide her ownership and make the sale through a "straw man."

Even if the principal does consent, the duty of loyalty continues to affect the transaction. In an arm's-length transaction, each party is obliged merely to avoid misstatements. When an agent acts as the adverse party, the agent has an affirmative duty to disclose all facts that the agent knows or should know could affect the principal's decision.

Good Conduct The agent's conduct can reflect on the principal, so the agent must not act in a way that brings disrepute on the principal. "Regardless of its size, power, or wealth, a principal is always vulnerable to the impact that its agents' actions may carry for its reputation."[16]

This aspect of the duty of loyalty "may extend to conduct that, although

it is beyond the scope of activity encompassed by the agency relationship itself, is nonetheless closely connected to the principal or the principal's enterprise and is likely to bring the principal or the principal's enterprise into disrepute."[17]

Example

Charlie works as a manager at a clinic that specializes in teaching people to quit smoking. On the job, Charlie is completely smoke-free. Outside of work, however, he is often seen smoking. Patrons and potential patrons of the clinic begin making remarks like, "Some clinic. Its business manager smokes." Since public smoking can reflect adversely on his principal, Charlie's duty of good conduct requires that he refrain from smoking, at least where the public can observe him.[18] ◂

The Agent's Legitimate Disloyalty According to the R.2d, an agent may legitimately act against the principal's interests "in the protection of [the agent's] own interests or those of others."[19] The notion of self-protection seems straightforward. The agent may assert its contract rights against the principal and may defend itself if the principal makes accusations of misconduct. The notion of protecting others is far vaguer. For instance, must the other party's interest be especially substantial in order to warrant the agent being disloyal? If the disloyalty will undermine one of the principal's significant interests, must the other party's interest be even more substantial?

In extreme circumstances, the answers seem clear enough.

Example

Arnold works for a real estate development company in the land acquisition department. He knows that his friend, Alice, is about to give Ralph an option to buy some land she owns. Through his work, Arnold knows that: (i) the real estate company plans to develop the area in which Alice's land is located; (ii) the value of Alice's land is therefore destined to rise sharply; and (iii) the option Alice plans to grant will allow Ralph, rather than Alice, to profit from the increase in value. Arnold may not disclose his principal's confidential information to Alice. ◂

Example

Through his work in the land acquisition department, Arnold discovers that the real estate company is engaged in a pattern of criminal fraud that, if unchecked, will cost innocent landowners thousands of dollars. Arnold may disclose the information not only to the landowners, but also to the police.

Between the extremes, however, the rule is obscure. A court might consider the following factors to determine whether "the protection of…[the] interests of…others"[20] justifies an agent's act of disloyalty:

- the legitimacy of the other party's interest and the importance of that interest to the other party;
- to the extent to which the other party reasonably expects that the interest will be respected by the world in general and the principal in particular;
- the legitimacy of the principal's interest and the importance of that interest to the principal; and
- the extent to which the agent might have protected the other party's interests while using means that were either less injurious or less disloyal to the principal.

Reshaping the Duty of Loyalty by Consent Agency law allows a principal and agent wide latitude to reshape the duty of loyalty. Agreements can limit or even eliminate each of the specific duties discussed in this section. For instance, a principal can always consent to the agent's disclosure of confidential information or allow the agent to profit from agency efforts.[21]

Three qualifications do exist, however. First, the duty of loyalty applies to the manner in which an agent obtains agreement from the principal. The overall relationship remains a fiduciary one, so arm's-length bargaining is inappropriate. When an agent seeks agreement from the principal, the agent must refrain from overreaching and must disclose to the principal all material information.

Example

A real estate broker agrees to help Sam locate and purchase a new house. The broker already has in mind a house owned by Rachael. Without disclosing that information, the broker asks Sam, "If I find a house, would you mind if I also worked with the seller to work out a deal you both can live with?" Sam

agrees, but the broker's conflict-of-interest problem remains. Since the broker breached its duty of disclosure in obtaining Sam's consent, the consent is ineffective.

Second, to be effective, a limitation to fiduciary duty must be clearly stated and unequivocal. Although a limitation can be implied (e.g., a waiter's right to retain tips), most limitations are stated in writing. Any ambiguity or vagueness will be strictly construed against the person who owes the fiduciary duty. If the agent (or other fiduciary) drafted the limitation, the contract rule of *contra proferentem* will also apply.[22]

Third, the common law disfavors "general provisions eliminating fiduciary duties."[23] The fiduciary duty of loyalty is of the essence of an agency relationship, and the common law limits the power of a principal to contract away wholesale the protections of fiduciary duty:

> Common-law agency does not accord effect to all manifestations of assent by a principal that purports to eliminate or otherwise affect the fiduciary duties owed by an agent.…[T]he law, and not the parties, determines whether a particular relationship is one of agency…; and the law applicable to relationships of agency…imposes mandatory limits on the circumstances under which an agent may be empowered to take disloyal action. These limits serve protective and cautionary purposes. Thus, an agreement that contains general or broad language purporting to release an agent in advance from the agent's general fiduciary obligation to the principal is not likely to be enforceable. This is because a broadly sweeping release of an agent's fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective, the release would expose the principal to the risk that the agent will exploit the agent's position in ways not foreseeable by the principal at the time the principal agreed to the release. In contrast, when a principal consents to specific transactions or to specified types of conduct by the agent, the principal has a focused opportunity to assess risks that are more readily identifiable. Likewise, when a principal consents after-the-fact to action taken by an agent that would otherwise breach the agent's fiduciary duty to the principal, the principal has the opportunity to assess what the agent has done with a degree of specificity not available before the agent takes action.[24]

To a contractarian, this approach may seem paternalistic. However, both history and epistemology support the approach:

> The open-ended nature of fiduciary duty reflects the law's long-standing recognition that devious people can smell a loophole a mile away. For centuries, the law has assumed that (1) power creates opportunities for abuse, and (2) the devious creativity of those in power may outstrip the prescience of those trying, through *ex ante* contract drafting, to constrain that combination of power and creativity. For an attorney to advise a client that the attorney's drafting skills are adequate to take the place of centuries of fiduciary doctrine may be an example of chutzpah or hubris (or both).[25]

§4.1.2 Duty to Act Within Authority

Although an agent may have the power to act beyond the scope of actual authority,[26] an agent does not have the *right* to do so. To the contrary, the agent has a duty to act only as authorized.[27] An agent who violates this duty is liable to the principal for any resulting damage. A parallel rule applies to nonagents who purport to be agents and thereby bind the apparent principal.

If an agent has reason to doubt the scope of authority, except in emergency situations the agent has a duty to inquire of the principal.

Example

Sally arranges for Ralph to buy a car on her behalf. She specifies, "Buy American." Ralph finds a good deal on a car assembled in the United States from components made almost exclusively overseas. Before buying the car for Sally, Ralph should check with her. ◂

§4.1.3 Duty to Obey Instructions

The principal always has the *power* to instruct the agent concerning the subject matter of the agency. Accordingly, an agent has a duty to obey instructions from the principal unless the instructions call for the agent to do something improper.

Example

Sam works for a car dealership in the used car department. He reports to the owner that he cannot sell a particular used car at the desired price because the car has too many miles on it. The owner responds, "Well, just roll back the odometer a bit." Despite being the owner's agent, Sam has no duty to comply. Rolling back an odometer is illegal, and Sam has no duty to obey instructions that call for wrongful conduct. ◂

The agent's duty to obey instructions is consistent with the agent's duty to act within authority. Instructions from the principal are manifestations from the principal, and the agent's authority comes from the agent's reasonable interpretation of the principal's manifestations. Therefore, if an agent disregards the principal's instructions, the agent is in effect acting without actual authority.

The duty to obey instructions exists even if the principal has contracted

away the *right* to instruct. The agent may have a claim for breach of contract, but nonetheless is obliged either to obey the principal's instructions or resign.[28]

§4.1.4 Duty of Care

An agent has a duty to act with "due care." How much care is due depends on: (i) whether the agent is paid or unpaid (gratuitous); and (ii) any relevant agreement between the principal and agent.

For paid agents, due care is ordinary care; a standard of ordinary negligence applies. The determination of what constitutes ordinary negligence is quite similar to the determination made under the "negligence" rubric in the law of torts. Indeed, the R.3d characterizes the agent's duty of care as "derived from tort law,"[29] and the R.3d black letter reads like a tort formulation:

> Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances. Special skills or knowledge possessed by an agent are circumstances to be taken into account in determining whether the agent acted with due care and diligence.[30]

As to gratuitous agents, older cases hold that the standard of care is the same standard that applies to other gratuitous actors (e.g., gratuitous bailees) —gross negligence. In contrast, the black letter of the R.3d makes no reference to whether the agent acts gratuitously. A comment suggests that the ordinary care standard applies to gratuitous agents as well as to paid agents, but the discussion and illustrations center on professionals (i.e., lawyers) or other situations in which the principal might reasonably be expected to be relying on some special skill or knowledge possessed by the agent.[31]

Agreements Affecting the Standard of Care An agreement between the principal and agent can change the level of care owed by the agent or the consequences of the agent's failure to meet the standard of care. For instance, a principal might agree (i) that a paid agent is obliged only to avoid gross negligence;[32] or (ii) not to hold the agent responsible for harm caused by ordinary negligence (an "exculpatory agreement").

Public policy limits the validity of some "care reducing" agreements. For example, ethical rules prohibit lawyers from making "an agreement

prospectively limiting the lawyer's liability to a client for malpractice."[33] In some states, exculpatory provisions relating to negligence are void or subject to strict construction.

It is theoretically possible for an agent to agree to raise the general standard of care, but such agreements are rare. More common are agreements under which an agent promises to produce certain results. In that case, the agent is contractually obliged to produce the promised results and cannot excuse failure by claiming the exercise of due care.[34]

§4.1.5 Duty to Provide Information

If an agent possesses information and has reason to know that the principal may need or desire the information, the agent has a duty to provide the information to the principal. This duty underlies the attribution rule that binds a principal on account of information possessed by its agent.[35] An agent's duty of care may require the agent to acquire information for the principal.

Of course, an agent's duty to provide information pertains only to the agent's principal and not to any other person.

Case in Point—Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC

A lessor sued the lessee's real estate agent for failing to disclose that the lessee had financial difficulties that might interfere with the lessee's ability to make the lease payments. The court rejected that assertion: "[N]o…authority known to us…supports the imposition of a duty on a lessee's agent in a commercial real estate transaction to disclose to the lessor information, acquired after execution of a lease, concerning the buyer's finances."[36]

§4.1.6 Contractual Overlay

As the previous sections have discussed, an agent has obligations to its principal as a matter of agency law. Those obligations are only part of the story, however. A contractual relationship usually overlays the agency relationship, and so an agent typically owes duties in contract as well as under agency law.[37]

Not every agency relationship has a contractual overlay. As explained in Chapter 1, an agency relationship is consensual, but not necessarily contractual.[38] Typically, however, the reciprocal consents that create an agency relationship also reflect an exchange of consideration. The agent undertakes to perform some task or achieve some objective for the principal, and the principal undertakes to compensate the agent for the agent's efforts. Thus, a process of contract formation typically accompanies the process of "agency formation."[39]

Rights and duties created by contract often supplement the rights and duties existing under agency law. For example, a contract may set performance standards for the agent, and the agent will then have to satisfy those standards as well as agency law's duty of care.[40] A contract may also define or circumscribe duties arising under agency law. For example, a contract can delineate the scope of an agent's duty of care by specifying the scope of the agent's endeavors. A contract can also limit an agent's agency law duties. For instance, as discussed previously an agent has a duty not to compete with its principal, unless the principal consents.[41] A contract can embody that consent.

There are, however, certain agency law duties that a contract cannot waive. For example, under agency law the principal always has the power to control the goals of the agency relationship and the means by which the agent pursues those goals.[42] A contract may limit a principal's rights in these matters but cannot abrogate the power. Accordingly, when a principal exercises the power of control, the agent has an agency law duty either to comply or to resign. If the principal's exercise of agency law power violates the agent's contractual rights, then the agent may pursue contract law remedies.

Example

Ralph hires Sally, a real estate broker, to sell his house. The brokerage agreement gives Sally the right to decide when to show the house. Ralph subsequently decides that he does not want the house shown on weeknights. Sally has a duty to abide by Ralph's decision or to resign. In either case, however, she can sue Ralph for breach of contract. (To recover, of course, she must prove damages). ◂

In like fashion, the principal always retains the power, if not the right, to

terminate the agency relationship.[43]

§4.1.7 Principal's Remedies for Agent's Breach of Duty

Damages If an agent's breach of duty to the principal causes damage to the principal, the principal can recover those damages from the agent. If an agent's breach of duty renders the principal liable to a third party, the agent must indemnify and hold harmless the principal from that liability.

Additional Remedies for Breach of the Duty of Loyalty If the agent breaches a duty of loyalty, the principal's remedies include not only *damages* (if provable) but also *disgorgement* of any profits derived by the agent from the disloyal transaction and *rescission* of any transaction between the principal and agent if the breach infected that transaction.

Example

Mikki is selling her hobby farm to a shopping mall developer and must therefore dispose of five horses. Four of the horses are quite old, but the fifth is quite valuable. Helen approaches Mikki and proposes to arrange the sale of the four older horses for a five percent commission and then buy the fifth horse for herself at a below-market price. Mikki agrees, on condition that Helen sells to "people who will care about my horses." Helen accepts the condition.

Within a few days Helen reports that she has sold the horses to "some real nice folks." After those horses are shipped, Helen collects her commission and pays for and takes the fifth horse.

Mikki later discovers that Helen sold the four horses to a glue factory. Because Helen gained the commission through dishonesty to her principal, the commission is subject to a constructive trust. Because Helen's disloyalty infected her purchase of the fifth horse, Mikki may rescind that transaction. ◂

Both disgorgement and rescission are considered equitable remedies, and both are available without proof of damage. Courts ordering disgorgement often do so by imposing a "constructive trust" on the agent's ill-gotten gains. A court will order disgorgement even though the remedy leaves the principal better off than the principal would have been had the agent complied with its duty of loyalty.

Example

A blockbuster adventure movie creates intense demand for a line of toys based on the movie. Williams Manufacturing, Inc. ("Williams") has the exclusive right to manufacture the toys. Although it raises its prices to take advantage of the demand and increases production, for several months Williams has more orders than it can fill. During this time, Max, Williams's national sales manager, gives order preference to those customers willing to "make it worth my while." The gratuities range from cash to cases of wine to airline tickets. No one else at Williams is aware of what Max is doing. If Williams can prove that Max's conduct damaged Williams's good will, Williams can recover from Max the amount of the damage. Even without proof of damage, Williams can recover from Max the value of the gratuities. By profiting without his principal's consent, Max breached his duty of loyalty. He must disgorge all benefits resulting from that breach. Williams may also be able to recover from Max whatever salary he received during his period of dishonesty. ◂

In many jurisdictions, breach of the duty of loyalty can support a claim for punitive damages. Also, in many jurisdictions the statute of limitations incorporates some form of the "discovery" rule—that is, the clock does not start until the principal knows or has reason to know of the breach.

§4.2 DUTIES AND OBLIGATIONS OF THE AGENT TO THIRD PARTIES

§4.2.1 Obligations "On the Contract"

Rules for Determining Agent's Liability Agents often make contracts on behalf of principals, and agency law provides rules for determining whether the agent is liable on such contracts.[44] The analysis turns on whether the agent's principal is disclosed.[45]

If the principal is disclosed, then the agent is not liable on the contract. The rationale for this rule is straightforward. With a disclosed principal, the third party enters into the contract knowing that the agent is merely a representative and that the principal will be the obligor. The agent is not promising any performance of its own,[46] and the third party may look only to

the principal for performance.

This rule applies even if the third party bases a warranty claim on a statement made by the agent.

Example

A patron at a gambling casino approaches the roulette wheel and asks the employee operating the wheel, "Is this game honest?" The employee responds, "As honest as the day is long." The patron places several bets, losing each one. Subsequently the patron discovers that the wheel is rigged and claims breach of warranty against both the employee and the casino. The claim against the employee will fail.[47] The patron's bets were transactions between the patron and the casino, and the employee's principal was disclosed. The employee is therefore not liable on the contract—even though the employee's statement gave rise to the breach of warranty claim.[48] ◂

If the principal is only partially disclosed (or, in R.3d terms, unidentified), then the agent is almost always liable on the contract. The rationale is again one of expectations. Without knowing the identity of the principal, the third party is presumably relying on the trustworthiness, creditworthiness, and *bona fides* of the agent.

Example

An attorney contacts an art dealer and contracts to buy a famous Picasso print. The attorney explains that she is acting for a client, but declines to identify the client. (The client dislikes notoriety.) The attorney is liable on the contract.[49] ◂

Expectations also explain the "auctioneer" exception to this rule. When an auctioneer sells an item for an unidentified owner, no one expects the auctioneer to "stand behind" the goods.[50]

When the principal is undisclosed, the agent is liable *a fortiori*. As far as the third party knows, the contract is with the agent and none other.

Example

A power company authorizes a coal broker to buy coal for it. The broker contracts to buy the coal in its own name, without disclosing its status as

agent for the power company. The broker is liable on the contract.[51]

These rules on contract liability are default rules. They can be overridden by express or implied agreement between the agent and third party.

Example

Return to the roulette wheel scenario (above), adding the following dialogue to the conversation between the patron and the employee:

> **Patron:** Are you sure this wheel is as honest as the day is long?
>
> **Employee:** I personally guarantee it. I wouldn't work at a crooked wheel.

The conversation reflects an agreement by the employee to guarantee one aspect of the principal's performance—namely, that the wheel will operate honestly. That agreement overrides the default rule, and the employee is liable, together with the principal.

As a practical matter, a person signing a contract as an agent should always make that status known on the face of the document, by means of the signature block. Otherwise, the obligee may point to the signer's bald signature as a manifestation that the signer agreed to be party to the contract.

The Agent's Liability and Available Defenses Unless otherwise agreed, an agent's contractual liability is as a *guarantor*. The agent partakes of any of the principal's defenses that arise from the transaction and can also assert any personal defenses or setoffs the agent may have vis-à-vis the third party. The agent may not assert defenses or setoffs that are personal to the principal (i.e., defenses arising from other transactions between the principal and the third party).

§4.2.2 Warranty of Authority

When a person purports to bind another person to a contract, the law implies a warranty of authority—that is, a promise that the purported agent actually has authority to act for the purported principal. If the purported principal is not bound, then the purported agent has breached the warranty of authority and is liable to the third party for expectation damages as well as reliance

damages.

The warranty applies:

- both to true agents who act outside their authority and to mere purported agents who have no actual authority at all;
- regardless of whether the purported principal is disclosed or partially disclosed (unidentified);[52] and
- even though the third party could have discovered the lack of authority by exercising reasonable care.

The warranty does *not* apply if:

- the purported agent disclaims having authority to bind or indicates that it doubts its own authority; or
- For some other reason, the third party knows that the purported agent lacks authority.

Example

An employee of Harris, Inc. ("Harris") purports to retain Pauline, a real estate broker, to sell two acres of land that Harris owns. The employee signs an engagement letter, purportedly on Harris's behalf, agreeing that Harris will reimburse Pauline's reasonable expenses and will pay a commission in the event Pauline finds a buyer willing and able to pay the asking price. Pauline finds such a buyer, who signs and delivers an offer letter to her. She takes the letter, making clear that she has no authority to accept the offer on Harris's behalf. When Pauline brings the offer to Harris, she discovers that: (i) the Harris employee acted without authority in dealing with Pauline; and (ii) Harris does not wish to sell the land. If the deal does not go through, the Harris employee will be liable to Pauline for breach of the warranty of authority. The liability will include not only Pauline's reasonable expenses but also the commission she would have earned on the sale. Pauline, in contrast, will not be liable to the disappointed buyer, since she never represented that she had authority to bind Harris. ◂

If a purported agent acts without actual authority but manages to bind its purported principal through apparent authority, inherent agency power, or

estoppel,[53] the warranty of authority is not breached. The third party has received just what the purported agent promised—a binding contract with the purported principal.[54] Likewise, no breach occurs if the purported principal ratifies the contract.[55]

Example

The counter clerk in a dry cleaner promises to have your interview "power suit" ready by the next day. The clerk has made comparable promises to you before, and the dry cleaner has always fulfilled them. Last week, however, the owner instituted a new policy, depriving employees of the authority to promise next-day service. Although the clerk lacks actual authority to bind the dry cleaner to a contract for next-day service, the clerk's apparent authority binds the principal. Therefore, there is no breach of the warranty of authority. ◂

§4.2.3 Obligations in Tort

A Tort Is a Tort Is a Tort Being an agent does not immunize a person from tort liability. A tortfeasor is personally liable, regardless of whether the tort was committed on the instructions from or to the benefit of a principal. A tortfeasor cannot defend itself by saying, "Well, I did what I did to serve my principal."[56]

For example, if a supermarket employee negligently drops a carton of cans on a customer's foot, the customer has a negligence claim against the employee.[57] Similarly, an agent who intentionally misstates a material fact while selling its principal's goods is personally liable for misrepresentation,[58] and, in some jurisdictions, can also be liable for aiding and abetting the principal's fraud. For aiding and abetting to apply, the agent must know of the fraudulent plan and give substantial assistance. The assistance need not involve directly fraudulent conduct.

Example

Al's Used Cars advertises for sale an automobile with interiors of "fine Corinthian leather." In response to that ad, a customer comes in and talks with Emily, a salesperson for Al's. Emily knows that the interiors are not

leather and that the ad was a purposeful "come on." However, she closes the deal without mentioning the interiors. She is liable to the buyer for knowingly assisting in her principal's fraud. ◂

Agency-Related Rights and Duties that Negate or Give Rise to Torts Although agency status does not create tort immunity, rights created by agency status can negate the existence of a tort. For example, an agent acting within the scope of authority may exercise and benefit from its principal's privileges. Those privileges can transform otherwise tortious conduct into lawful behavior.

Example

The owner of Sherwood Forest allows none but his guests to enter the Forest. Robin purchases the right to enter the Forest to collect certain examples of local fauna. Acting as Robin's agent, Tuck enters Sherwood Forest to collect specimens. Tuck's conduct is proper. He benefits from Robin's right to enter the land. Were Tuck entering for his own purposes, he would be committing the tort of trespass. ◂

Agency status can also give rise to duties, the breach of which will constitute torts.

Example

The owner of Sherwood Forest is leaving the country on an extended sabbatical. She hires John Little to conduct hunting expeditions into the Forest and gives him complete authority to manage the Forest premises. As a matter of tort law, Little has a duty to third persons to use care in maintaining the Forest.[59] Little's duty arises from his control of the premises, and that control comes from his authority as an agent. ◂

§4.2.4 Breach of Duty to Principal Not by Itself a Breach to Third Party

When an agent breaches a duty of care or proper performance to its principal and the principal suffers harm, the agent is liable to the principal for damages.[60] The same misconduct may also harm a third party, but an agent's

breach of duty to its principal does not automatically create a damage claim for the third party.[61] Rather than simply "borrowing" the principal's breach of duty claim, the third party must characterize the agent's conduct as breaching a duty to the third party.

A third party can succeed with such a characterization if the tortfeasor's role as an agent happens to involve tasks that, *as a matter of tort law,* create an independent duty to third parties. In such circumstances, the same pattern of conduct happens to breach both a duty to the principal and, separately, a different (albeit somewhat similar) duty to the third party.

Case in Point—Baird v. Shipman

"It is not [the agent's] contract with the principal which exposes him to, or protects him from, liability to third persons, but his common-law obligation to so use that which he controls as not to injure another. That obligation is neither increased nor diminished by his entrance upon the duties of agency; nor can its breach be excused by the plea that his principal is chargeable."[62]

Case in Point—Schur v. L.A. Weight Loss Centers, Inc.

After a customer of a weight loss center died of liver failure, her estate sued the center in state court. The defendant removed the case to federal court asserting diversity jurisdiction and complete diversity between itself and the customer, an Illinois resident. The plaintiff then sought to add as defendants two employees of the center, both Illinois residents, and have the case remanded to state court for lack of complete diversity. The district court refused, seeing the addition of the employees as "fraudulent joinder" because "Poole and Morr, as agents of LA Weight Loss, would not be personally liable for any tort they may have performed while working within the scope of their employment." The court of appeals reversed, noting: "The district court may have confused the doctrines of vicarious (derivative) liability and individual (direct) liability.…[A]n agent can be individually liable even where his employer is *also* vicariously liable."[63]

§4.3 DUTIES AND OBLIGATIONS OF THE PRINCIPAL TO

THE AGENT

§4.3.1 Principal's Duty to Indemnify

When an agent acts on behalf of its principal, the agent may incur expenses, make payments, suffer injury, and even offend the rights of third parties. As a matter of agency law, a principal has a duty to indemnify its agent for:

- payments made or expenses incurred within the agent's actual authority;
- payments made to the principal's benefit, but without authority, if:
  — the agent acted in good faith (and unofficiously), mistakenly believing itself to be authorized; and
  — under the principles of restitution it would be unjust not to require indemnity[64];
- claims made by third parties on contracts entered into by the agent, with authority, and on the principal's behalf;
- claims made by third parties for torts allegedly committed by the agent, if:
  — the agent's conduct was within the agent's actual authority; and
  — the agent was unaware that the conduct was tortious.

No duty to indemnify exists for:

- payments made or expenses incurred that are neither within the agent's actual authority nor of benefit to the principal;
- losses resulting from the agent's negligence or from acts outside the agent's actual authority; and
- losses resulting from the agent's knowing commission of a tort or illegal act.

A duty to indemnify is a duty to hold harmless; that is, to reimburse the agent for payments made, to compensate the agent for losses suffered, to protect the agent from third-party claims. Protecting against claims means: (i) providing or paying for a defense, including reasonable attorney's fees and other costs of litigation ("the duty to defend"); and (ii) paying for any liability, including reasonable settlements.

To invoke the principal's duty to defend, the agent must give the principal reasonable notice of the claim, allow the principal to manage the defense, and cooperate with the principal in the defense. If the agent fails to notify the principal, the principal is not responsible for the costs of defense and will be responsible for the agent's liability only if the agent made a reasonable defense.

Example

Alvin, an up-and-coming rock singer, hires Dave as road manager for Alvin's new tour. On Alvin's instructions, Dave uses his own credit card to book Alvin into the fanciest suite in the fanciest hotel in each of the tour stops. Alvin has a duty to indemnify Dave for the room charges. Alvin's instructions gave Dave actual authority to incur the expenses. ◂

Example

Following a concert, Alvin directs Dave to bring back to the hotel a new amplifier that Alvin used during the concert. The amplifier actually belongs to the owner of the concert hall, and the owner subsequently sues Dave for conversion. Dave promptly notifies Alvin. Although Dave may well be liable for conversion,[65] Dave is entitled to indemnity from Alvin. Dave did not know he was committing a tort, and, as between Dave and Alvin, taking the amplifier was an authorized act. Alvin must therefore: (i) defend Dave or pay Dave's reasonable costs of defense; and (ii) cover any liability. ◂

Example

Although Dave's responsibilities only relate to the road tour, Dave has visions of getting Alvin a recording contract. Without checking with Alvin, Dave starts wining and dining various record company executives. Dave's efforts are fruitless, but he does manage to run up $2,000 in "entertainment" expenses. Alvin has no duty to indemnify Dave. Dave had no actual authority to incur the expenses, and the expenses were of no benefit to Alvin. ◂

The principal's duty to indemnify is a "default rule"—subject to change by any valid contractual arrangement between the agent and principal. A contract can expand, reduce, or merely further define the scope of the principal's duty.

§4.3.2 Principal's Duties in Tort (Physical Harm to the Agent)

Nonemployee (Nonservant) Agents A principal owes its nonemployee agent whatever tort law duties the principal owes to the rest of the world. In addition, a principal has a duty to warn its nonemployee agent of any risk involved in the agent's tasks if the principal knows or should know that: (i) the risk exists; and (ii) the agent is unlikely to be aware of the risk.[66]

Example

Rachael owns and runs her own hauling service, and Samuel hires her on commission to sell and deliver firewood. To pick up the firewood Rachael must enter Samuel's property, and, in most jurisdictions, Samuel will owe her a duty of reasonable care. That duty arises from Rachael's status as an entrant on land and not from her status as Samuel's agent. ◂

Example

On Samuel's land, the shortest route to the stacks of firewood crosses an old wooden bridge. After one of Rachael's trips to pick up firewood, Samuel notices a hairline crack in the bridge's supporting structure. The crack is not visible from the road. Samuel has reason to know that the bridge is dangerous and that Rachael is unlikely to be aware of the danger. He therefore has a duty to inform Rachael of the risk before she makes her next trip to the stacks of firewood. ◂

Employees (Servants) Before the advent of workers' compensation statutes, the common law delineated a master's liability for work-related physical injuries suffered by its servants. The common law was complex and confusing. In theory, the master had a duty to provide reasonably safe working conditions for its servants. In reality, three doctrines combined to eviscerate that duty and tilt the law strongly toward the master.

The "fellow servant" rule. This rule prevented servants from holding their masters vicariously liable for the tortious conduct of a "fellow servant." The R.2d defined fellow servants as "servants employed…in the same enterprise or household and so related in their labor that, because of proximity or otherwise, there is a special risk of harm to one of them if the

other is negligent."[67] The definition (and therefore the rule) swept broadly. For instance, if a master operated several tugboats within a harbor and the negligence of a servant on one boat happened to cause injury to a servant on another, the fellow servant rule barred recovery. Since many workplace injuries resulted, at least in part, from the negligence of fellow employees, this rule left many injured servants without a remedy.

Assumption of risk. At one time this doctrine applied generally within tort law. In the master-servant context, it barred servants from recovering for injuries arising from the ordinary dangers of their work, because servants were said to have assumed the risk of such injuries. The more dangerous the work, therefore, the less likely a servant was to recover.

Contributory negligence. At one time this doctrine also applied generally within tort law. In the master-servant context, it barred recovery whenever an injured servant's own negligence had helped cause the injury.

Today, workers' compensation statutes provide a no-fault compensation regime and preempt the common law.

§4.3.3 Contract-Based Duties

As explained previously, usually a contract between agent and principal overlays the agency relationship and imposes contractual duties on each party.[68] For principals, the most common contract-based duty is compensation.[69]

Although the rules for construing a principal's contract-based duties are for the most part identical to the rules for construing the duties of any party to any contract, the concept of implied terms does require some special attention. As with contracts generally, the law can supply a term ("implied in law") and terms can be implied "in fact" from the: (i) express terms of the agreement; (ii) the parties' conduct (before or after contract formation); and (iii) other circumstances (including usages of trade). However, no implication arises solely by reason of the agency relationship or the principal's promise to pay the agent.

§4.4 DUTIES AND OBLIGATIONS OF THE PRINCIPAL TO THIRD PARTIES

§4.4.1 Agency Law Duties

Duty to Properly Select and Use Agents Under the rules discussed in Chapters Two and Three, an agent's conduct can indirectly cause the principal to be liable to a third party. Agency law also imposes obligations that run directly from principals to third parties.

Most importantly, a principal has a duty to use reasonable care in choosing, informing, training, and supervising its agents. If a principal breaches this duty of care and as a foreseeable result the principal's agent injures a third party, the principal is liable. This liability "stem[s] from general doctrines of tort law"[70] and results from the principal's direct duty to the third party. The liability exists even though the most direct cause of the harm was the act or omission of the agent.

Example

Speedy Delivery Company ("Speedy") uses college students to deliver messages on bicycles. Speedy does not supply the bicycles, pays per delivery (not by the hour), does not control routes, and requires only that students give at least a 48-hour notice of when they plan to work. One day, Speedy gives a delivery assignment to a student who is obviously intoxicated. The student rides carelessly and runs into the dean of the law school. The dean drops her portable computer, which breaks. The dean will not succeed with a *respondeat superior* claim against Speedy, because the student is not an employee (servant). The dean will succeed, however, with a direct claim based on the principal's duty of care. Speedy breached that duty by selecting an obviously intoxicated person to make a delivery and will therefore be directly liable to the dean. The liability will exist even though it was the student's negligence that most directly caused the dean's loss. ◂

Example

The employee of a private snowplowing company drives one of the company's trucks to a customer's residence in order to plow snow from the driveway. Unbeknownst to the agent, the company has installed a new module to control the snowplow attached to the front of the truck. When the agent arrives at the customer's residence and attempts to lower the plow to

street level, the plow lowers so quickly that it gouges a hole in the city street. The company is liable to the city for the cost of the street repair, even though the employee has not been negligent. The relevant negligence is that of the company, which failed to properly instruct and inform its agent. ◂

The fact that an agent has acted negligently does not by itself establish that the principal breached its direct duty of care.

Example

Harris Carpeting sells floor coverings and provides installation services through various nonemployee agents. It is customary for Harris to deliver the floor covering to the customer's location and for the installer to arrive separately. Harris uses only skilled installers and follows up with customers to determine their satisfaction both with the carpet and the installation. Harris therefore sees no need to incur the expense of supervising the installers.[71]

One of Harris's regular installers is Albert, who has done installation work for 15 years and has an exemplary record. One day Albert uses a new type of adhesive to install vinyl tile and carelessly fails to read the instructions. He therefore fails to ventilate the room properly, and a fire results. Despite Albert's negligence, Harris has not breached its duty of care. In light of Albert's experience and reputation, it was reasonable to select Albert and to allow him to work without supervision.[72] ◂

The Nexus Requirement (Causation) "Liability under this rule also requires some nexus or causal connection between the principal's negligence in selecting or controlling an actor, the actor's employment or work, and the harm suffered by the third party."[73] This nexus requirement conceptually parallels the "scope of employment" requirement of *respondeat superior*.

Example

Richard is employed as a camp counselor at a summer camp. During the summer he steals property from other counselors and from campers as well. A simple background check would have revealed that Richard has a criminal record that includes several convictions for theft. The camp's negligence in hiring Richard makes it liable to the counselors and campers for the thefts.[74] ◂

Restatement on Point

"If the actor's tort is causally unrelated to the actor's employment by the defendant, [the principal's duty of care] does not subject the defendant to liability to a third party injured by the actor's tort although the defendant was negligent in employing or retaining the actor."[75]

Case in Point—Phillips v. TLC Plumbing, Inc

"In 1999 TLC employed Cain as a plumbing service repairman. At the time Cain was hired, Condon, as owner of TLC, learned Cain was on parole and apparently had been convicted of a domestic violence and/or arson offense involving his then wife. On April 2, 2003, TLC dispatched Cain on a service call to Judith's residence. On April 24, TLC dispatched Cain on another service call to her residence. On or about May 21, TLC terminated Cain's employment for misuse of a company vehicle, drug and alcohol use, and apparently threatening a coworker. Cain and Judith apparently began a social relationship in April 2003 after his first service call. Their relationship seemingly evolved over time into a romantic one. On May 19, 2005, after Judith had ended their relationship and applied for a restraining order against Cain, he shot her. She died the following day and Cain was convicted of her murder." Judith's daughter sued TLC for negligent hiring and retention and lost on summary judgment. The appeals court affirmed: "[A]n employer does *not* owe a plaintiff a duty of care in a negligent hiring and retention action for an injury or other harm inflicted by a *former* employee on the plaintiff even though that employee, as in this case, initially met the plaintiff while employed by the employer. Accordingly, we agree with Defendants' assertion that because Cain's tortious act on Judith occurred *two years after* his employment with TLC was terminated, Defendants did not owe Plaintiff a duty of care at the time of Cain's tortious act and therefore cannot be held liable on a cause of action for negligent hiring and retention."[76]

The Standard of Care and Vulnerable Customers, Patients, etc. A standard of ordinary care requires different conduct in different circumstances. "The most important circumstances are the foreseeable likelihood that conduct will result in harm, the foreseeable severity of that harm, and the burdens imposed by precautions to eliminate or reduce the possibility of harm."[77]

More particularly, the risk of harm is greater if those at risk of harm cannot protect themselves from an agent's improper conduct:

> [I]n some settings and relationships, a person's vulnerability to harm may affect the measures that a principal may reasonably be required to take to safeguard against risks, including those posed by employees and other agents. In particular, relationships that expose young children to the risk of sexual abuse are ones in which a high degree of vulnerability may reasonably require measures of protection not necessary for persons who are older and better able to safeguard themselves. Such measures may include prohibiting unsupervised contact between a child and an employee. Likewise, persons of any age taken into custody by law-enforcement officers are vulnerable to risks of harm against which they may lack the ability to safeguard themselves.[78]

Relationship of Principal's Direct Duty to Principal's Vicarious Liability

The principal's liability under the direct duty of care is different from the principal's vicarious liability under the doctrine of *respondeat superior*. The two liabilities can, however, overlap. If a principal negligently selects, informs, trains, or supervises an employee and the employee negligently injures a third party while acting within the scope of employment, the principal will be liable to the third party on two counts: directly, for a breach of the duty of care, and vicariously, through the doctrine of *respondeat superior*.

Besides overlapping, the two liabilities can create a double bind for principals who hire agents to do potentially dangerous work. If the principal adopts a hands-off attitude and something goes wrong, the principal may be liable for failure to adequately supervise, train, inform, or instruct. If, in contrast, the principal seeks to avoid such a result with a hands-on approach, the law will take the principal's right of control to mean that the agent is an employee. If so, any negligence of the employee will make the principal vicariously liable.

The following table shows how the principal's direct and vicarious liability relate to each other and also how the principal's liability in tort is affected by the negligence of the principal, the negligence of the agent, and the status of the agent as employee or nonemployee. The table assumes that conduct of the agent has caused physical injury to the person or property of a third party.

4.1 Principal's Direct and Vicarious Liability: The Roles of Negligence and Agent Status (assuming negligence is otherwise actionable under applicable tort law)

	Principal Breached Duty of Care	Principal Did Not Breach Duty of Care
Agent's Conduct ***Negligent***	Regardless of whether agent is an employee, principal liable on direct claim *if* sufficient nexus exists. Also liable vicariously *if* agent was employee acting within scope of employment.	Principal not liable on direct claim. Liable vicariously *if* agent was employee and was acting within scope of employment.
Agent's Conduct ***Not Negligent***	Principal liable on direct claim only, regardless of whether agent is employee *if* sufficient nexus exists.	Principal not liable.

§4.4.2 "Nondelegable" Duties Imposed by Other Law

Nonagency law sometimes imposes duties on account of a person's status or relationship to others. For example, in most jurisdictions the owner of a business has a duty to use reasonable care to make the premises safe for customers. Although the law sometimes calls such obligations "nondelegable duties," the term is usually a misnomer. With most such duties a person may indeed delegate the responsibility to others. For example, a store owner may appoint a store manager and leave her in charge of the premises. The mere fact of delegation breaches no duty.

A better, albeit more cumbersome, name for these duties would be "duties that may be delegated but that are not discharged merely by delegation." When a person delegates to an agent, the delegating person's relationship with the person accepting the delegation is a matter of agency law. However, neither the delegation nor the law of agency affect the original duty. Regardless of the care the principal uses in selecting, informing, training, and supervising the agent, the principal remains on the hook until and unless the agent properly performs the delegated tasks. If the agent does so, then the principal has satisfied its obligations under nonagency law. If, however, the agent does not perform properly, the principal is liable. The principal may have a claim against the agent, but that claim does not excuse

the principal.

Example

Under a statute governing the leasing of residential premises, a landlord owes a tenant a duty to maintain the premises in "habitable" condition. The landlord hires a resident manager and instructs the manager "to do whatever is necessary to keep this place in good condition." The resident manager neglects the job, and a tenant sues the landlord for breach of the statutory "warranty of habitability." The landlord cannot successfully defend by blaming the resident manager, because delegating the responsibility did not discharge it.[79] ◂

§4.4.3 Duties Assumed Under Contract

In any contract the parties undertake duties to each other, and in most situations a contract obligor may delegate performance of a duty to someone else.[80] When a contract obligor does delegate performance to an agent,[81] agency law relates to that delegation in the same way it relates to the delegation of duties imposed by law. The delegation does not discharge the duty. The obligor remains strictly responsible to the obligee, even if the obligor uses the greatest care in selecting, supervising, and instructing the agent.

Problem 32

In his first meeting with Friar Tuck, Robin Hood compels Tuck to carry him across a stream. Hood uses his sword as the instrument of coercion. Tuck undertakes the task, but midway across purposely drops Hood into the stream. Has Tuck breached his duty of loyalty? Would it matter if Tuck's conduct were grossly negligent rather than intentional? ◂

Explanation

Tuck has not breached his duty of loyalty, because none exists. For an agency relationship to exist, *inter alia* the agent must manifest consent to act on the principal's behalf. Tuck made no such manifestation, but merely yielded temporarily to coercion. (Moreover, even assuming consent, Tuck is most

likely a nonservant service provider—in R.2d terms, an independent contractor—not an agent.)

Problem 33

Traveling across country by car after the death of her husband, Alice stops at a roadside diner for lunch. The diner is in chaos. The one waitress has just quit, and Mel, the owner and cook, has a room full of increasingly irate customers. Sensing a job opportunity, Alice says to Mel, "Hey, I can wait tables. Want some help?" Mel responds, "Minimum wage. You're hired. Your shift ends at *7* P.M."

Alice works hard and extremely well. By the end of the day, she has collected $150 in tips. She is shocked when Mel says, "The tips belong to me. I didn't say nothing about you keeping the tips." Is Alice obliged to surrender the tips?

Explanation

No. Although an agent must have the principal's consent to profit from the agency, custom may imply the necessary consent. It is certainly customary for waitresses and waiters to retain their tips unless the restaurant specifies otherwise.

Problem 34

Victoria commissions Albert to get a Contracts casebook for her at the used bookstore. She specifically instructs him that she wants him to buy a book that was previously used, underlined, and annotated by someone who received at least a A- in the Contracts course. She promises to pay Albert a $5 fee if he succeeds in purchasing for her a book that meets her specifications.

Albert goes to the bookstore and initially attempts to perform his task. However, the bookstore clerk tells Albert that the bookstore has no way of knowing how well the former owner of any particular book did on any particular exam. Not wanting to lose a sale and always on the lookout for a little personal gain, the clerk suggests a little scam. The clerk will telephone Victoria and tell her that the bookstore does indeed have a book that was owned by someone who received an A in Contracts. The clerk will also tell

Victoria that, since the book has such a good pedigree, the book costs $15 instead of the regular used price of $12. If Albert will back up the story, the clerk will split the extra $3 with him, fifty-fifty. Albert agrees.

The scam works. Victoria gives Albert $20 ($15 for the supposed price of the book and $5 for Albert's commission). Twelve dollars of Victoria's money goes into the bookstore's cash drawer. The clerk splits the other $3 with Albert. Albert also pockets the $5 commission.

But not for long. The scam unravels when Victoria learns that the former owner of the book flunked out of law school without ever having achieved a grade above C−. Threatened with dire consequences, the clerk spills his guts and tells Victoria the whole sordid story. Victoria rescinds her purchase. The clerk returns to Victoria the full $15 purchase price, taking $12 from the bookstore's cash drawer and the other $3 from his own pocket. Victoria then goes after Albert. She sues him not only for the return of the $5 commission, but also to disgorge the $1.50 kickback. Albert concedes the $5 and pays it back to Victoria. Albert contests the $1.50, however. He points out that he has paid the $5 and the clerk has paid the $15, so Victoria is now "whole." According to Albert, Victoria has recovered whatever damages she suffered and is now looking for a windfall. What result? ◂

Explanation

Albert must disgorge the $1.50. When an agent profits by breaching the duty of loyalty, the law imposes a constructive trust in favor of the principal. It is irrelevant that Victoria can prove no damages, and it is immaterial that disgorgement will make Victoria "more than whole" financially. It is better that the principal receive a windfall than the agent profit from a breach of fiduciary duty. ◂

Problem 35

After graduating from law school, Beth goes to work for a law firm. Several months later, an uncle contacts Beth and asks her to handle a closing on the sale of some land. Beth says, "I'd be delighted. When would you like to come down to the office?" The uncle responds, "Oh, I don't want to get your office involved. I don't really want to pay downtown lawyer fees. Why don't I just come by your house tonight?"

Beth explains that she is really obligated to work through her firm, but

her uncle is insistent. Finally, Beth hits upon a solution. “Listen, uncle,” she says, “You’re family. Let me do this closing as family, no charge. We’ll call it an introductory offer.” Her uncle agrees.

Beth spends about six hours preparing for and attending the closing, and all goes well. Two weeks later, she receives at home a beautiful silver necklace, with a note from her uncle: “Dear Beth, With thanks to my favorite niece. Love, Your Uncle.” The necklace is worth approximately $1200. What should Beth do?

Explanation

Beth faces a difficult situation. Presumably, she does not want to hurt her uncle’s feelings, and for sentimental, aesthetic, and financial reasons she may well want to keep the necklace for herself. However, as Beth explained to her uncle, she is obliged to do her legal work through her firm. Her duty of loyalty precludes her acting in competition with her principal or from secretly benefitting from doing irregularly the type of work she is regularly employed to do. No matter how earnest her efforts to avoid a problem and how pure her motives, she cannot retain benefits made through such activity unless she has her principal’s informed consent.[82]

That analysis dictates Beth’s next steps. She must either return the necklace to her uncle or disclose the situation to the firm and seek the firm’s permission to retain the necklace.

Problem 36

Sam obtains from a video game distributor the right to place its video games in bars, restaurants, and video parlors throughout a tri-state area. The right is quite valuable, because this manufacturer has several very popular video games and rations the number of games allowed in any one geographic area. Sam retains Eli to represent him in locating the best possible locations for the games and to negotiate with the owners and managers of those locations. Eli makes a number of recommendations, which Sam follows. Per their agreement, Sam pays Eli a fee of $500 per location selected.

The games do not produce the revenue Sam expected, and after about six months he looks more carefully into the locations Eli recommended. Sam discovers that: (i) half of the locations are owned by Interactive Display Outlets, LLC (“IDO”); (ii) during the time that Eli was advising Sam, Eli was

also on retainer to IDO as a management consultant; (iii) many of the IDO locations are not in high-traffic areas; and (iv) Eli could easily have arranged superior, non-IDO placements that would have produced better revenues for Sam. What recourse does Sam have against Eli?

Explanation

By acting for IDO, a potentially adverse party, without having Sam's consent, Eli breached his agent's duty of loyalty. He is liable to Sam for damages, that is, the present value of the additional revenues that would have been produced by the easily arranged, superior, non-IDO placements. Eli may also have to disgorge the compensation he received from Sam, as well as any compensation he received from IDO for having gotten Sam's video games into IDO locations.

Problem 37

Sandy agrees to go to an auction for Ralph and bid for a particular picture. Ralph authorizes Sandy to bid up to $20,000. Both Sandy and Ralph expect the auction to end by 6 P.M. The auction runs late and Sandy must leave to pick up a child from day care. The day care center closes at 6:30 P.M. After Sandy leaves, the picture Ralph wanted is sold for $18,000. Ralph later buys the picture from the purchaser for $20,000. He learns that the purchaser would have stopped bidding at the auction when the price hit $19,000. Ralph then sues Sandy for $1,000—the difference between what would have been a winning bid at the auction and the price Ralph had to pay to get the painting after the auction. What is Ralph's theory of recovery? What will Sandy argue? What will Ralph respond?

Explanation

Ralph will argue that: (i) Sandy was his agent; (ii) Sandy owed Ralph an agent's duty of loyalty, which Sandy breached by leaving the auction before the bidding finished (or at least before the $20,000 limit was reached on the picture); and (iii) Sandy is liable for the $1,000 of damages proximately caused by Sandy's breach of fiduciary duty.

Sandy will make two arguments. First, Sandy will argue that, by at least tacit agreement of the parties, the agency (and Sandy's fiduciary duty of

loyalty) terminated at 6 P.M., when both the principal and agent expected the auction to be over. Second, Sandy will argue that even assuming the agency continued past 6 P.M., the agent's duty of loyalty yields when necessary to protect important interests of others. Preventing a child from being abandoned at a day care center should qualify as such an interest. Protecting children is certainly a legitimate social value and should outweigh some relatively minor financial harm to the principal.

Ralph will respond that Sandy had available at least two alternatives for protecting the child's interest without sacrificing the principal's. First, by anticipating the problem and disclosing it in advance to Ralph, Sandy would have allowed Ralph to make other arrangements for covering the auction. Second, when the auction appeared to be running long, Sandy could have used her cell phone to call the day care center to try to arrange for a late pickup. ◂

Problem 38

Sylvia decides to enter the silk importing business. The trade is notoriously biased against women, and she fears that her company will suffer if her interest in it is known. She therefore hires Phil as her general manager, but sets up the company so that Phil appears to the outside world as the owner. It is common in this trade for silk importers to sell to large customers on credit, but Sylvia instructs Phil never to extend more than $50,000 of credit to any customer without Sylvia's approval. One day, in order to close an important deal, Phil extends $150,000 of credit to one customer without consulting Sylvia. The customer makes only $20,000 of payments and then defaults. Assuming that Phil's judgment about the customer's creditworthiness was reasonable, does Sylvia have any claim against Phil? ◂

Explanation

Yes. Phil owes Sylvia $130,000. He breached his duty to act within his authority, and he is liable to his principal for the resulting harm. The reasonableness of Phil's judgment about the customer's creditworthiness is irrelevant. Sylvia is not claiming breach of the agent's duty of care. ◂

Problem 39

The owner of a car dealership appoints Rachael to manage the used car department. The owner promises that Rachael can have a “free hand” running the department. Rachael decides to open the department on Sundays. Although Sunday openings are not against the law, the owner considers them “inappropriate.” The owner instructs Rachael to stay closed on Sunday. Must Rachael comply?

Explanation

Although this instruction breaches the agreement between the owner and Rachael, Rachael has a duty either to obey or to resign. If Rachael can prove damages, she may recover for breach of contract.

Problem 40

Sidney hires Sam, a private detective, to locate and deliver to Sidney a valuable statue of a bird. Sidney agrees to a fee of $200 per day, plus reasonable expenses, with a $15,000 bonus if Sam succeeds in finding and delivering the statue. Sam is on the verge of locating the statue when Sidney learns that Sam is carrying a gun. Sam is properly licensed to do so, but Sidney tells Sam, “I abhor violence. You may not carry that thing when you are working for me.” Must Sam obey? Does he have any recourse against Sidney?

Explanation

A principal always has the power to control the agent, so Sam must either obey or resign. Sam may nonetheless have a claim against Sidney for breach of contract. If, for example, the local custom is for detectives to use whatever lawful tactics they choose, that custom may have implied an agreement requiring Sidney to respect Sam’s discretion. If so, and if Sam could for instance prove that his lack of a gun cost him the opportunity to retrieve the statue, Sam could recover the $15,000 bonus from Sidney.

Problem 41

Esther seeks to sell her business and enlists Harry to locate and help evaluate prospective buyers. With Harry’s advice, Esther decides on a price of $1.5

million. She is willing to finance the sale (i.e., to receive payments in installments) but only with a down payment of at least 10 percent. Both Esther and Harry believe that buyers are more likely to succeed if they have some of their own money at risk.

Initially Harry has difficulty locating qualified buyers, but after three months he presents an offer from JoDot Enterprises ("JoDot"). JoDot offers to pay $1.5 million, with $150,000 down. Esther accepts the offer, and the sale goes through.

Unfortunately, JoDot cannot operate the business at a profit and defaults on its obligations to Esther. Esther then learns that: (i) JoDot did not actually have the $150,000 needed for the down payment and had to borrow $75,000 from a third party; and (ii) Harry was aware of that fact when he presented JoDot's offer to Esther. Does Esther have any recourse against Harry? ◂

Explanation

Yes. Harry breached his duty to provide information to Esther, his principal. Harry understood both the importance of the down payment and Esther's view of the subject. He therefore knew or should have known that Esther would want to know that the prospective buyers lacked a true down payment.[83]

Esther can compel Harry to disgorge any commission he earned on the deal. If she can prove causation, she can also claim damages. ◂

Problem 42

An attorney contacts an art collector, seeking to buy a famous Picasso print on behalf of a client. The attorney explains to the collector that she is acting for a client but declines to identify the client. (The client dislikes notoriety.) The attorney has actual authority to offer up to $450,000 for the print, and she persuades the collector to sell for $415,000. It is late Friday afternoon, and the attorney can have a cashier's check for the contract price by 10 A.M. Monday morning. The attorney wishes, however, to sign a binding sale agreement with the art collector, so that the collector cannot change his mind over the weekend. The attorney has $5,000 of her own money immediately available that she is willing to use as an earnest deposit. The attorney does not, however, wish to be liable on the contract itself. What should she do? ◂

Explanation

The attorney's potential problem comes from a rule of agency law. When an agent makes a contract for an identified (i.e., partially disclosed) principal, the agent is liable to the third party as a guarantor of the principal's performance—unless the agent and the third party have agreed otherwise. This rule dictates the attorney's strategy. The sale agreement must let her off the hook.

From the attorney's perspective, the ideal solution would be to include in the sale agreement an express statement that the attorney is not liable. It seems possible, however, that the collector would balk at such a term. After all, he would be committing to take the print off the market in return only for a promise to pay from a party whose creditworthiness he is unable to assess. The attorney could respond to this concern by limiting the duration of the collector's risk. The agreement could require payment by cashier's check by Monday at noon and provide that any delay in payment would entitle the collector to rescind the agreement. If the collector required further inducement, the agreement could provide for a nonrefundable "earnest money" payment of $5,000, or could offer to recast the contract as involving $5,000 payment for an option contract, with the payment to be credited to the purchase price if the unidentified principal timely exercises the option. ◂

Problem 43

Rose's Marina rents berths to various boat owners and also does boat and engine repair. The Marina does not ordinarily sell boats. Phil rents a berth at the Marina for his cabin cruiser. He happens to mention to Rose that he is thinking about selling his boat. Phil then leaves town on a two-week vacation. Three days later Rose meets Irv, who is interested in buying a cabin cruiser just like Phil's. Rose shows Phil's cruiser to Irv, and Irv immediately offers to pay $25,000 for the boat. Overcome by her enthusiastic desire to help Phil, Rose says, "Okay. He'll take it. Give me $500 earnest money." Irv does so, receiving in return a receipt from Rose: "Received from Irv, nonrefundable down payment on Phil's boat. By Rose, acting for Phil."

When Phil returns to town, he refuses to go through with the sale. Assuming that Phil is not bound,[84] does Irv have any recourse against Rose? ◂

Explanation

Yes. When Rose purported to act on Phil's behalf in selling the boat, she impliedly warranted her authority to bind Phil. In fact, she was not Phil's agent and lacked any power to bind him. She has breached her warranty of authority and is liable to Irv for both reliance and expectation damages.

Problem 44

Jerry, the owner of Jerry's Gas, Service, and Repair Station, instructs Leah, one of his employees, to "pick up the blue Chevy station wagon parked in the driveway of 1346 Lincoln Avenue. Customer called and says it won't start and we should get it and fix it." Leah takes the Station's tow truck and does as instructed. On the way back from the driveway, a semi trailer crosses a median strip and smashes into the station wagon. Fortunately, no one is injured, but the station wagon is totaled. Moreover, it later develops that Jerry made a mistake on the address: The customer who authorized the repair work lives at 1436 Lincoln. Is Leah liable to the owner of the station wagon?

Explanation

Yes. Leah is liable for conversion, a strict liability tort. That she acted on her principal's instructions and without negligence is irrelevant to the question of her liability. Leah certainly has a right to be indemnified by her principal, and her principal is doubtlessly liable to the wagon's owner.[85] Nonetheless, she remains responsible for the tort she committed.

Problem 45

Seller owned five acres of land on which he had built stables, corrals, fencing, and other improvements useful for raising horses. He retained Broker to sell the land on his behalf. Seller walked the property with Broker, showing Broker the various improvements and the property lines. Together they found most of the boundary markers, but could not find some. On the east side of the property, they found the northeast marker but could not find the southeast one. A line of trees seemed to confirm Seller's description of the east boundary. Moreover, Seller assured Broker, "I know where my land is and where I built. All my improvements are on my property." Broker did

not independently verify the boundary lines.

When Broker showed the land to the eventual Buyers, Broker represented that all the improvements were within the property. After closing, the Buyers discovered that a corral on the east side of the property encroached several feet into the neighboring parcel. The cost for moving the improvements was $6,000. Was Broker liable for that amount?

Explanation

No. An agent is not liable for an innocent misrepresentation. The third party must show either intentional or negligent misrepresentation. There is no case here for intentional misrepresentation. Broker actually believed its own statements about the boundaries. Nor do the facts support a finding of negligent misrepresentation. Broker had no reason to doubt Seller's assurances, especially when the land's natural features (i.e., the trees) and what markers could be found seemed to support those assurances.

Problem 46

In an attempt to get better bookings for his client, Dave (Alvin's road manager) threatens a booking agent with imminent bodily harm. The booking agent sues Dave for assault and for intentional infliction of emotional distress. Is Alvin obliged to indemnify Dave?

Explanation

No. The suit arises from a tort knowingly committed by an agent. The principal therefore has no duty to indemnify.[86]

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1. R. 3d, §1.01begins, "Agency is the fiduciary relationship…," and R.2d, §1(1) characterizes agency as a "fiduciary relation." R.3d, §1.01, comment *e* explains: "The word 'fiduciary' appears in the black-letter definition to…emphasize that an agency relationship creates the agent's fiduciary obligation as a matter of law." Nonetheless, R.3d, Introduction accurately recognizes that: "The fiduciary character of the relationship does not explain all of the doctrine included within agency law. For example, the bases for the *respondeat superior* doctrine are not necessarily linked to the bases for treating agents as fiduciaries." For a further discussion of this point, see section 3.2.4 (Relationship of Employee Status to Agent Status).

2. This legal characteristic does not always comport with the practical reality. In the lay sense, the agent may be the "star" and the principal merely the supporting context. Consider, for example, Itzhak Perlman serving for a season as first violinist of a metropolitan orchestra or Michael Jordan playing

basketball for the Chicago Bulls.
3. See below in this section for discussion of "reshaping the duty of loyalty by consent" and "the agent's legitimate disloyalty."
4. R.2d, §387, quoted in Reporter's Notes to R.3d, §8.01, comment *a*.
5. "Monitoring costs" are the principal's costs of keeping guard against misconduct by the agent. The stricter the rules of loyalty, the easier it will be to establish misconduct and obtain a right of recovery. The most important monitoring costs, however, relate not to recovering for misconduct but rather to preventing it. It is not clear how strict loyalty rules reduce those costs.
6. Justice Cardozo's comment in Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928), exemplifies this tone: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Meinhard* concerned a joint venture, but the case is often cited and Cardozo often quoted in cases concerning an agent's duty of loyalty.
7. R.3d, §1.01, comment *e*.
8. For further discussion of this point, see section 5.3.5 (use of confidential information following termination of agency).
9. Huong Que, Inc. v. Luu, 58 Cal. Rptr. 3d 527 (Cal. Ct. App. 2007).
10. For further discussion of this point, see section 5.3.5 (post-termination competition and the duty to "get out clean").
11. See section 4.1.3.
12. See section 4.1.5. Some states have adopted statutes or regulations governing dual agency situations in the context of real estate brokers.
13. R.3d, §§8.01, comment *d*(1) and 8.03, comment *d*.
14. Restatement §389, comment *d*.
15. R.3d, §8.03.
16. R.3d, §8.10, comment *b*.
17. R.3d, §8.10, comment *b*.
18. If Charlie fails or refuses to refrain and the clinic fires him, it is a separate question whether he is entitled to unemployment compensation. Although unemployment compensation statutes typically model their respective concepts of "employee" on the corresponding agency law concept (see section 3.2.4), they have their own, somewhat narrow notion of what constitutes disqualifying misconduct.
19. R.2d, §387, comment *b*. R.3d considers this issue only in the context of an agent's duty to safeguard the principal's confidential information. R.3d, §8.05, comment *c* states, "An agent may reveal otherwise privileged information to protect a superior interest of the agent or a third party," and provides examples of legitimate "whistle-blowing" activities.
20. R.2d, §387, comment *b*.
21. Cases and practitioners sometimes use the term "waiver" to describe an agreement to limit or eliminate a particular facet of the loyalty duties, although "waiver" is most often used to describe a relinquishment of a known right, which, being extra-contractual and not separately supported by consideration, can be withdrawn absent reliance by the other party.
22. BLACK'S LAW DICTIONARY, 8th ed. (2004) ("The doctrine that, in interpreting documents, ambiguities are to be construed unfavorably to the drafter").
23. Reporter's Notes to R.3d, §8.06, comment *b*.
24. R.3d, §8.06, comment *b*.
25. Carter G. Bishop and Daniel S. Kleinberger, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW (Warren Gorham & Lamont/RIA, 1994; Supp. 2011-1) ¶14.05[4][a][ii].
26. See sections 2.3 (apparent authority) and 2.6 (inherent agency power).
27. The scope of that authority is determined objectively, based on the agent's reasonable interpretations of the principal's manifestations. See section 2.2.2.

28. See section 4.1.6.
29. R.3d, §8.08, comment *b*.
30. R.3d, §8.08.
31. R.3d, §8.08, comment *e*.
32. Under the Revised Uniform Partnership Act, a partner's duty of care is to avoid gross negligence. RUPA §404(c). For further discussion, see section 9.6.2.
33. Model Rules of Professional Conduct Rule 1.8(h) (1983).
34. For precisely this reason, agents (as well as independent contractors) prefer to promise "reasonable efforts" to produce specified results.
35. See section 2.4.
36. *BlickmanTurkus, LP v. MF Downtown Sunnyvale, LLC*, 76 Cal. Rptr. 3d 325, 339 (Cal. Ct. App. 2008). Note, however, that an agent has a tort-based duty to avoid fraud and misrepresentations in dealing with a third party. See section 4.2.3.
37. Likewise, the principal may have contractual obligations to the agent. See section 4.3.3.
38. See section 1.4.5.
39. As with most contracts, terms may be implied by custom and usage.
40. Section 4.1.4 discusses the agent's duty of care.
41. See section 4.1.1.
42. If the principal also has the *right* to control the means, then the agent is likely an employee (R.3d)/ servant (R.2d). See section 3.2.4.
43. See section 5.2.
44. Agency law also determines whether the principal is liable. See Chapter 2.
45. Section 2.2.2 (in creation of actual authority, third-party knowledge of principal-agent relationship is irrelevant).
46. The agent is, however, implicitly promising that the principal will be obligated. If the principal is not obligated, the agent will be liable. See section 4.2.2 (agent's warranty of authority).
47. The claim against the casino will prevail, however, since the employee's statement is attributed to the casino. See section 2.4.6 (agent's statements attributable to the principal for contract law purposes).
48. If the employee made the misstatement negligently or intentionally, the employee may be liable in tort. See section 4.2.3.
49. The client is liable, too. See sections 2.2.2 and 2.2.4.
50. R.3d, §1.04, Reporter's Notes, section *b*. The situation might be different if the auctioneer has a reputation for probity and is known to check items for authenticity before offering them at auction.
51. The power company is liable too. See sections 2.2.2 and 2.2.6 (in creation of actual authority, third-party knowledge of principal-agent relationship is irrelevant). As for the relationship of the broker's liability to the power company's liability, see *infra* this section.
52. With a partially disclosed (unidentified) principal, the purported agent will be bound whether or not a contract is formed. If the principal is bound, a contract results and the agent is liable as a guarantor. See section 4.2.1. If the principal is not bound and no contract is formed, then the agent is liable under the warranty of authority. With an undisclosed principal, the warranty does not apply because the agent is not purporting to act on behalf of another. However, the agent is bound on the contract. See section 4.2.1.
53. For a discussion of these attribution rules, see sections 2.3 (apparent authority), 2.6 (inherent agency power), and 2.5 (estoppel).
54. The purported agent may be liable to the purported principal. See section 4.1.2 (duty to act within of authority).
55. For a discussion of ratification, see section 2.7.
56. The principal may well be liable, too. The liability may be vicarious (see Chapter Three), or direct (see section 4.4, principal's direct duties), or both.
57. For tactical reasons the customer may decide not to assert this claim, instead relying exclusively on

claims against the principal (e.g., *respondeat superior*, failure to provide reasonably safe premises to business invitees). Tactical considerations could include: the small chance of collecting any substantial judgment from the employee; removing the employee as a party to allow the jury to see the matter as a David versus Goliath conflict (i.e., injured "ordinary folk" versus rich, impersonal mercantile establishment); eliminating the employee's financial incentive to justify his or her own conduct.

58. If the agent innocently passes on the principal's misrepresentations, the agent is not liable. For the tort of intentional misrepresentation, most jurisdictions require intent to deceive or at least reckless disregard of truthfulness. Some jurisdictions also recognize a claim for negligent misrepresentation.

59. How much care is due depends on the jurisdiction and, in some jurisdictions, on the status of the injured party (e.g., business invitee, trespasser).

60. The duty of care arises from the agency relationship. See section 4.1.4. A duty of proper performance may arise from a contract between the principal and agent. See section 4.1.6. Section 4.1.7 discusses the damage remedy.

61. The principal may well be liable to the third party, either vicariously (see section 3.2, *respondeat superior*), or directly (see section 4.4).

62. Baird v. Shipman, 23 N.E. 384, 384 (Ill. 1890) (per curiam).

63. Schur v. L.A. Weight Loss Centers, Inc., 577 F.3d 752, 764-65 (7th Cir. 2009).

64. Note that a mistaken belief of authority does not by itself qualify the resulting loss or expense for indemnity.

65. Conversion is a strict liability tort. Therefore, Dave's innocent state of mind is irrelevant to the owner's suit.

66. For the rules that determine whether an agent is a servant (R.2d nomenclature) or employee (R.3d nomenclature), see section 3.2.4.

67. R.2d, §475.

68. See section 4.1.6.

69. Indeed, agency law traditionally subdivided agents into two categories depending on whether the principal has agreed to pay the agent for the agent's efforts. See section 1.4.5 (defining gratuitous agents). The R.3d takes a less dichotomous approach, abandoning the categorical distinction with regard to an agent's duty of care. See section 4.1.4.

70. R.3d, §7.05, comment *b*.

71. Moreover, direct supervision might create *respondeat superior* exposure. See sections 3.2.4 and 3.5.

72. The customer may have a contract claim against Harris, however. See section 4.4.3.

73. R.3d, §7.05, comment *c*.

74. Note that, assuming the jurisdiction uses the purpose test, *respondeat superior* will not apply. However, the campers may have a contract claim.

75. R.3d, §7.05, comment *c*.

76. Phillips v. TLC Plumbing, Inc., 91 Cal.Rptr.3d 864, 866, 870 (Cal.App. 4 Dist.2009).

77. R.3d, §7.05, comment *b*, citing Restatement Third, Torts: Liability for Physical Harm §41 (Proposed Final Draft No. 1, 2005).

78. R.3d, §7.05, comment *e*.

79. The results are the same when a person delegates a duty to a nonagent. See, e.g., Restatement (Second) of Contracts §318(3) (unless otherwise agreed by the obligee, delegation does not discharge the obligor's duty to the obligee).

80. Sometimes the nature of the obligation (e.g., personal service) precludes delegation. Sometimes the contract validly prohibits delegation. In such circumstances, contract duties are genuinely "nondelegable," and the obligee need not accept the delegated performance.

81. It is possible and quite common to delegate duties to a nonagent independent contractor. See section 6.1.2 (distinguishing agents from independent contractors).

82. It might be argued that Beth took an opportunity away from her principal when she undertook to do her uncle's work for free. That argument presupposes that the firm could have convinced the uncle to

hire the firm. Nonetheless, Beth probably should have discussed the matter with her principal before "diverting" her uncle into the "no charge" arrangement.

83. It is also possible to view Harry's conduct as a breach of his duty to obey instructions. This view assumes that Esther instructed him to bring her only offers from "qualified" buyers, that is, buyers capable of meeting the 10 percent down-payment requirement.

84. According to the rules discussed in Chapter Two, Rose had no power to bind Phil. He made no manifestation that could have *reasonably* caused her to believe that he wanted her to sell his boat. Therefore, she had no actual authority. He made only one manifestation that reached Irv—leaving the boat at the Marina. That manifestation was insufficient to cause Irv to *reasonably* believe that Rose was Phil's authorized agent. Therefore, Rose had no apparent authority. *Cf.* U.C.C. §2-403(2) (power of merchant who deals in goods of the kind to transfer entruster's title to a buyer in ordinary course). Inherent power is inapplicable, because Rose was not Phil's agent, much less his general agent. Estoppel will not work because Phil neither knew of nor carelessly caused Irv's misapprehension.

85. This liability rests on *respondeat superior*. See section 3.2.

86. Alvin may yet get involved, however, since the booking agent may have a respondeat superior claim. Dave's intentional tort may have been within his scope of employment. See section 3.2.6.

§5.1 ENDING THE AGENCY RELATIONSHIP

An agency relationship may end in numerous ways, many of which have analogs in the law of contracts.

§5.1.1 Through the Express Will of Either the Principal or the Agent

Both the principal and the agent have the *power* to end the agency relationship at any time.[1] Either party can exercise this power simply by communicating to the other that the relationship is at an end. The principal's exercise of this power is sometimes called *revocation* (as in revocation of the agent's authority), while the agent's exercise is sometimes called *renunciation*. Like other agency manifestations, communications of revocation and renunciation are judged by an objective standard.

Example

The City Opera Company signs Maestro Donna Prima to an agreement under which Ms. Prima agrees to conduct exclusively on behalf of the Company

throughout the upcoming season. Like the opera star stereotype, Ms. Prima is a mercurial personality and is given to emotional outbursts. At one rehearsal, during which the violin section makes several mistakes, she loudly proclaims, "I am sorry, but I cannot tolerate mediocrity. I resign." On two prior occasions she has made similar announcements during rehearsals only to return a few hours later. Viewed objectively, in light of what the Opera Company knows of Prima's personality and her past conduct, this latest pronouncement does not constitute a renunciation and does not terminate the agency relationship. ◂

Example

The sheriff of a Western town is well known as a man slow to make decisions but resolute once a decision is made. Despite receiving no support from the townspeople, the sheriff has just survived a gunfight with several outlaws. As the townspeople come out of hiding and try to congratulate the sheriff, he looks at them with disgust, takes off his badge, and throws it into the dirt. The sheriff has renounced his agency. ◂

§5.1.2 Through the Expiration of a Specified Term

Principal and agent can and often do specify that the relationship will last for a particular period of time. If so, the relationship automatically terminates at the end of the specified period unless the parties agree to an extension or renewal. That agreement can be inferred from the parties' conduct.

Example

Mark retains Tonya to find a buyer for Mark's condominium. They agree that Tonya will have the exclusive agency for 90 days. They also agree that during those 90 days Tonya will have the authority to accept any cash offer of at least $90,000. On the 101st day, Tonya purports to accept a cash offer for $92,000. Tonya lacks the actual authority to accept the offer on Mark's behalf. That authority, and Tonya's role as agent, terminated at the end of 90 days. ◂

Example

Same facts, except that following the 90th day, Mark and Tonya continue to discuss the condo, and Tonya, with Mark's knowledge, continues to show the condo to prospects. The conduct of Mark and Tonya implies an agreement to extend the agency. ◂

§5.1.3 Through the Accomplishment of the Agency's Purpose

If the manifestations that create an agency indicate a specific objective, achieving that objective ends the agency. Without further manifestations from the principal, the agent has no basis for believing that either its authority or its agency continues.

Example

Capitalist, Inc. hires Veronica to lobby for the passage of a bill in Congress and to negotiate on Capitalist's behalf concerning any proposed changes in the bill language. As part of her efforts, Veronica "wines and dines" Congressional staff members. She sends the bills to Capitalist. On October 12th, the bill passes and is sent to the President. The next day, Veronica takes three staffers out to a "thank you for all your hard work" lunch. Without some additional manifestation from Capitalist, Veronica may not bill this lunch (or her time) to Capitalist. Her agency relationship with Capitalist ended when the goal of the agency was accomplished. ◂

Sometimes an agent will continue to exert effort for the principal even after accomplishing the agency task. The principal's acceptance or even acknowledgment of those efforts may manifest consent for the agency to continue or resume.

Example

Irv hires Jeff to help arrange a loan to finance Irv's acquisition of a business. Jeff arranges a loan and receives a fee from Irv. Jeff keeps in touch with the lender and some months later learns that Irv is having difficulty meeting his payments. Without first talking to Irv, Jeff contacts the lender to talk about refinancing the loan. At this point, Jeff is not acting as Irv's agent.[2] Subsequently, Jeff talks to Irv and says, "I understand from your lender that the payments are too large. I think I can work something out. Do you want

me to try?" Irv replies, "Sure. Why not?" From that point, Jeff is again acting as Irv's agent. ◂

§5.1.4 By the Occurrence of an Event or Condition

Sometimes the manifestations that create an agency indicate that a particular event or condition will end the agency. If so, once the event or condition occurs the agent can no longer reasonably believe itself authorized to act on the principal's behalf. The agency therefore terminates.

Example

Larry hires Howie to sell hot dogs at the beach, "but only until my daughter gets here from summer school." When Larry's daughter arrives, Howie's agency ends. ◂

The same rationale applies if the original manifestations call for the agency to end if a particular event or condition does not occur.

§5.1.5 By the Destruction of or the End of the Principal's Legal Interest in the Property

If the agent's role is predicated on some particular property and the property is no longer practically or legally available to the agent, the agency ends.

Example

Larry hires Howie to skipper Larry's yacht during the summer, including to make appropriate arrangements on Larry's behalf with harbor authorities. In June the yacht sinks. Howie's agency ends. ◂

Example

Same facts, except that the yacht does not sink. In June Larry sells the yacht. The yacht still exists, but Larry no longer has a legal interest in it. Howie's agency ends.[3] ◂

§5.1.6 By the Death, Bankruptcy, or Mental Incapacity of the

Agent or Principal

Under traditional common-law rules, any of these events terminates the agency relationship. However, modern statutes allow for substantial exceptions, and the R.3d, "following the lead of commercial legislation and §4(a) of the Uniform Durable Power of Attorney Act,"[4] has reformulated the common law. Section 5.3.2 discusses the R.3d's approach.

§5.1.7 By the Expiration of a Reasonable Time

Where the original manifestations set no specific term, the agency relationship expires automatically after a reasonable time has passed. What constitutes a reasonable time depends on a number of factors, including:

- the manifestation of the parties when the agency is created;
- the extent and nature of the communications between the parties after the agency is created (including indications by a party that it wishes to end the agency or that it believes the agency has ended);
- the particular objective of the agency;
- past dealings, if any, between the principal and agent; and
- the custom, if any, in the locality with regard to agency relationships of the same or similar type.

§5.2 POWER VERSUS RIGHT IN TERMINATION

As previously indicated,[5] both principal and agent always have the *power* to end a true agency relationship. Whether either has the *right* to do so depends on the content of any contract overlaying the agency relationship as well as on contract law concepts of good faith and detrimental reliance.

§5.2.1 The Role of Contract

Contractual terms can, *inter alia:*

- set a specific duration for the agency, during which neither party may

rightfully end the relationship without having cause;

- provide for the agency to continue indefinitely, until ended by either party giving notice;
- define "cause" sufficient to allow one party, the other, or both to end the agency;
- provide for the agency to continue so long as the agent meets certain performance requirements.

Regardless of its terms, a contract leaves intact the parties' *power* to end the agency relationship. If revocation or renunciation breaches a contract, the non-breaching party may seek contract damages but cannot avoid the destruction of the agency. In any damage action, ordinary contract rules (e.g., assertions of prior breach, the duty to mitigate) will apply.

Example

Marge enters into a contract calling for her to serve as Mountain Fleece, Inc.'s East Coast regional sales representative for 18 months. Despite the contract, Mountain Fleece terminates the agency a mere six months later. As a matter of agency law, Marge cannot compel Mountain Fleece to continue the relationship.[6] She can, however, sue for damages. ◂

Example

Same situation, except that Marge prematurely renounces. As a matter of agency (and contract) law, Mountain Fleece cannot compel Marge to serve. It can sue her for damages. ◂

§5.2.2 Implied Terms

For the most part, the rules on implying terms in an agency contract are identical to the rules for implying terms in any contract. A difference exists, however, with regard to terms restricting the right of the parties to terminate the relationship.

An express term can certainly restrict either party's right to terminate the agency. For example, most collective bargaining agreements expressly preclude the principal (i.e., the employer) from terminating without "just

cause" an employee covered by the agreement. Courts will not, however, easily imply such a restriction. To the contrary, most agents have the right to renounce at will and most serve at the will of the principal.[7]

Courts are most likely to find an implied, contractual limit on termination when:

- the agency relationship is outside the employment context;
- the limitation is asserted against the principal; and
- either:
  — the principal's manifestations are the source of the implication; or
  — the agent has reasonably incurred costs in undertaking the agency and needs time to earn back those costs.

Example

A manufacturer retains a salesperson as the manufacturer's selling agent and states, "We will supply all the widgets you can sell during the next year." A court may imply a term under which, during that next year, the manufacturer has the right to terminate the agency only for cause. ◂

Example

A manufacturer retains a salesperson as the manufacturer's selling agent. Nothing is said about duration, but the salesperson does buy from the manufacturer demonstration equipment costing $4,200. The manufacturer may be contractually obliged either to buy back the demonstration equipment or to let the agency exist long enough to allow the agent to recoup the $4,200 through commissions. ◂

§5.2.3 Breach of the Duty of Good Faith

A principal may not terminate an agency relationship in order to deprive the agent of a bonus or commission that would otherwise be due to the agent. However, the remedy is not reinstatement but rather the value of the bonus or commission improperly avoided.

Example

Marcia tells Teri, “Find me a bona fide buyer for my restaurant and help put the paperwork together, and I’ll pay you a finder’s fee of $10,000.” Teri finds a prospect. As soon as Marcia learns of the prospect, she tells Teri, “Changed my mind. Think I’ll wait awhile.” Marcia then contacts the prospect directly and arranges the sale. Even though the agency relationship contained no express limitations on Marcia’s right to terminate the relationship, Marcia will be liable to Teri for the finder’s fee. Marcia terminated the relationship in bad faith. ◂

§5.2.4 The Gratuitous Agent and Detrimental Reliance

If the agency is gratuitous, then by definition the agent’s right to terminate is not limited by contract.[8] However, principles akin to promissory estoppel impose some restrictions. If a gratuitous agent: (i) makes a promise or engages in other conduct that causes the principal to refrain from making different arrangements; and (ii) the gratuitous agent had reason to know that the principal would so rely, then:

- if alternative arrangements are still possible, the agent has a duty to end the agency only after giving notice so the principal can make alternative arrangements; and
- if alternative arrangements are not possible, the agent has a duty to continue to perform the agency as promised.

Like any other agent, a gratuitous agent always has the power to renounce. However, if a gratuitous agent improperly leaves the principal in the lurch, the agent will be liable for damages.

§5.3 EFFECTS OF TERMINATION

§5.3.1 Effects on Agent’s Authority and Power to Bind Principal—R.2d Approach

According to traditional common law principles, the agent’s actual authority to bind the principal terminates when the agency terminates. Any inherent

agency power also ends, because that power presupposes the status of general agent.

The fate of the agent's apparent authority depends on the reason the agency terminated. According to the R.2d and some older cases, if the principal has died or lacks capacity, the agent's apparent authority terminates immediately. In other circumstances, the agent's apparent authority terminates as to any particular third party only when: (i) the third party learns that the agency has ended; or (ii) in light of other information, the third party can no longer reasonably believe that the agent is authorized to act.

Example

Melinda is a rancher. Sam is a horse breeder. On Monday, Melinda introduces Rebecca to Sam as "my agent for buying horses." On Tuesday, as Rebecca is negotiating with Sam, Melinda dies. Unaware of the death, Rebecca and Sam reach agreement on a horse purchase and Rebecca purports to bind Melinda. Under R.2d, Melinda's estate is not bound, because Melinda's death terminated Rebecca's apparent as well as actual authority.[9] ◂

Example

Same situation, but Melinda does not die. Instead, Melinda fires Rebecca for insubordination but fails to tell Sam. The next day, Rebecca purports to buy a horse from Sam for Melinda. Under R.2d, Rebecca's action binds Melinda, although the firing ended Rebecca's actual authority. Because neither death nor incapacity caused the agency relationship to end, Rebecca's apparent authority remained intact. ◂

§5.3.2 Statutory Developments and the R.3d Approach

In some jurisdictions, statutes have changed the common law, providing that upon a principal's death or incapacity the agent's actual authority continues until the agent knows of the death or incapacity and the apparent authority continues until the third party knows.[10] Other statutes allow principals to execute documents creating agency powers that survive the principal's disability or incapacity, even after the disability or incapacity becomes known.[11]

R.3d has reformulated the common law rules in this area:

> The impact of the principal's death on an agent's actual authority has the potential to create harsh consequences because the agent, unaware of the principal's death, may continue to act in good faith following it. The agent risks claims from third parties that the agent breached express or implied warranties of authority. Third parties risk the loss of transactions to which the agent committed the principal. Legislation has long mitigated the common-law result. Widespread adoption of consistent legislation of general applicability is a reliable measure of contemporary policy. The residual common-law rule should reflect the policy judgments reflected in legislation such as the Uniform Commercial Code, the Uniform Durable Power of Attorney Act, and contemporary partnership statutes.[12]

Accordingly, R.3d §§3.07(2) and 3.08(1) state that:

> The death of an individual principal terminates the agent's actual authority. The termination is effective only when the agent has notice of the principal's death. The termination is also effective as against a third party with whom the agent deals when the third party has notice of the principal's death.[13]
>
> An individual principal's loss of capacity to do an act terminates the agent's actual authority to do the act. The termination is effective only when the agent has notice that the principal's loss of capacity is permanent or that the principal has been adjudicated to lack capacity. The termination is also effective as against a third party with whom the agent deals when the third party has notice that the principal's loss of capacity is permanent or that the principal has been adjudicated to lack capacity.[14]

As to apparent authority, the R.3d states: "An agent may act with apparent authority following the principal's death or loss of capacity because the basis of apparent authority is a principal's manifestation to third parties, coupled with a third party's reasonable belief that the agent acts with actual authority. Neither element requires that the principal consent or manifest assent at the time the agent takes action. When third parties do not have notice that the principal has died or lost capacity, they may reasonably believe the agent to be authorized."[15]

Example

Same facts as in the first Example in section 5.3.1 (involving Melinda's death). Subject to any contrary provisions of applicable estate law, Melinda's estate is bound. Neither the agent (Rebecca) nor the third party (Sam) had notice of her death, so at the time of the transaction the agent had both actual and apparent authority. ◂

§5.3.3 Agent's Obligation to Cease Acting for Principal

Once the agent has reason to know that the agency relationship has ended, the now former agent has a duty not to act for the principal. If the former agent violates this duty and binds the former principal, the former agent will be liable for damages.

§5.3.4 Principal's Duty to Indemnify Agent

The termination of the agency relationship does not eliminate any right of indemnity that the agent may have on account of events that occurred before the termination.

Example

As an authorized part of her lobbying for Capitalist, Inc., Veronica "wines and dines" important people. She periodically submits her bills to Capitalist for reimbursement. Capitalist one day decides that having lobbyists is not good for its image and therefore terminates its relationship with Veronica. At that time, Veronica has $500 of reimbursement claims submitted but as yet unpaid and $400 of expenses incurred but not yet submitted for reimbursement. Veronica is entitled to both the $500 and the $400. Both amounts relate to events that occurred before the termination of the agency relationship. ◂

§5.3.5 Agent's Right to Compete with Principal

While an agency relationship exists, the agent's duty of loyalty precludes competition with the principal. Unless the principal consents, the agent must refrain from engaging in any competitive activity that relates to the scope of the agency relationship.[16]

Once the agency relationship ends, however, so does the absolute barrier to competition. Public policy strongly favors free competition, and the former agent has a right to compete with its former principal. A former agent may even recruit customers from the former principal's clientele.[17]

The right to compete does, however, have three limitations: a prohibition against using the former principal's confidential information; the

duty to “get out clean”; and the obligation to abide by any valid “non-compete” agreements.

Prohibition Against Using the Former Principal’s Confidential Information The agent’s duty not to disclose or exploit the principal’s confidential information[18] clearly continues after the agency relationship ends. Disputes about the duty center around the question of just what kinds of information are protected from use.

Although in theory the same question exists during the agency relationship, at that juncture the question has far less practical import. Most alleged misuses involve some form of competition, and during the agency relationship competition is itself barred. As a result, during the relationship a claim of misuse of confidential information is often just a “tagalong” to a claim of improper competition. The question of whether allegedly misused information is truly confidential (and therefore protected) is unlikely to be crucial.

Post-termination competition, however, is not by itself improper,[19] and a claim of information misuse can therefore be crucially important in a conflict between former principal and former agent. In that context the question of what constitutes confidential information can be dispositive.

Analyzing that question can involve two opposite but complementary perspectives:

1. Does the information warrant protection as a trade secret? That is:
   — Has the principal expended effort and incurred expense to obtain or create the information?
   — Does the principal derive economic advantage from the information’s not being generally known?
   — Has the principal used reasonable efforts to protect the confidentiality of the information?
2. Does the information consist of facts or specialized techniques as distinguished from general expertise that an agent might develop while performing agency tasks?

A “yes” answer to question 1 means the information is confidential and belongs to the principal. A “yes” to question 2 means the opposite.

Duty to "Get Out Clean" During the agency relationship an agent may properly contemplate post-termination competition with the principal. An agent may not, however, disregard its current loyalty obligations to further its post-termination plans. Put colloquially, the agent must "get out clean."

This part of the duty of loyalty has two major aspects. First, the agent has a duty not to begin actual competition while still an agent. Thus, during the agency relationship, an agent may not discuss with the principal's customers or potential customers the agent's post-agency venture. In addition, attempts to enlist other *key* agents of the principal may also violate the duty of loyalty. However, the agent may have discussions and even make agreements with parties *other than customers, potential customers, and key fellow agents* of the principal. For instance, the agent may properly have stationery printed, rent an office, and apply for a license.

Second, the agent may not actively deceive the principal as to the agent's reasons for terminating the agency relationship. The agent probably has no affirmative duty to provide reasons or even to respond if the principal asks, "Why are you quitting?" The agent may not, however, lie to conceal its plan to compete. Moreover, subject to its right not to reveal its plans for the future, the agent must continue to provide agency-related information to the principal[20] right up to the moment that the agency ends.

An agent who fails to "get out clean" may be liable to the former principal both for damages and for disgorgement.[21]

Example

May works as the headmaster of a private school. Frustrated by policies set by the board of trustees, she decides to start her own school. Before resigning, she discusses her plans with several of the private school's major donors and obtains commitments from them for start-up funding. She also copies the private school's mailing list of the families of current students. Her actions breach her duty of loyalty. She has the right to compete with the private school for donations, but only after she terminates her agency relationship. She never has the right to purloin her principal's mailing list.[22]

Noncompetition Obligations Imposed by Contract A contract between the principal and agent can restrain the agent from competing after the relationship ends, although the law's strong pro-competition stance causes

courts to scrutinize such agreements carefully. The restraints must be reasonable with respect to the scope of activities foreclosed, the geographic area foreclosed, and the duration of the foreclosure. In some states, overbroad restraints are simply unenforceable. In most states, however, courts will "blue-pencil" overbroad "non-competes"—carving the restraints back until they are reasonable.

Despite the judicial skepticism, contractual non-competes are common and quite important whenever an agent is likely to develop strong relationships with the principal's customers.

Example

A wholesale tire company assigns a three-state territory to a sales representative and instructs that representative "to get to know every potential buyer in the territory. Get them to know us and like us." As the sales rep fulfills those instructions, there will almost necessarily develop a personal relationship between the sales rep and the tire wholesaler's customers. It makes little sense for the tire wholesaler to pay the sales rep to develop all this "good will" if the sales rep can simply resign and take the business to a competing wholesaler. ◂

Problem 47

For the past several years, Ventura Company ("Ventura") has been acting as a buying agent for Ilan Enterprises ("Ilan") in the U.S. soybean market. Ventura has had authority to make purchases up to $250,000 without prior approval from Ilan.

Recently, Ilan discovered improprieties in Ventura's conduct. Ilan wishes to terminate the relationship immediately and wants to know how to do so. Ilan is also concerned about its responsibility if Ventura continues to trade on Ilan's account even after Ilan terminates the relationship. Advise Ilan how best to proceed. ◂

Explanation

Ilan can terminate the agency simply by giving notice to Ventura. A principal always has the power to terminate an agency. In this instance Ilan also has the right to do so, since the facts reveal no express or implied agreement as to

term. Ilan should make the notice in writing and use some means of transmission that allows proof of delivery. (Agency law does not require written notice. The writing and delivery precautions are to simplify proof.)

As for the possibility that Ventura will bind Ilan through post-termination trading, the termination notice will end Ventura's actual authority and inherent agency power.[23] Ilan should be concerned, however, with Ventura's lingering apparent authority. If Ilan has a list of traders and other parties with whom Ventura has dealt, Ilan should send each a brief notice, stating in effect, "Effective [date of termination], Ventura Company is no longer authorized to sell, buy, make trades, or conduct any other business for Ilan Enterprises."[24] This notice will prevent the recipients from reasonably believing that Ventura remains authorized and will thereby stop them from claiming apparent authority as to any future transactions.

Ilan must also consider the rest of the marketplace. It is possible that Ventura possesses apparent authority in the soybean market generally—even with parties who have never dealt with Ventura. Ventura may have previously and accurately described itself as having authority, and that description is attributable to Ventura's principal.[25] Moreover, the Ventura–Ilan relationship may be generally known, with that knowledge traceable to the fact that Ilan has followed through on deals made by Ventura.

Because this aspect of the Problem relates to a possible public perception, public preventative measures are necessary. Ilan should identify some trade publication or other medium of communication that reaches those who participate in the soybean market and insert in that medium the same "no longer authorized" notice just described. Ilan should also post the notice conspicuously on Ilan's website.

Besides addressing the apparent authority concerns, Ilan's private and public notices will also block attempts to claim agency by estoppel. Knowing that market participants might believe Ventura is still authorized to act for Ilan and that they "might change their position because of it," Ilan will have taken "reasonable steps to notify them of the facts."[26] ◂

Problem 48

Roseanne gets a job at a posh new restaurant in an upscale mall where the wait staff all wear uniforms. Each uniform costs $85 dollars, and the restaurant requires Roseanne to buy four before starting work. Three days

after Roseanne starts work, the restaurant manager decides that the staff is too large for the current volume of business. He fires the newest employee—Roseanne. Does Roseanne have any recourse?

Explanation

The answer will probably depend on how strongly the relevant jurisdiction adheres to the employment-at-will doctrine. Roseanne will argue that, by requiring her to buy so many uniforms, the restaurant impliedly agreed not to terminate her without cause at least until she had worked long enough to make the uniform purchase an economically rational act. As a fallback, she will argue that the restaurant must buy the uniforms back from her.

Problem 49

Eli is a regional sales agent for Maurice Ball Bearing, Inc. ("Maurice"). Eli and Maurice have a written agreement that: (i) grants Eli an exclusive territory in which to promote and solicit orders for Maurice products; (ii) provides that Eli has no authority to accept any order on behalf of Maurice and that all sales will be made by Maurice directly to customers; (iii) establishes a commission schedule; (iv) requires Eli to follow lawful and ethical business practices but otherwise allows him complete discretion in how he conducts his operations; and (v) allows either party to terminate the relationship without cause on seven days' notice. Under the commission schedule, Eli qualifies for a $25,000 bonus in any calendar year in which he books orders aggregating more than $3 million.

It is October. So far Eli has booked $2.8 million, and he will certainly reach the bonus level by year's end. However, Maurice has decided for its own reasons to "go direct" in Eli's region. That is, Maurice wishes to use its own employees, rather than Eli, to solicit orders. The CEO of Maurice wishes to terminate Eli immediately and asks you for legal advice. Provide it.

Explanation

Maurice has the power to terminate its agent at any time and appears to have the right to do so simply on seven days' notice. However, with Eli so close to qualifying for the bonus, a precipitous termination could raise suspicions of bad faith. A principal has no right to terminate an agency merely to deprive

the agent of benefits that the agent is on the verge of earning.

Even if Maurice succeeds in demonstrating a good faith reason for terminating Eli, Eli might still make trouble by claiming breach of an implied agreement. He could argue that the agreement, which offers a large bonus based on a calendar year's effort, impliedly prohibits Maurice from terminating at year's end any agent who is about to earn the bonus, unless the agent has engaged in misconduct.

If Maurice believes it essential to terminate the agency before year's end, in the long run Maurice may find it less expensive and less stressful to send with the termination notice an offer to pay the $25,000 bonus. ◂

Problem 50

May works as an agent for Broker, Inc. ("Broker"), a company that, for a commission, helps U.S. firms sell goods to foreign governments. May's responsibilities include traveling around the United States to try to persuade U.S. companies to use Broker's services. During one trip, May decides to go into business for herself. Aware (because Broker has told her) that the government of Argentina is seeking bids for major construction projects, May contacts a number of U.S. companies. She gets "in the door" as a representative of Broker, but once in she tells the companies that she will soon be providing the same services as Broker—and for a lower commission. She does not, however, close any deals for herself. At the end of the trip, May returns to Broker's home office and resigns. She explains her resignation by saying that her brother-in-law has offered her a job in the family upholstery business. May then promptly sets up her own firm, pursues the contacts she made on the last trip, and lands a number of lucrative contracts related to the Argentine project. Does Broker have any recourse against May? ◂

Explanation

Broker has a claim for disgorgement of May's profits. In two or perhaps three ways, May has breached her duty of loyalty. First, by promoting her own services in contrast to Broker's, she began to compete while still an agent. Second, she lied to her principal about her reasons for leaving. Third, her pursuit of contracts related to the Argentine project *may* have been a misuse of Broker's confidential information. Broker's information about the project certainly was of economic importance to Broker, but Broker would have to

show in addition that: (i) the existence of the project was not generally known; (ii) Broker had expended effort or expense to obtain the information; and (iii) Broker used reasonable means to protect the information.

Problem 51

Captain Miles Standish found himself deeply in love with "the damsel Priscilla." Unfortunately, Captain Standish was a shy fellow (except in matters of war) and could not find within himself the strength to approach Priscilla on his own behalf. He turned, instead, to his good friend John Alden. He asked Alden to visit Priscilla and express to her Standish's feelings.

Alden also loved Priscilla, but did not mention that fact to Standish. Instead, "[f]riendship prevailed over love," and Alden agreed to act on Standish's behalf. Alden went to Priscilla's house and explained his mission. Priscilla responded with the immortal words, "Why don't you speak for yourself, John?" Consistent with the principles of agency law, could he? If not, what could he have done to free himself to speak?

Explanation

Alden may not speak for himself right away. He has consented to act on Standish's behalf. He is therefore Standish's agent and has a duty of loyalty that bars selfish conduct. That he is acting gratuitously affects neither his status as agent nor his duty of selflessness. While he remains Standish's agent, Alden simply cannot advance his own cause adverse to his principal's interests.

If Alden wishes to respond to Priscilla's invitation, he must first "get out clean" from his agency. To do so, he must notify Standish that he (Alden) can no longer represent Standish's interests to Priscilla. Although Alden probably has no duty to disclose that he intends to compete for Priscilla's attention, he probably does have a duty to report to Standish what Priscilla has said. That information came to Alden during his agency, and he has reason to know that his principal would consider the information important. He therefore must communicate that information to his principal.

Once has he done so, he may terminate the agency. Then he may indeed speak for himself.[27]

1. As discussed previously, power is not the same as right. See sections 1.5.1, 4.1.3, and 4.1.6. Whether a particular revocation or renunciation is "rightful" depends on the contract overlaying the agency relationship. See section 5.2. If the principal lacks the power to terminate, no true agency exists. See section 6.2 (power coupled with an interest; authority [or power] given as security).
2. Jeff may nonetheless have the apparent authority to bind Irv. See section 5.3.1.
3. If the end of the agency means that Larry has breached an agreement with Howie, Howie may pursue contract remedies. See section 5.2. Nonetheless, the agency ends.
4. R.3d, §3.06, comment *d*.
5. See section 5.1.1.
6. Nonagency law may provide for such compulsion. For example, a state statute may protect sales representatives against unfair termination and may allow a court to order Marge's reinstatement.
7. In the employment context, this situation is known as *employment at will*, and the employment-at-will doctrine dates back more than a century. Many modern commentators have attacked the doctrine, and some courts have created exceptions relating, for example, to retaliatory firing of whistleblowers and to promissory estoppel. Statutory developments have also made inroads. Statutes prohibiting employment discrimination, for instance, do not directly require an employer to have "good cause" to terminate an employee but do prohibit an employer from terminating an employee for bad cause—i.e., in violation of the statutory rules prohibiting discrimination. For the most part, however, the employment-at-will doctrine remains intact. See Restatement (Third) of Employment Law §3.01 (T.D., 2006). ("Absent an agreement, statutory provision, or public-policy rule to the contrary, an employment relationship is terminable at the will of either party.").
8. Although an agency can exist without consideration, a contract generally requires consideration to be enforceable.
9. Rebecca is therefore liable for breach of the warranty of authority. See section 4.2.2.
10. Uniform Durable Power of Attorney Act §4 (1979) (applicable to written powers of attorney).
11. Uniform Durable Power of Attorney Act §2 (1987).
12. R.3d, §3.07, comment *d*.
13. R.3d, §3.07(2). R.3d, §1.04(4) defines "notice" as "A person has notice of a fact if the person knows the fact, has reason to know the fact, has received an effective notification of the fact, or should know the fact to fulfil a duty owed to another person."
14. R.3d, §3.08(1).
15. R.3d, §3.11, comment *b*.
16. See section 4.1.1.
17. However, customer lists can be confidential information. If so, a former agent will breach a duty by making use of the lists to compete with the former principal.
18. See section 4.1.1.
19. A valid "non-compete" agreement can make post-termination competition improper. See below.
20. See section 4.1.5.
21. See section 4.1.7 for a discussion of the principal's remedies for an agent's breach of the duty of loyalty.
22. It is immaterial whether May copies the list or commits it to memory. R.3d §8.05, Reporter's Notes, comment c.
23. See section 5.3.1.
24. As a matter of agency law, the notice need not explain why this change has occurred; as a matter of *defamation* law, the notice *should* not explain. (Even if the explanation were accurate and even though truth is a defense to a defamation claim, why invite trouble?)
25. See section 2.3.3 (agent has implied actual authority to accurately describe its authority to act for the principal).
26. R.2d, §8B(1)(b). See section 2.5. Note that this Explanation does not mention that Ventura would be breaching a duty if it purported to act for Ilan after receiving a termination notice. Although that

assertion is correct, see section 5.3.3, the breach of duty is not relevant to the issue presented.

27. It might seem at first glance that Alden may not use his knowledge of Priscilla's interest, because he gained that information during the agency. However, the information is not Standish's property; it is not confidential to Standish. Priscilla can rightfully disclose the information as she sees fit.

§6.1 AGENCY AND OTHER BENEFICIAL RELATIONSHIPS

§6.1.1 The Existence and Consequences of the Issue

There are myriad relationships in which one party benefits another, but not all "beneficial" relationships qualify as agency relationships. Consider, for example, the relationship between you and:

- the dry cleaner that cleans your wool sweater;
- the firefighter who carries you out of a burning building;
- the espresso cafe that feeds your caffeine habit;
- the law school that provides you a legal education;
- the bank that provides you a student loan; and
- the trustee who administers the trust fund established for you by your late, lamented, rich aunt.

In each of these relationships, the other party provides you benefits (goods, services, money) without becoming your agent. Likewise, an executor of an estate benefits the heirs and the conservator of a person benefits the

conservatee, but neither the executor nor the conservator are agents.

Agency *vel non*[1] is often a high-stakes issue because the agency label carries significant legal consequences. Indeed, disputes about the label are essentially disputes about those consequences. The consequences can follow from agency law itself or from the interaction of agency status and some other body of law.

Example

A grain elevator goes bankrupt owing money to local farmers and to the multinational company that provided the elevator a line of credit. The farmers try to establish that the elevator acted as the agent of the multinational company and not merely as a debtor. The farmers care about the "agent" label only as a means of establishing that the multinational company is liable for the debts incurred by the elevator. ◂

Example

A cattle rancher delivers cattle to a cattle company, which delivers the cattle to a meatpacker. The meatpacker pays the cattle company, but the cattle company fails to pay the rancher. The rancher seeks to characterize the cattle company as the meatpacker's agent and not an independent buyer/reseller, so that agency law attribution rules will make the meatpacker liable to the rancher for the unpaid contract. ◂

Example

A manufacturer markets its products by delivering them to intermediaries who then sell them to the ultimate users at a price dictated by the manufacturer. Accused of an antitrust violation known as "resale price maintenance," the manufacturer asserts that the intermediaries are its agents and not distributors, and so the resale price maintenance rule does not apply. ◂

Example

A service station operator obtains gas from an oil company and sells it to customers. The operator fails to pay for the gas and is charged with

embezzlement. The prosecution asserts that the operator was the oil company's *agent* and therefore (i) the proceeds from the sale belonged to the oil company, minus only the operator's agreed-upon commission, and (ii) the operator had a fiduciary duty to turn the proceeds over to the oil company. The operator defends by denying an agency relationship and asserting that a *buyer's* failure to pay for goods is not criminal. ◂

§6.1.2 Distinguishing Agency from Other Similar Relationships

Disputes over the existence of an agency relationship usually relate to one of the two fundamental characteristics of an agency: the principal's right of control or the fiduciary nature of the relationship. For an agency to exist, the party receiving the benefits must have the right to control at least the goals of the relationship, and the person providing the benefits must be acting "on behalf of" the person receiving the benefits.[2] A beneficial relationship that lacks either or both of these characteristics is not an agency.

The Party Providing Benefits Is Not a Fiduciary and Is Not Subject to Control The parties to most ordinary contracts fit into this category. The typical contract is an "arm's length" relationship. Neither party has consented to serve primarily the interests of the other; to the contrary, each party has entered into the contract to further its own interests. Neither party has manifested assent to act "on behalf" of the other, and the contract does not contemplate one party having any "power to subject the [other party] to personal liability" to third parties.[3] Both parties are subject to the obligations of the contract, but that control device is a product of the agreement between the parties.

The R.2d uses the term "independent contractor" to refer to a person who provides benefits to another under a *nonagency*, contractual relationship.[4] However, that usage is confusing because the R.2d also uses the same words to describe *agents* who are not servants: that is, "independent contractor agents."[5] The R.3d eschews the term "independent contractor" entirely and substitutes "nonagent service provider" and "nonemployee agents."[6]

A building contractor is often described as the classic example of an independent contractor (or, in R.3d terms, a nonagent service provider). However, *most* commercial and consumer relationships involve nonagent

service providers.

Example

Exhausted but exalted after completing your final exams, you decide to go to a local shopping mall for some "R & R." Contemplating the eventual consumption of alcoholic beverages, you decide to take the bus rather than drive. The bus company is a nonagent service provider. ◂

Example

When you are at the mall, you enter Sharon's Custom T-Shirts and purchase a custom-made T-shirt that says, "I Survived the Rule Against Perpetuities." Sharon's relationship to you as she prepares and sells the T-shirt is that of an independent contractor. ◂

Example

Slipping on your new T-shirt, you proceed to Don't Doubt This Thomas—Homemade Desserts, where you purchase a dish of peach cobbler, which is handed to you by Malika, the general manager of the store. Malika is an agent of the store, but the store is acting as an independent contractor when it provides you the peach cobbler. ◂

An escrow arrangement provides a more specialized example. When two parties agree that a third will hold an item of value (e.g., money, stock, a deed) until specified conditions are met and then deliver the item per the agreement, the item is considered in escrow and the third party is the escrow holder. Neither of the escrow parties has a right to control the escrow holder, who is obligated only to perform as the escrow agreement requires. The escrow holder does not act primarily for the benefit of either party to the escrow agreement, but rather acts to fulfill its own obligations. The escrow holder is therefore not an agent.

The Party Providing the Benefits Is Subject to Control but Is Not a Fiduciary Under some contracts, one party may have substantial control over the conduct of the other, but the relationship is still not an agency. The "on behalf of" (fiduciary) element is missing, and the control is not general.[7]

Distributor of goods and its supplier. Some distribution agreements

give the supplier considerable control over the distributor, regarding, for example: (i) where the distributor can resell the goods; (ii) how the distributor may advertise the goods, and (iii) what kinds of after-sale service the distributor must provide. The distributor is not the supplier's agent, however, because the relationship's primary purpose is not to benefit the supplier. In this arm's-length transaction, each party's own interest is primary to that party.[8] Moreover, the supplier does not have the overarching right to control the goals of the relationship.

Supplier of specially designed goods and its customer. In some circumstances, a customer will exercise considerable control over its supplier. For example, if the customer is buying components from the supplier to incorporate into the customer's own products, the customer may (i) design the component; (ii) specify the raw materials the supplier is to use; and (iii) even insist on the right to monitor the supplier's production activities. The supplier is not the customer's agent, however, because the relationship's primary purpose is not to benefit the customer. In this arm's-length transaction, each party to the relationship seeks its own benefit, and neither party's benefit is primary to the other party.

The Party Providing the Benefit Is a Fiduciary but Is Not Subject to Control Trustee of a trust and the trust beneficiary. The trustee is obliged to act solely for the benefit of the beneficiary, but the beneficiary does not have the right to control the trustee.

Conservator and conservatee. Appointed by a court to take care of the financial affairs or personal decisions (or both) of an incompetent person, the conservator is obliged to act in the best interests of the conservatee. The conservatee has neither the right nor power to control the conservator.

Directors of a corporation and the corporation. Although the directors do owe duties of loyalty to the corporation, the corporation does not control the directors. To the contrary, the directors control the corporation.[9]

§6.2 ERSATZ AGENCY

In two related circumstances, what may appear to be an agency is in fact a different, *irrevocable*, nonagency relationship. In each situation:[10]

- one person grants another the right to bind the grantor and lacks the power (not merely the right) to revoke that grant;
- the authority to bind is granted *not* to benefit the grantor (i.e., the party who seems like a principal), but rather to benefit the grantee (i.e., the party who seems like the agent); and
- the grantee (not the grantor) is in charge.[11]

The two circumstances have traditionally gone under the names of "agency (or power) coupled with an interest" and "authority (or power) given as security." The R.3d treats the former concept as encompassed within the latter[12] and provides this black letter definition:

> A power given as security is a power to affect the legal relations of its creator that is created in the form of a manifestation of actual authority and held for the benefit of the holder or a third person. It is given to protect a legal or equitable title or to secure the performance of a duty apart from any duties owed the holder of the power by its creator that are incident to a relationship of agency….[13]

Because many jurisdictions still treat the two concepts separately, and because the "coupled with an interest" concept has "a distinguished lineage,"[14] the following sections separately describe the two concepts.

Whichever concept applies, under whatever name, the salient purpose of the relationship is to protect or otherwise benefit the grantee, and the key practical consequence is irrevocability. While in a true agency the principal always has the power to revoke the agent's authority, the concepts discussed here involve irrevocable grants. "If the creator of a validly created power given as security purports to revoke the holder's authority contrary to the agreement pursuant to which the creator granted the power, specific enforcement of the holder's rights is an appropriate remedy, subject to the court's discretion in granting an equitable remedy."[15]

§6.2.1 Power Coupled with an Interest

For a power to be coupled with an interest:

- the grantee's power (i.e., the authority to bind, which appears like agency authority) must relate to some particular right or other property; and

- the same transaction that establishes the grantee's power must also provide the grantee some "interest" in that particular right or other property.[16]

Example

Ophelia owns 200 acres of land. To induce Hamlet to sell the land for her, she gives him an undivided one-tenth interest in the land, coupled with an irrevocable power of attorney to sell her interest at any price above $500 per acre. Hamlet's power relates to the land, and he has received that power at the same time he has received an interest in the land. The power is coupled with an interest and is irrevocable. Hamlet is not Ophelia's agent. ◂

For the power to be "coupled with an interest," the power and the interest must relate to the same aspect of the particular property. If the grantee receives an interest not in the underlying property itself, but rather in the proceeds that result from the grantee's exercise of the granted power, then a true agency results and the grantee's authority is revocable.

Example

As above, Ophelia owns 200 acres of land and wishes to have Hamlet sell them for her. Instead of giving him an interest in the land, however, she sends him a letter: (i) giving him a right to 30 percent of the sale price over $300 per acre; and (ii) purporting to grant him irrevocable authority to sell the land for $300 or more per acre. Hamlet's power is not coupled with an interest. His power relates to the land, and his interest relates only to the proceeds of the sale of the land. Hamlet is Ophelia's agent, and despite the letter his authority is revocable.[17] ◂

A power coupled with an interest survives the death of the grantor.

§6.2.2 Authority (or Power) Given as Security

If:

- an obligor owes a debt or other obligation to an obligee; and
- in order to provide the obligee with security the obligor grants the

obligee a power to bind the obligor; then:
— no agency is created;
— the power is "given as security;" and
— the power is irrevocable during the life of the obligor.[18]

Example

Ophelia, in Dunsinane, appoints Hamlet as her agent to sell 700 crates of oranges being stored in a warehouse in Elsinore. Hamlet informs Ophelia that $500 of storage fees must be paid or the warehouse will sell the oranges. Ophelia has no funds available, and Hamlet agrees to advance the $500. To secure her obligation to repay Hamlet, Ophelia grants him the irrevocable right to collect all payments on the oranges and to repay himself from those proceeds before sending any money to Ophelia. The relationship between Ophelia and Hamlet is no longer an agency. Instead, Hamlet possesses a power given as security, which is irrevocable except through the death of Ophelia. ◂

In the above Example, the power given as security is *not* a power coupled with an interest. Hamlet has no interest in the underlying property (i.e., the oranges). Often, however, circumstances will satisfy both concepts, and a power given as security will also be a power coupled with an interest.

Example

Hamlet borrows money from Ophelia, and as collateral grants Ophelia a security interest[19] in 100 shares of stock in Birnam Forest, Inc. Hamlet also grants Ophelia his proxy to vote the stock. The proxy is "given as security" for the debt and is therefore irrevocable except by Hamlet's death. Moreover, since the same transaction that granted Ophelia the proxy also gave her a security interest in the underlying property, the proxy is "coupled with an interest." The proxy is therefore irrevocable even if Hamlet dies.[20] ◂

Whether a stock proxy is revocable also depends on the rules contained in the statute governing the corporation whose stock is involved.[21]

§6.3 CONSTRUCTIVE AGENCY

§6.3.1 The *Cargill* Case and R.2d, §14 O

Sometimes a court construes a seemingly arm's-length arrangement into an agency relationship. The case of A. Gay Jenson Farms v. Cargill, Inc.[22] provides one of the best-known examples of such *constructive agency*.[23]

Cargill arose from the financial collapse of the Warren Grain & Seed Co. ("Warren"), a grain elevator located in rural Minnesota. Warren was in the business of buying grain from farmers and then reselling that grain on the market or directly to grain companies. Cargill, Inc., financed the operations of Warren (i.e., Cargill loaned the elevator money with which to operate) and also bought substantial amounts of grain from Warren. As Warren's debt to Cargill increased, Cargill exercised more and more control over Warren's operations.

Warren's owners diverted large amounts of the company's money to their personal ends, and Warren's business eventually collapsed. At the time of the collapse, Warren owed $2 million to farmers who had sold grain to Warren but had not been paid. Warren also owed $3.6 million to Cargill.

The farmers sought to recover their $2 million from Cargill, contending that: (i) Warren was Cargill's agent; and (ii) Cargill, as principal, was liable on any grain contracts made by its agent. The jury, the trial judge, and the Minnesota Supreme Court all agreed.

Although *Cargill* quoted and purported to apply both R.2d, §1 and R.2d, §14 O, the decision turns on the latter. Comment *a* to §14 O states in part:

> A security holder who…takes over the management of the debtor's business…and directs what contracts may or may not be made…becomes a principal, liable as any principal for the obligations incurred thereafter in the normal course of business by the debtor who has now become his general agent. The point at which the creditor becomes a principal is that at which he assumes de facto control over the conduct of his debtor, whatever the terms of the formal contract with his debtor may be.

The *Cargill* decision held that Cargill had indeed taken over the management of the debtor's business and had consequently become liable as a principal for Warren's debts to the farmer plaintiffs.

The R.3d contains no analog to R.2d, §14 O, and dismisses *Cargill* as "[a]n unusual example…contrary" to the well-established proposition that "[c]ontrol, however defined, is by itself insufficient to establish agency."[24] However, the case remains a favorite of casebook editors and provides a useful lesson in distinguishing true agency from other relationships.

§6.3.2 *Cargill*: Conceptual Confusions and Practical Concerns

The *Cargill* case is troubling both conceptually and practically. The court tries to justify its decision under R.2d, §1, as well as under §14 O, and thereby confuses constructive agency with true agency. Practically, the decision is dangerous for any creditor that eschews immediate foreclosure of a problem loan and tries instead to guide its debtor through a workout.[25]

Constructive versus Genuine Agency *Cargill* is confusing because it misunderstands the relationship between R.2d §§1 and 14 O. Although both sections concern agency creation, they apply to quite different situations and state different and even inconsistent rules.

For an agency to exist under R.2d, §1, the principal must manifest consent for the agent to act on the principal's behalf, and the agent must manifest consent to do so. R.2d, §15 states that "an agency relation can exist *only*" under such circumstances.[26] Yet R.2d, §14 O also establishes agency status and nowhere mentions consent. Instead, §14 O focuses exclusively on control.

The inconsistency exists because the R.2d uses the same label ("agency") to describe two different kinds of situations:

(1) "garden-variety" situations, in which the parties act in a manner that reasonably suggests they intend to establish the consensual and fiduciary relationship of true agency; and
(2) extraordinary situations, in which for policy reasons the law wishes to treat creditors and debtors *as if* they had manifested consent to the garden variety of agency.

The situations share a key consequence[27]—the principal's liability on contracts made by the agent—but the criteria that trigger the consequence are fundamentally different. For the garden-variety situation, mutual consent; for the extraordinary situation, overbearing control.[28]

The rationales underlying the rules are likewise different. With a true agent, acting within its actual authority, liability arises at least in part from consent. In the extraordinary, §14 O situation, liability arises for reasons akin to the rationale for inherent agency power. That is, liability follows control, because (i) those who exercise control have the ability to avoid harm and

should therefore be liable when avoidable harm occurs and (ii) when an undertaking causes harm to others, the cost of that harm should be borne by those who stand to benefit from the undertaking, and typically it is those in control who stand to benefit.

The *Cargill* decision concerns an extraordinary situation, and the opinion becomes confusing when it seeks to apply the garden-variety rule (manifestation of consent; fiduciary relationship) as well as the extraordinary rule (exercise of control). Referring, for instance, to the *principal's* manifestation of consent, *Cargill* states, "By directing Warren to implement its recommendations, Cargill manifested consent that Warren would be its agent."[29]

This assertion seems to equate control with consent. If party *A* controls party *B*, then through that control *A* manifests consent that *B* act for *A in dealing with third parties*. Although such an inference may often be reasonable, it is not necessarily so. For example, a department store may control in detail the work assignments of a custodian without consenting to the custodian placing orders with dress manufacturers.

Equally troubling is the decision's treatment of the *agent's* manifestation of consent. In this respect, the question is whether Warren manifested consent to place Cargill's interests above its own; that is, consented that the primary purpose of the relationship was to serve Cargill rather than Warren. The *Cargill* court never mentions any direct evidence on this point. Instead, the decision states: "Cargill did not think of Warren as a operator who was free to become Cargill's competitor, but rather conceded that it believed that Warren owed a duty of loyalty to Cargill."[30]

The logic here is flawed. An agent's duty of loyalty includes the duty not to compete, but an agreement not to compete does not by itself establish either a full-fledged duty of loyalty or a fiduciary relationship. A party's agreement to defer to another party's interest in one specific area neither constitutes nor implies an agreement to defer to that other party's interest throughout the relationship. In particular, non-compete agreements occur in many arm's-length relationships.

The *Cargill* decision would have been considerably clearer if the court had simply stated, "This situation warrants constructive agency analysis. Therefore, R.2d, §14 O applies, and therefore R.2d, §1, with its garden-variety criteria for establishing true agency, is irrelevant."

Dangers for Workouts In applying R.2d, §14 O, the *Cargill* court noted a number of factors that evidenced Cargill's control over Warren. The court acknowledged that many of these same factors appear in ordinary debtor-creditor transactions, but assured the banking community that ordinary delinquent loans were not destined to turn into principal-agent relationships.

To support its assurances, the court noted the following differences between the Warren-Cargill relationship and an ordinary lending situation: (i) Cargill aggressively financed Warren; (ii) Cargill "was an active participant in Warren's operations rather than simply a financier"; (iii) Cargill's relationship with Warren was "paternalistic"; and (iv) Cargill's purpose, in lending money to Warren "was not to make money as a lender but rather to establish a source of market grain for its business."[31]

Of the four distinctions noted by the court, the first three (aggressive financing, involvement in the debtor's operations, a "paternalistic" attitude) occur in most workouts. The fourth purported distinction—that Cargill was really "in it" not for the interest but rather to obtain a supply of grain—is irrelevant under §14 O. That provision makes no reference at all to the creditor's purpose in becoming a creditor.

Moreover, there are many lending relationships in which the lender seeks more than interest payments. A company like GMAC, for example, lends money to General Motors car dealers in part to allow them to buy cars from GM, and lends money to the dealers' customers in order to allow them to buy GM cars from the GM dealers. Is GMAC in it just for the interest, or does GMAC have the ulterior motive of increasing the marketability of GM cars?

In sum, the *Cargill* court's attempt to distinguish the Cargill-Warren situation from normal debtor-creditor relationships is unpersuasive. For lenders considering workouts, the case is a cautionary tale.[32]

Problem 52

A homebuyer ("Would-Be") contacts a real estate broker ("Broker") and solicits her assistance in locating a suitable property. Would-Be seeks a modern, upscale house with enough land to allow the installation of a swimming pool. Over the next two months, Broker calls Would-Be frequently to discuss possible purchases, and occasionally goes with Would-Be to view properties. Eventually she locates a house that Would-Be decides

to purchase. As Would-Be contemplates making the purchase, Broker explains, “My fee comes from the seller. It’s no big deal. That’s the way we do it. So you can figure out the price you’re willing to pay without worrying about a commission.”

Would-Be makes the purchase and subsequently discovers that his neighbors will raise zoning law objections to any pool. He also learns that the lower portion of his land is subject to flooding during the early spring. He sues Broker for not having informed him of these problems.

Assume that:

- Broker never thought of herself as Would-Be’s agent, and never intended to act on Would-Be’s behalf. She saw herself as acting at “arm’s length” from him.
- Would-Be, in contrast, believed all along that Broker was “on my side, looking out for my interests.”
- When Would-Be expressed serious interest in the house he eventually purchased, Broker contacted the seller and arranged to act as the seller’s agent in the transaction.
- Other than her comment about the seller paying her fees, Broker never explained to Would-Be her view of her relationship to Would-Be. She never disclosed that she was acting as the seller’s agent.
- Broker’s view of the relationship is consistent with the way real estate brokers in the locality ordinarily approach similar matters.
- Broker knew that the neighbors would probably object to the building of a pool, but never mentioned anything about that problem to Would-Be.
- Broker did not know about the flooding, but could have discovered the problem through the exercise of ordinary care.
- Broker never made any representations to Would-Be concerning the pool or the flooding.
- There are no statutes or government regulations relevant to this situation.[33]

Can Would-Be recover from Broker? ◂

Explanation

Since Broker made no representations about the pool or the flooding, Would-Be can recover from Broker only if he can establish that Broker had an affirmative duty to disclose. Moreover, as to the flooding problem, Would-Be will also have to establish that Broker had a duty to inquire.

Both duties existed if Broker was acting as Would-Be's agent.[34] To establish that agency relationship, Would-Be must show: (i) some manifestation from him that, reasonably interpreted, indicated his desire to have Broker act on his behalf; and (ii) some manifestation from Broker that, reasonably interpreted, indicated Broker's "consent…to so act."[35] The first showing is easy: Would-Be expressly and specifically solicited Broker's assistance. As for Broker's manifestation, her two months of effort provide at least a "peppercorn."

Broker's subjective view of the situation is irrelevant. What matters is the reasonableness of Would-Be's interpretation, and on that point the evidence is mixed. The local custom *as known to brokers* may weigh against reasonableness, but reasonableness is determined from the perspective of an ordinarily prudent person *in the position of the principal*. The facts do not indicate whether the brokers' custom is generally known and understood by ordinary homebuyers.

The payment arrangement may also weigh against reasonableness. If Broker was looking out for Would-Be's interests, why would someone else—especially the adverse party—be paying the fee? Although with the principal's consent an agent may receive compensation from a third party, arguably the circumstances were unusual enough to prompt a reasonable person to inquire.

Despite this negative evidence, Would-Be may still prevail by pointing to Broker's conduct as a whole. Would-Be sought out Broker and asked for her assistance. For two months Broker provided that assistance without once indicating her arm's-length attitude. Moreover, when—at the crucial moment—Broker pledged allegiance to the adverse party, she failed to warn or even advise Would-Be. To the contrary, she induced his continuing trust by treating the fee question as "no big deal." Taking all these circumstances together, perhaps it was reasonable for Would-Be to believe that Broker had agreed to act on his behalf.

If so, Broker was acting as Would-Be's agent and was subject to duties of disclosure and due care. Broker would therefore be liable for damages suffered by Would-Be due to Broker's failure to disclose the zoning difficulty

and for her failure to discover and disclose the flooding problem.[36]

Problem 53

Tim buys a new truck from a local car dealer. The dealer purchases its truck inventory from the manufacturer under a dealership agreement. That agreement: (i) states that the dealer is an independent contractor and not the agent of the manufacturer; (ii) acknowledges that the dealer, not the manufacturer, controls the management of the dealer's business; (iii) describes the six-year warranty that the manufacturer extends to customers who purchase the manufacturer's trucks through the manufacturer's network of dealers; (iv) obligates the dealer to provide service under the manufacturer's warranties at no charge to the customers; and (v) provides that the dealer will bill the manufacturer for this warranty service at specified rates. Each new truck comes with an owner's manual that describes the manufacturer's warranty and directs customers to have warranty service performed at any of the manufacturer's authorized dealers.

Tim is quite happy with his purchase for the first week. Then a problem develops in the truck's steering. Tim immediately notifies the dealer and brings the truck in for repair. Over the next two years, the truck has a series of problems with its steering mechanism. Each time a problem occurs, Tim brings the truck back to the dealer, and the dealer attempts to fix the problem. Each time the dealer assures Tim that "this is under warranty" and there is no charge. After two years, however, Tim has had enough. He decides to sue the dealer for breach of warranty and wishes also to sue the manufacturer.

Under the jurisdiction's version of the Uniform Commercial Code, a remote buyer (such as Tim) can bring a breach of warranty claim against the remote seller (such as the manufacturer) if the remote buyer has given timely notice of the defect to the remote seller or the remote seller has knowledge of the defect.[37] Tim has told the dealer of the problems as they have occurred, so the dealer has known of the defect since one week after the sale. Tim has never informed the manufacturer, however. Under the jurisdiction's case law, it is now too late to first notify the manufacturer. May Tim nonetheless bring a warranty claim against the manufacturer?

Explanation

To safeguard his claim against the manufacturer, Tim must show that his notice to the dealer suffices as notice to the manufacturer. To do that, he must use the attribution rules of agency law.

The agreement between the manufacturer and dealership expressly disclaims agency status, but the parties' actual relationship belies their words, at least with regard to the manufacturer's warranty program. Through its customer warranty, the manufacturer undertook to provide services to Tim. Through its dealership agreement, the manufacturer manifested consent for the dealer to provide those services on the manufacturer's behalf and the dealer manifested consent to do so. For the purposes of providing warranty service, the dealer is indeed the manufacturer's agent.

Under this agency relationship, the dealer may have implied actual authority to receive notices of defects on the manufacturer's behalf. Implied actual authority exists as acts "which are incidental to…, usually accompany, …or are reasonably necessary to accomplish" expressly authorized acts,[38] and a customer typically invokes the manufacturer's warranty (and triggers the dealer's expressly authorized act) by communicating with the dealer. Notice received within an agent's actual authority (express or implied) binds the principal.

Even if the dealer is not authorized to receive notice on the manufacturer's behalf, the dealer's knowledge of the defect binds the manufacturer. The defect information certainly concerns a matter within the dealer's actual authority and is therefore attributed to the principal.[39]

Problem 54

Fred Hornet ("Hornet") is a midlevel manager at Commerce Bank whose responsibilities include evaluating applicants for business loans. For the past several years, Hornet has been trying to persuade the Loan Committee (a committee of five senior managers that must approve any business loan) to take a more accommodating attitude toward loan applications from female- and minority-owned start-up businesses. The discussion has proceeded through several stages, with the key points being roughly as follows:

> **Hornet:** Our regular evaluation criteria make it highly unlikely that we will approve loan applications from minority-owned or female-owned businesses. We put a lot of weight on whether the key people in the new business have any significant prior entrepreneurial experience. It's a matter of history that, for women and minorities, access to that type of experience has been far more difficult to obtain. It's important morally, and for the social stability of our country, that we

increase the access. As a practical matter, that access depends fundamentally on being able to borrow money. The way we're going now, though, it's a vicious circle. Can't borrow the money because not enough experience. Can't get experience running a small business because can't borrow any money to get one started. This bank quite rightfully prides itself on being "a good corporate citizen." To live up to our own ideals we need to relax our emphasis on prior entrepreneurial experience.

Loan Committee: We're with you in spirit, but we also have a responsibility to our stockholders and our depositors not to be careless in lending money. We have found that a lack of "prior entrepreneurial experience" tends to increase the likelihood of a loan going bad. What can you suggest to offset the increased risk?

Hornet: First, more rigorous attention to the application process—the applicant's proposed business plan, for instance. But, more importantly, I suggest an increased commitment at the bank to keeping an eye on these businesses. If we think that trouble is developing, we'll get in and work with the people—provide them advice, make sure they're using sensible business practices. In other words, if we find out that a lack of entrepreneurial experience is beginning to cost them (and threatening their ability to pay us back), we'll temporarily roll up our sleeves and help provide them the expertise that comes with experience. I realize that this approach involves an extra commitment of resources, but I think it's worth it.

Loan Committee: What if the borrowers don't want our help?

Hornet: I think for this program to work we have to be up front with the people, and tell them when they apply what might happen if things go sour later on. Also, we have to choose to lend to people whom we think will be willing to take help. Finally, under our standard loan agreements, if push comes to shove, we have the right to take control.

The Loan Committee is just about convinced to give Hornet's approach a try. Assume that they turn to you, as the Bank's lawyer, and ask, "Are there any legal wrinkles?" Advise them by: (i) identifying and explaining any legal risks involved in Hornet's proposal; and (ii) suggesting changes in the proposal that will decrease those risks without sacrificing the business objectives. ◂

Explanation

Cargill and R.2d, §14 O appear to create a Hobson's choice for the bank. Measures designed to meet the bank's business needs seem destined to

increase the bank's legal risk. Moreover, the legal risks will be most substantial just when the business needs are the most intense. The bank is most likely to exert control when a borrower has fallen behind in its loan payments. At that juncture, the borrower is likely also to be falling behind in its obligations to other creditors. Exerting control will create a *Cargill* claim, and the other obligations will constitute the damages.

The solution to this conundrum lies in analyzing Hornet's proposal and separating, as follows, the tactical objective, the tactics proposed to achieve that objective, and the rationale that links those tactics to that objective:

- *Tactical objective:* Increase the quality of the borrower's management, especially at times of financial distress.[40]
- *Rationale:* All other things being equal, inexperienced management is likely to be less effective than experienced management. A firm, experienced hand is especially necessary when a business is trying to "work out" from under financial difficulties.
- *Tactics:* Empower the bank to be that firm, experienced hand.

This analysis indicates the source of the legal risks within Hornet's proposal and thereby suggests a way to reduce those risks. R.2d, §14 O problems arise from control, and within Hornet's proposal the only flavor of control comes from the proposed tactics. Taking the tactical objective and the rationale as given,[41] the lawyer's challenge is to find substitute tactics that lack that flavor. In other words, to find another firm, experienced hand.

For example, the loan agreement might require the borrower to designate an experienced business consultant, acceptable to the Bank, to advise the borrower on an ongoing basis, and temporarily turn over management of the business to that consultant (or some other independent business expert chosen by the Bank), if: (i) the borrower falls behind in its loan payments or gives the Bank other reasonable grounds for insecurity; and (ii) the Bank elects to require the management change. These arrangements would of course require the agreement of the specified consultant and experts, but that agreement could be obtained in advance. The loan agreement could also provide mechanisms for choosing replacements in case the designated individuals become unable or unwilling to serve.

In all events, it would be essential for the consultant and the expert to remain independent of the Bank. If the Bank controls them, they could be

deemed the Bank's agents and *Cargill* could apply by attribution. The loan agreement should therefore provide that the consultant and the expert will each: (i) work for and be paid by the borrower, not the Bank; and (ii) have a duty to serve the best interests of the borrower, not the Bank. It should also provide that the Bank will have no right to control the advice given or the decisions made by either the consultant or the expert. The rationale and importance of these provisions should be explained to those Bank employees who deal with the borrower, so that the Bank's conduct (through those employees) conforms to these restrictions.

This structure is admittedly more cumbersome than Hornet's proposal and certainly provides less direct control for the Bank. The structure's virtue is that it significantly reduces the Bank's legal exposure while still serving the basic tactical objective of Hornet's plan.[42]

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1. This Latin phrase means "or not" and is a very useful term of art because so many points of legal analysis involve "yes/no" characterizations.
2. These characteristics are introduced in sections 1.2.7 and 1.2.8.
3. R.2d, §12 (Agent as Holder of a Power), comment *c*. See also R.3d, §1.01, comment *c*. ("The common-law definition requires that an agent hold power, a concept that encompasses authority but is broader in scope and connotation.").
4. R.2d, §14 N, comment *b*.
5. R.2d, §14 N, comment *a*.
6. R.3d, §1.01, comment *c*.
7. Some courts, seeking the liability consequences that attach to the agency label, will ignore the fiduciary element of the agency relationship and find agency based on control alone. See section 3.2.4 (explaining how "servant" status is not necessarily a subcategory of "agent" status, because, in the context of *respondeat superior* claims, some courts make the servant determination without first considering whether the tortfeasor is an agent of the alleged master) and section 6.3 (discussing R.2d, §14 O and the *Cargill* case).
8. Also, some arguably crucial aspects of control are lacking, such as (in most circumstances) the power to set the distributor's resale price.
9. Some commentators describe directors as the agents of the shareholders (i.e., of the people and organizations who own stock in the corporation). Although used in this way the agency concept helps analyze certain corporate law issues, the usage does not fit with the common law definition of agency. Shareholders have the right to exercise only limited and intermittent control over the directors.
10. From the German, meaning "seeming proper but actually not genuine."
11. This description states the default rules. The parties may agree to provide the grantor a right of revocation.
12. R.3d, §1.04, comment *f* ("A power coupled with an interest is an instance of a power given as security.").
13. R.3d, §1.04(6).
14. R.3d, §3.12, comment *c*.
15. R.3d, §3.12, comment *b*.
16. R.3d, §3.12, comment *c*, notes that, under this rubric, "it is necessary that a power holder possess a

proprietary interest in the 'subject matter of the agency itself.' This test also requires that the power and the proprietary interest be united in the same person."
17. "An agent's interest in being paid a commission is an ordinary incident of agency and its presence does not convert the agent's authority into a power held for the agent's benefit." R.3d, §3.12, comment *b*. The letter probably does obligate Ophelia to refrain from revoking. She nonetheless retains the power to revoke. See section 5.2 (power versus right to terminate).
18. Under R.3d, §3.13(2)(e), in most circumstances this type of power would also survive the obligor's death.
19. A security interest is like a mortgage on personal rather than real property.
20. By its terms the proxy will likely be automatically revoked when the underlying debt is paid.
21. E.g., West's Ann. Cal. Corp. Code §705(e); McKinney's Business Corporation Law §609(f).
22. A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285 (Minn. 1981).
23. The term "constructive agency" is the author's.
24. R.3d, §1.01, Reporter's Notes to comment (f)(1) ("In the debtor-creditor context, most courts are reluctant to find relationships of agency on the basis of provisions in agreements that protect the creditor's interests.").
25. When a debtor has difficulty paying its major lender, the lender can typically demand immediate payment of the full amount due, foreclose on any collateral, and put the debtor out of business. However, with that approach lenders rarely recover the full amount owed. Lenders therefore often try to help the debtor work its way out of its financial difficulties. Hence the term *workout*.
26. Emphasis added. Although, as stated above, the R.3d has no analog to R.2d, §14 O, R.3d, §§1.01 and 1.02 combine to reiterate the point made by R.2d, §15.
27. In the extraordinary situation, the agency label does not produce all of the consequences that attend that label in the garden-variety situation. For example, §14 O the debtor, as agent, owes a fiduciary duty to its principal, the creditor.
28. The control is "overbearing" in the sense that the creditor "takes over the management of the debtor's business." R.2d, §14 O, comment *a*.
29. 309 N.W.2d at 291.
30. 309 N.W.2d at 292.
31. 309 N.W.2d at 292-293.
32. Although any informed attorney representing lenders will think about *Cargill*, few other reported cases have taken the *Cargill* approach. Only 10 reported decisions have discussed R.2d, §14 O. Only one affirmed recovery for the plaintiff, and another reversed summary judgment for the defendant. One case, Buck v. Nash-Finch Co., 102 N.W.2d 84 (S.D. 1960), acknowledged that a major creditor had controlled substantial portions of the debtor's operations, but denied recovery because the major creditor had not controlled the particular area of operations that gave rise to the plaintiff's claim. Compare section 3.2.5 (*respondeat superior* liability attaches to servant's scope of employment not to master's zone of control). Another case held that section 14 O imposed liability only when the controlling creditor had engaged in wrongdoing. Mere control was insufficient. Lubrizol Corp. v. Cardinal Construction Co., 868 F.2d 767 (5th Cir. 1989).
33. Many jurisdictions now have statutes or regulations governing this type of situation.
34. See sections 4.1.5 (agent's duty to disclose information that agent knows or should know is of interest to the principal) and 4.1.4 (agent's duty of care).
35. R.2d, §1.
36. Note that if Broker was acting as Would-Be's agent, she has a "dual agency" problem. See section 4.1.1 (no acting for others with conflicting interests).
37. See Uniform Commercial Code §2-318 (third party beneficiaries of warranties) and §2-607(3)(a) (buyer must give timely notice of breach or be barred from remedy) and comment 5 (requirement of timely notice applies to remote buyer making third party beneficiary claim).
38. R.2d, §35. See section 2.2.4.

39. See section 2.4.4. Tim might also assert that the dealer has apparent authority to receive notices for the manufacturer. This argument seems weaker than the actual authority arguments, because Tim can point to only two relevant manifestations of the principal: the appointment of the dealer as an authorized seller of the manufacturer's trucks, and the direction in the owner's manual that customers have warranty work done at the manufacturer's authorized dealers. From these manifestations it is reasonable to believe that the dealer is authorized to act for the manufacturer in providing warranty service, but not necessarily that the dealer is authorized to accept pre-suit notices on the manufacturer's behalf.

40. The tactical objective is intended to make possible the pursuit of another objective—increasing the bank's lending to minority- and female-owned businesses.

41. It might be possible to propose additional options for the Bank by challenging the rationale. That approach is not pursued here, however, because that kind of analysis presupposes considerable familiarity with the way businesses function.

42. This approach will not work, however, if the Bank's objectives include causing the borrower to prefer the Bank's claims over the claims of other creditors. If that is an objective, *Cargill* exposure is probably inevitable and appropriate.

EMPLOYMENT LAW HANDBOOK FOR NON-LAWYERS

COMMITTEE ON
LABOR AND EMPLOYMENT LAW

AUGUST, 2006

THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK
42 WEST 44TH STREET, NEW YORK, NY 10036

EMPLOYMENT LAW HANDBOOK
FOR NON-LAWYERS

This handbook is designed to assist individuals who have legal questions about their rights in the workplace. Work, of course, is the place where we spend the majority of our waking lives, and frequently individuals believe that they have been treated unfairly and seek redress.

Most of the time, individuals are able to resolve work problems at work, and have no need for the intervention of the courts or an administrative agency. However, sometimes individuals are simply unable to resolve their work place problems and believe they need some sort of intervention. This pamphlet is designed to provide a brief introduction to those individuals who feel they have a workplace problem and believe they require outside assistance.

Unfortunately for non-lawyers – and occasionally for lawyers as well – the field of labor and employment law can be extremely complex. The law of the work place is governed by a mixture of Federal, State, and City statutes, some of which over-lap, and some of which are mutually exclusive. An individual who believes that he or she has a problem at work has to determine a method for resolving the problem.

Among the questions that you will need to resolve in determining your rights are:

1. Do I work under a union contract, an individual employment contract, or am I an employee at will?
2. Am I a victim of discrimination in regard to race, sex, age, religion, disability, sexual orientation?
3. Is there an agency or court to which I can turn to resolve my problems? Is there more than one agency or court? What are the comparative advantages or disadvantages of choosing one forum over the other?

Because of the complexity of the issues, this handbook is largely limited to private sector employees. However, the appendix includes some information for public sector employees. See Appendix A.

While this handbook will not provide precise direction, we hope that this booklet can guide you toward making the appropriate decision.

SECTION I: AM I AN EMPLOYEE AT WILL OR AM I COVERED BY A UNION CONTRACT? DO I HAVE AN INDIVIDUAL CONTRACT OF EMPLOYMENT?

Most employees in New York State are considered to be employees at will. Employees at will do not have individual written contracts with their

employers, nor are they working under a union contract. It sounds harsh, but employees at will may have the terms of their employment changed at any time. They may quit at any time and they can be disciplined or discharged for any reason or no reason. However, employees at will may not be discharged or disciplined for an illegal reason. As this handbook will demonstrate, there are a number of Federal, State and City statutes that protect your rights in the workplace. If you are an employee at will, in order to successfully assert the rights guaranteed by the statutes, you must be able to demonstrate that your employer in some way violated the law. There have been limited exceptions to the Employment-at-will doctrine, but they are extremely rare.
(See Section III).

Employees who have individual written contracts of employment or who are covered by a union contract frequently have far greater protections. This is because their union contracts or individual employment contracts frequently contain restrictions placed on their employers' ability to impose discipline.

In order to enforce an individual contract of employment, you may have to sue in court. In addition, individual contracts and almost always collective bargaining agreements contain mechanisms for resolving disputes. Frequently individual employment contracts provide for some form of alternate dispute resolution, usually arbitration. Certain contracts provide that disputes arising under the contract will not be resolved in court, but instead submitted to an arbitrator or a panel of three arbitrators to resolve the dispute. Arbitrators are independent and neutral people selected by the parties to a contract to resolve disputes arising under the contract. There are several agencies that administer these proceedings including the American Arbitration Association, JAMS, and for the securities industry, the NASD and New York Stock Exchange. If you have an individual contract of employment, and a dispute arises that you cannot resolve, be sure to review your contract to determine if you are required to arbitrate your claims. Arbitration provisions are very common in the securities industry but may appear in any agreement. The decision of the arbitrator is final and binding, and there are only limited means of challenging an arbitrator's award.

If you work under a collective bargaining agreement and you feel that you have been improperly disciplined or discharged, or your employer has in some way violated the contract, your claim is almost always subject to the grievance and arbitration provisions of the collective bargaining agreement. You should be familiar with the grievance and arbitration provisions of your collective bargaining agreement, because they frequently contain very rigid time limits. You should also be aware because the collective bargaining agreement is between the union and your employer; the union is empowered to determine how to prosecute your grievance.

While the union has a well-enshrined duty to represent you fairly, it is not obligated to take every case to arbitration. The union may decide that the facts

and circumstances of a particular grievance merit settlement prior to arbitration.

In most cases the only recourse an individual covered by a collective bargaining agreement may have is the contract's grievance and arbitration procedures. The arbitrator's decision is almost always final and binding, and there are only limited means of challenging an arbitrator's award.

The only exception to this rule concerns victims of statutorily defined discrimination. If you contend that you are a victim of such discrimination, then you may pursue both a grievance under a collective bargaining agreement and - as we will demonstrate - file a charge of discrimination with an appropriate agency. This exception is made in the collective bargaining context because your union controls the grievance and arbitration procedure, but the statutory protections are given to the individual employee.

SECTION II: AM I A VICTIM OF EMPLOYMENT DISCRIMINATION IN REGARD TO RACE, SEX, SEXUAL ORIENTATION, AGE, RELIGION, OR DISABILITY?

Discrimination on the basis of race, sex, age, religion, or disability is generally prohibited by federal, state, and local laws. However, one law may specifically cover a certain type of discrimination or group of people, while the others may not. As you read through this section, pay close attention to the important differences between each law. The distinctions may ultimately have a significant effect on where you file your discrimination claim.

Race Discrimination

It is unlawful for your employer to discriminate against you because of your actual or perceived race. You may be a victim of race discrimination if you believe an employer chose not to hire you, promote you, or retain you on the basis of your race. An employer is also prohibited from making decisions about your hours or wages because of your race. Furthermore, it is illegal for an employer to harass you because of the color of your skin, or to print or circulate messages or advertisements that discriminate on the basis of race.

National Origin Discrimination

An employer is also prohibited from discriminating against you because of your birthplace, ancestry, national culture, or because of an accent you may have. An employer may only require that you and other employees speak only English at work if he or she can prove that the requirement is necessary for conducting business. If the employer believes that the English-only rule is necessary, he or she must inform you when English is required and explain the

consequences for violating the rule.

Sex Discrimination: Gender Discrimination, Sexual-Orientation Discrimination and Sexual Harassment

Sex discrimination can take many forms. First, you may be a victim of sex discrimination if your employer has made decisions about your employment on the basis of your gender. An employer is prohibited from considering your gender when hiring, firing, transferring, promoting, or setting wages or hours. Second, you may be the victim of discrimination if your employer discriminates against you on the basis of your sexual orientation. Sexual orientation is defined as heterosexuality, homosexuality, bisexuality, asexuality, whether actual or perceived. Third, sexual harassment is also a form of sex discrimination. If you have experienced unwelcome, unprovoked sexual advances from an employer, supervisor, manager or co-employee, you may be a victim of sex discrimination. It is unlawful for your employer to require you to engage in sexual relations as a basis for employment decisions or as a condition to keep your job.

You may also have grounds for a sex discrimination charge if your employer's sexual conduct interferes with your ability to perform your job or creates a work environment that is intimidating, hostile or offensive. The employer and the victim can be male or female and the behavior that may constitute harassment may take many forms. For example, you may have a sexual harassment claim if your employer makes physical sexual advances towards you, says or writes sexually inappropriate remarks, draws sexually charged pictures or sends you sexual photos. Even if the sexual harassment is not directed towards you, you may still be a victim if you are affected by your employer's unlawful sexual behavior.

You should be aware that not every form of sex discrimination is covered by Federal, New York State, and New York City law. Title VII is a federal law that prohibits gender discrimination and sexual harassment. Title VII also specifically prohibits pregnancy discrimination. Employment policies or practices that negatively affect female employees because of pregnancy, child birth, and related medical conditions constitute unlawful sex discrimination. Pregnancy, childbirth, and related medical conditions must be treated in the same way as other temporary illnesses or conditions. New York State Human Rights Law also prohibits pregnancy discrimination, but classifies it as disability discrimination not sex discrimination. New York City Law does not specifically prohibit pregnancy discrimination, but the law has been interpreted to protect victims of pregnancy discrimination.

Additionally, the Equal Pay Act is a federal law that requires that men and women receive equal pay for equal work in the same establishment. For you to make a claim under this Act, your job must be the same or substantially equal to that of an employee of the opposite sex. Two jobs are substantially equal if each

requires the same skills, effort, and responsibility and the jobs are performed in substantially equal working conditions in the same establishment. It is, however, lawful for an employer to pay different employees different amounts on the basis of seniority, merit, quantity or quality of production, or factors other than sex. If your employer is paying one employee less than another because they are of different sexes, both employees are entitled to the higher of the two's pay. (No employee's pay may be lowered.)

Sexual orientation discrimination is not covered by federal law. However, under the New York State Human Rights Law and the New York City Human Rights Law it is unlawful for an employer or labor organization to discriminate against you on the basis of your sexual orientation. Furthermore, under the New York City Human Rights Law and the New York State Human Rights Law you may be the victim of gender discrimination or "gender identity" discrimination, if you are discriminated against because of your actual or perceived sex, including your gender identity, self-image, appearance, behavior or expression, whether or not your gender identity, self-image or appearance, behavior or expression is different from that traditionally associated with legal sex assigned to that person at birth. Although an employer may not discriminate on the basis of gender or sexual orientation, the New York City Human Rights Law does not authorize or require employers to establish affirmative action quotas based on sexual orientation or ask or inquire about the sexual orientation of its employees or applicants. Finally, the New York City Law specifically prohibits your employer or union from discriminating against you because you have been a victim of domestic violence, stalking or sex offenses.

Discrimination against individuals with Disabilities

An employer or labor organization is prohibited from discriminating against you on the basis of your physical or mental disability or medical condition. Under Federal, New York State, and New York City law it is generally unlawful for an employer or union to discriminate on the basis of your disability, but the protection provided by each law varies.

The Americans with Disabilities Act of 1990 is a federal law that prohibits an employer in the private sector or a state or local government or agency from discriminating against an employee or applicant on the basis of an individual's disability when hiring, firing, promoting, setting wages, training, and when considering other terms and conditions of your employment. The ADA's non-discrimination policies also apply in the federal sector under Section 501 of the Rehabilitation Act. You may have a disability under the ADA if you have a physical or mental impairment that substantially limits one or more major life activities, have a record of your impairment, or are regarded as having a disability. If you are using illegal drugs you are not protected by the ADA and the employer can make a job-related determination on the basis of your illegal use of

drugs. Tests for illegal drugs are not subject to the ADA's restrictions on medical examinations.

The New York State Human Rights Law prohibits an employer or labor organization from discriminating against you because of (a) a physical, mental or medical impairment resulting from anatomical, physiological, genetic or neurological conditions which prevents the exercise of a normal bodily function or is demonstrable by medically accepted clinical or laboratory diagnostic techniques or (b) a record of such an impairment or (c) a condition regarded by others as such an impairment. New York State law specifically protects you from "genetic discrimination" on the basis of predisposing genetic characteristics. Genetic characteristics are "any inherited gene or chromosome, or alteration of a [gene or chromosome], [that] are determined by a genetic test or inferred from information derived from an individual or family member that is scientifically or medically believed to predispose an individual or the offspring of that individual to a disease or disability, or to be associated with a statistically significant increased risk of development of a physical or mental disease or disability. "

Under New York State law, it is unlawful for an employer or labor organization to require you to take a genetic test or solicit information about your genetic characteristics as a condition of your employment. However, an employer may require a specified genetic test as a condition of employment where such a test is shown to be directly related to the work environment. For example, individuals with a specific genetic condition may be at an increased risk of disease if exposed to a certain working environment and thus, an employer may be able to test applicants and employees for that specific genetic condition. Finally, for some purposes an employer may administer genetic tests to employees who request the test and provide informed consent in writing. This applies in the case of a worker's compensation claim, other civil litigation, or to determine whether the employee is at risk of disease if exposed to certain dangerous chemicals as long the employer does not subsequently fire, transfer, or demote the employee.

The New York City Human Rights Law prohibits discrimination on the basis of a physical, medical, mental, or psychological impairment, or a history or record of such impairment. New York City Law defines disability as "an impairment of any system of the body; including, but not limited to: the neurological system; the musculoskeletal system; the special sense organs and respiratory organs, including, but not limited to, speech organs; the cardiovascular system; the reproductive system; the digestive and genito-urinary systems; the hemic and lymphatic systems; the immunological systems; the skin; and the endocrine system; or (2) a mental or psychological impairment." In the case of alcoholism, drug addiction or other substance abuse, New York City law only protects an employee or applicant who (1) is recovering or has recovered and (2) currently is free of such abuse. New York City Law will not protect you if your employer makes a decision about your employment in response to your

illegal use of drugs.

If you have a protected disability, federal, state and city law require your employer to take reasonable steps to accommodate your needs and allow you to adequately perform the requirements of the job. Your must inform your employer if you have a disability that impairs your ability to perform a current or prospective job. In response, your employer may be required to reasonably accommodate your disability by providing you with an accessible worksite, different or modified equipment or special services if your hearing or vision is impaired. An employer may also need to restructure the job to accommodate your disability, find you another available position, or modify training materials or examinations. Keep in mind, however, that an employer must only provide you with *reasonable* accommodations. Therefore, an employer is not required to make changes or additions that are unreasonably costly or that generally cause undue hardship for the employer's business or organization. Furthermore, you must have the required education, skills, experience and ability to the extent that these qualifications are required of non-disabled employees and applicants. You must be able to "reasonably perform" the job which requires that you reasonably meet the employer's needs to achieve his or her business goals.

Age Discrimination

It is illegal for an employer to discriminate against you because of your age when making decisions about your employment, including hiring, firing, promotions, layoffs, compensation, benefits, job assignments, and training. It is also unlawful for the employer to include age preferences, limitations, or specifications in job notices or advertisements.

On rare occasions, age or gender may be a "bona fide occupational qualification, " known as a "BFOQ." An employer's age requirement is only a "BFOQ," if it is reasonably necessary to the operation of the employer's business. Also, if you are applying for a job, the employer is permitted to ask you your age or date of birth.

The Age Discrimination in Employment Act of 1967 is a federal law that prohibits private employers having **20 or more employees** from discriminating against their employees and job applicants who are **at least 40 years old** on the basis of age. The law also applies to federal, state and local governments, employment agencies and labor organizations with **25 or more members**. The ADEA also applies to labor organizations that operate a hiring hall or office that recruits potential employees or obtains job opportunities. Additionally, the Older Workers Benefit Protection Act of 1990 prohibits employers from denying benefits to older employees. Notably, New York State and New York City Law also prohibit age discrimination and these laws do not have a minimum age requirement. Thus, an employee of any age may have a legitimate age discrimination claim, and need not be 40 in order to assert an age discrimination

claim.

Discrimination on the basis of Religion

It is unlawful for an employer to force you to violate or abstain from observance of your religion, including the observance of any holy day, Sabbath day, religious custom or usage. An employer must reasonably accommodate your religious needs. Your employer is not required to make an accommodation that will cause an undue burden on his or her business.

An employer may not fire or transfer you or refuse to hire or promote you because you are unable to work on certain religious days. However, your employer is not required to pay for the time you take off for religious observance and the employer may require you to make up the time you missed.

Discrimination for Union Activity and for Engaging in Concerted Activity

The National Labor Relations Act is a federal law that provides in part that employees shall have the right to self-organization, to form, join or assist labor organizations, to bargain collectively through representation of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities ..." (Emphasis supplied).

While the National Labor Relations Act is the primary statute governing relationships in the private sector between unions and employers, and is, therefore, beyond the scope of this pamphlet, certain key points have to be made. If an employer or union violates the National Labor Relations Act ("NLRA"), a charge may be filed at the National Labor Relations Board. Under the NLRA, it is an "unfair labor practice for an employer - to interfere with, restrain or coerce employees in the exercise of the rights guaranteed [by the statute]". While many violations of the NLRA arise in the context of a union organizing campaign, individual employees covered by the statute - even in the absence of a union organizing campaign - who are disciplined for taking steps on behalf of their fellow employees are protected by the National Labor Relations Act. For example, an employer would not be permitted to discharge or discipline an employee merely because that employee asked for a raise on behalf of his/her colleagues or protested an employer's policy concerning discipline or leave. Such activity must be on behalf of his or her fellow employees or it will not be considered concerted activity and protected by the statute.

One other aspect of the National Labor Relations Act that is relevant to this handbook concerns a union's Duty of Fair Representation ("DFR"). As mentioned above, most union contracts contain a grievance and arbitration

mechanism for resolving disputes under the contract. If your employer disciplines or discharges you, and you contend that the employer violated the collective bargaining agreement, you must follow the contractual procedures and file a grievance. At this point the union is required to represent you. (You need not be an actual member of the union to receive representation. You need only be an employee covered by the collective bargaining agreement.)

The union is obligated to investigate your grievance to determine its merits, evaluate the facts, and determine your likelihood of success. You should be aware that not every grievance is meritorious and the union is not obligated to pursue each case to arbitration. However, if you have both a meritorious grievance, and the union has treated your grievance in an arbitrary and capricious manner or unlawfully discriminated against you and refused to process your grievance, then you may have a claim that the union breached its Duty of Fair Representation to you. At that point, you may file an unfair labor practice charge against both your union and your employer at the National Labor Relations Board. You also have the option of commencing a lawsuit in either state or federal court. In either case you must file your charge or commence your lawsuit within six months of the violation.

Retaliation

Federal, New York State, and New York City law prohibit an employer or labor organization from retaliating against you in any manner for reporting an employment discrimination incident or for filing a discrimination claim. For example, it is unlawful for your employer to fire, transfer, or demote you because you have revealed a discrimination incident that occurred at work. It is also unlawful for an employer to retaliate against you for testifying or assisting in legal proceeding related to employment discrimination. Even if you have not been directly discriminated against, you may still have a retaliation claim if you have complained about discrimination affecting others. Finally, your employer is prohibited from retaliating against you for engaging in concerted activity or for reporting an unfair labor practice.

SECTION III: AM I WHISTLE BLOWER PROTECTED BY A STATUTE?

It has been recognized that employees are often torn by loyalty to their employers, and the duty to report improper, illegal or dangerous conditions to public authorities. As a limited exception to the Employee-at-will Doctrine certain so-called whistle blowers are protected under particular statutes.

Section 740 of New York's Labor Law prohibits an employer from taking retaliatory personnel action against an employee because such employee:

(a) discloses, or threatens to disclose to a supervisor or to a public

body an activity, policy or practice of the employer that is in violation of law, rule or regulation which violation creates and presents a substantial and specific danger to the public health or safety;

(b) provides information to, or testifies before, any public body conducting an investigation, hearing or inquiry into any such violation of a law, rule or regulation by such employer; or

(c) objects to, or refuses to participate in any such activity, policy or practice in violation of a law, rule or regulation.

In order to be protected by this statute, an employee must first bring the violation to the attention of a supervisor, and provide his or her employer an opportunity to correct the violation. If an employer is able to demonstrate that it took action against an employee for reasons other than a violation of Section 740 then the employer may have a defense to the action.

An action under Section 740 must be brought in New York State Supreme Court within one year of the violation. If the employee is successful, the Court may order: (1) an injunction to restrain the continued violation of Section 740; (2) the reinstatement of the employee; (3) back pay, and (4) payment of reasonable costs and attorneys' fees.

You should be aware that if the Court determines that an action brought by an employee under Section 740 is without basis in law or fact, it may award attorneys' fees to the employer.

Employees in the health care industry are protected by Section 741 of the Labor Law.

Although it is beyond the scope of this handbook, it is worth noting that a number of Federal statutes provide whistle blower protections. These statutes include:

(a) Sarbanes Oxley Act, 18 USC Section 1514(A): protects employees of publicly traded companies who disclose information relating to a wide range of accounting fraud.
(b) Water Pollution Control Act, 33 USC Section 1367: protects employees who disclose information relating to unlawful water pollution.
(c) Clean Air Act, 42 USC Section 7622: protects employees who disclose information relating to unlawful air pollution.
(d) Toxic Substance Control Act 15 USC Section 2622: protects employees who disclose information pertaining to unlawful toxic substance (asbestos) pollution.

SECTION IV: WHERE DO I GO AND WHAT DO I DO IF I AM A VICTIM OF DISCRIMINATION?

Do you think you have experienced race, sex, age, disability, or religious discrimination at work? Has your employer or union committed an unfair labor practice? In addition to filing a lawsuit in court, there are several agencies here in New York that can help you. This section will describe the functions of four different agencies at the city, state, and federal level and provide you with a step-by-step guide for filing an employment discrimination or unfair labor practice claim against an employer or union. Finally, this section will attempt to highlight the benefits and disadvantages of each of the agencies and hopefully point you in the appropriate direction.

NEW YORK CITY COMMISSION ON HUMAN RIGHTS

The New York City Commission on Human Rights is a city agency that has the power to eliminate and prevent employment discrimination. The Commission specifically enforces New York City Human Rights Law Section 8-107. Under New York City's Human Rights Law it is an illegal discriminatory practice for an employer to hire or fire you because of your actual or perceived age, race, creed, color, national origin, gender, disability, marital status, partnership status, sexual orientation, citizenship status, arrest or conviction record, or status as a victim of domestic violence, stalking or sex offenses. Your employer cannot ask you discriminatory or prejudicial questions during an interview, circulate advertisements or publications that suggest a discriminatory preference, or make generally discriminatory statements. New York City's Human Rights Law does have boundaries and limitations and thus it is essential that you pay close attention to the information and instructions provided in this section.

You are protected by the New York City Human Rights Law if you are one of **4 or more employees** at your place of employment. Public and private employers must follow this law, as well as employment agencies and labor organizations. If you believe that you are the victim of employment discrimination you can file a complaint with the Law Enforcement Bureau of the New York City Commission on Human Rights. The Commission is located at 40 Rector Street, 9th Floor, in lower Manhattan. Complaints can also be filed at any of the Commissions Community Service Centers. (See Appendix B for more contact information).

How do I file a complaint with the New York City Commission on Human Rights?

The Complaint

If you are the victim of employment discrimination you may, by yourself, sign and

file a verified written complaint with the Commission. The complaint must include:

- The name of the person-employer who you believe discriminated against you and the person-employer's address.
- A detailed explanation of the discriminatory incident that you may have experienced or may be experiencing.
- Any further information required by the Commission

Processing Your Complaint

Step 1: Intake

After you have provided the necessary information to the Commission, an investigator or attorney will conduct an interview with you and will try to resolve the issue before filing an official complaint. You must file your complaint within **1 year** of the alleged act of discrimination. Furthermore, you cannot file a complaint with the Commission if:

You have previously sued in civil court alleging the same discriminatory practice, unless the action was dismissed without prejudice or withdrawn without prejudice,[1] or if you have filed the same complaint with another administrative agency or with the State Division of Human Rights and a final determination has been made.

> **As you read through this handbook and learn more about the other agencies that handle employment discrimination claims, keep in mind that you may not be able to file a claim with a different agency or court at a later date*.

Step 2: Filing of the Complaint:

If the Commission accepts your complaint after intake, the Commission's Office of Docketing will file and serve your complaint upon the Respondent. This means that a copy of your complaint will be sent to the employer or labor organization that you are charging with discrimination.

Step 3: The Answer

Within **30 days** after a copy of the Complaint is served on the employer by the Commission, the employer must file a written answer with the Commission. The Commission will then send you and other necessary parties a copy of the

1 If an action or proceeding is dismissed or withdrawn without prejudice, it may be recommenced. If it is dismissed with prejudice, it constitutes a final disposition.

employer's answer.

At this point, the parties may also choose to go to mediation to resolve the dispute. It is highly recommended that the parties attempt to resolve the dispute through the Human Rights Commission's mediation program. Mediation is a less formal alternative to the traditional litigation process. If you choose mediation, a neutral third party will help you and the employer or union reach a voluntary agreement that resolves the discrimination dispute. Your mediation session will be private and confidential and will not be disclosed publicly. The final agreement, however, will be made public unless you and the respondent ("the employer you have complained against") agree otherwise and if the Commission decides disclosure is not necessary.

Step 4: Investigation

An attorney or investigator for the Human Rights Commission will then investigate your charge by interviewing witnesses and reviewing relevant documents that may reveal evidence of the employment discrimination.

If the investigation reveals that there is "probable cause" to prosecute the employer for discrimination, the Commission will assign an attorney to prosecute your case. The investigator will only find that there is "probable cause" if the investigator determines that there is sufficient evidence to establish that discrimination took place. If the claim is dismissed for lack of probable cause, you may appeal the dismissal to the Commission.

Step 5: The Hearing

If your dispute is not settled at a pre-trial conference and the claim has not been dismissed for lack of probable cause, you and the employer must attend a formal hearing held by an administrative law judge of the New York City's Office of Administrative Trials and Hearings.

After the hearing, the judge will issue a report and recommendation about your case. A panel of Commissioners will then review the judge's report and the panel will issue a final Decision and Order.

Step 6: Remedies

If the New York City Human Rights Commission finds that an employer has discriminated against you, the Commission can order a number of different remedies. You may be hired, reinstated to the job you lost or equivalent position, or promoted to a higher position. Your employer may be also be ordered to "reasonably accommodate" your disability or religious observance. Additionally,

the Commission may mandate that the employer implement anti-discrimination policies or special anti-discrimination training programs. Finally, you may also be entitled to a financial award if the Commission determines that you have been the victim of employment discrimination. Pay close attention to the following information because forms of compensation do vary depending on the agency you file your claim with.

You may receive a financial award for damages and back pay for wages. In some circumstances you may also receive front pay. According to the New York City Administrative Code § 8-502, the Commission may award you uncapped compensatory damages for physical injury, pain and suffering, mental anguish, and shock and discomfort you may have suffered because of your employer's discriminatory conduct. Notably, a claim of "emotional distress" may not be successful if there are no "physical manifestations of your emotional distress." Punitive Damages may be available to punish the employer for extreme or outrageous conduct or to deter or prevent the employer from committing future acts of discrimination.

NEW YORK STATE DIVISION OF HUMAN RIGHTS

The State Division of Human Rights is another alternative for resolving employment discrimination disputes. The Division enforces the New York State Human Rights Law (Executive Law, Article 15), by preventing and eliminating employment discrimination and investigating and resolving employment discrimination claims. Under New York State Human Rights Law, it is unlawful for an employer, licensing agent, employment agency, or labor organization to fire you or refuse to hire you because of your age, race, creed, color, national origin, sexual orientation, military status, or sex. Furthermore, an employer cannot publish discriminatory job advertisements or ask you discriminatory questions on a job application or during an interview. Like the New York City Human Rights Law, the New York State Human Rights Law has its limitations and requirements. Again, please read the following procedural instructions carefully.

Like the New York City law, the New York State Human Rights Law only protects you if you work for an employer with **4 or more** employees. If you believe you are a victim of employment discrimination you should first contact your nearest regional office of the Division of Human Rights. (See Appendix B for contact information)

How do I file a complaint with the New York State Division of Human

Rights?

The Complaint

If you are the victim of employment discrimination you may, by yourself, sign and file a verified written complaint with the Commission. You must file the complaint within **1 year** from the date of the incident of employment discrimination. You may file the complaint in person or by mail and there is no filing fee. The complaint must include:

- The name of the employer who you believe discriminated against you and the employer's address;
- Any further information required by the Division (See Appendix F for a copy of the Commission's questionnaire).

Processing Your Complaint

Step 1: Intake

When you file a discrimination claim with the Division, an intake officer will evaluate your complaint and decide whether the New York State Human Rights Law protects you and applies to your situation. You will be asked to identify witnesses that may have seen or heard the discrimination incident. The intake officer will also request that you provide information about other employees that may have experienced the same type of discrimination scenario that you dealt with or are currently dealing with.

Step 2: Filing the Complaint

If the intake officer determines that your situation is covered by New York State Human Rights Law, the intake officer will write and file an official complaint. You must sign and notarize this complaint. You will be able to use the Division's notary services free of charge. A copy of the complaint will then be sent to the employer and other necessary parties.

- You may have to wait up to 180 days for the Division to decide whether it has the authority to decide your particular case.
- It may take up to 270 days for your complaint to be officially filed, but after the employer receives a copy of the complaint he or she must respond to the allegations within 5 to 15 days.

Step 3: Investigation

If the Division does have the authority to evaluate your case, an investigator will then conduct an investigation and gather facts and evidence about the employment discrimination that you experienced. The investigator will decide whether there is "probable cause" to continue pursuing your claim.

- If the Division decides that your case lacks probable cause, your claim will be dismissed.
- The Division may also dismiss your claim for "administrative convenience[2]."

Step 4: Investigation Conference

The Division may hold a conference while the investigation is going on to try to resolve the dispute between you and the employer. If you are required to attend an investigation conference, you will receive a notice in the mail stating the date, time, and location of the conference. At the conference, the Division will determine whether you and the employer can work out the discrimination dispute and reach a settlement agreement. If an agreement is reached, the Division will issue an official order. If you and the employer cannot reach a settlement agreement at the investigation conference, the Division will continue to investigate your claim.

Step 5: Pre-Hearing Settlement Conference

If the claim is not dismissed for lack of probable cause, you and the employer may also have the option of appearing before an administrative law judge. At this meeting, you will also have the opportunity to reach a settlement agreement with the employer.

Step 6: Public Administrative Hearing

If you and the employer do not reach a voluntary settlement agreement at the Pre-Hearing Conference, your case will be heard by an administrative law judge at a more formal administrative hearing. You can expect to receive a notice about the hearing at least 1 week before the hearing date. A Division lawyer will represent you at the hearing if you choose not to hire your own attorney. The hearing may only take one day, but it may require more days if necessary. After your employment discrimination case has been presented at the hearing, the administrative law judge will recommend an order to the Commissioner at the Division. Finally, the Commission will review the judge's

2 The Division has the discretion to dismiss your claim for "administrative convenience," as long as testimony has not yet been taken at a public hearing before an administrative law judge. According to Part 465.5, Subtitle J of the New York State Human Rights Law, the Division may dismiss your complaint for administrative convenience, if, for example, your objections to a settlement agreement lack substance, you are unavailable or unwilling to participate in conciliation, investigation, or go to a hearing, or if processing your complaint will not further New York State's human rights goals.

recommendation and issue a final decision.

Step 7: Remedies

If the Commissioner of the New York State Division of Human Rights concludes that you are the victim of employment discrimination, the Division may order the employer to stop committing the discrimination and hire, re-hire, or promote you. The Division may also order a union that has discriminated against you to restore your membership. The employer may also be ordered to reasonably accommodate your disability or religion as required by the New York State Human Rights law.

You may also receive a financial award for damages and back pay for wages. You may also receive front pay. The Division will only award you with compensatory damages, not punitive damages. Note, that under the *New York City* Human Rights Law, punitive damages are available and uncapped.

Can I Appeal the Division's Order to Court for Judicial Review?

Yes. If you are unsatisfied with the Division's order, you will have 60 days to appeal the Division's decision to the New York State Supreme Court. Finally, the Supreme Court's decision can then be appealed to an appellate court.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF FILING MY CLAIM WITH THE STATE DIVISION OF HUMAN RIGHTS OR THE NEW YORK CITY COMMISSION ON HUMAN RIGHTS, RATHER THAN GOING DIRECTLY TO STATE COURT?

While you can certainly file your complaint directly in state court, the State Division and City Commission specialize in preventing discrimination and enforcing New York State's and New York City's Human Rights laws. Furthermore, if you do not have a lawyer or cannot afford one, either the Division or Commission is a good option because the services are free.

As previously explained, you only have **1 year** from the date of the discriminatory incident to file your discrimination claim with either the State Division or City Commission. However, you have up to **3 years** to file your claim in state court. Please note that you cannot file your discrimination complaint both with the State Division or City Commission and in state court.

UNITED STATES EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

As discussed in Section II of this handbook, several Federal laws also prohibit an employer from discriminating against you when hiring, firing, setting wages, transferring, promoting and laying-off and other terms and conditions of employment. It is also unlawful discrimination if your employer harasses you about your race, color, religion, sex, national origin, disability, or age.

The Equal Employment Opportunity Commission (EEOC) enforces the following federal Laws: Title VII of the Civil Rights Act of 1964; as amended, the Age Discrimination in Employment Act of 1967, as amended (ADEA), the Equal Pay Act of 1963, as amended (EPA), Title I of the American Disabilities Act of 1990, as amended (ADA), and the Civil Rights Act of 1991 (CRA). (*See Section II for a more detailed explanation of each federal law*.)

For and employer to be covered by Title VII and the ADA, it must have at least fifteen employees. However, under the ADEA, it must have at least twenty employees.

How do I file a discrimination charge with the EEOC?

Any individual who believes that his or her employment rights have been violated may file a discrimination charge with the EEOC. Also, an individual, organization, or agency may file a charge on behalf of another person so as to protect the victim's identity. A charge may be filed by mail or in person at the nearest EEOC office (see appendix D for contact information). If you are employed at a federal agency and you believe you have been discriminated against you should contact your agency's EEO counselor before filing a formal complaint[3].

Your Complaint

If you file a complaint with the EEOC you must include:

- Your name, address, and telephone number on the complaint
- The employer, employment agency, or union that allegedly committed the discrimination and the number of employees [or union members] employed by that employer, business, or union.
- A short description of the alleged violation/event that occurred that caused the complaining party to believe that his or her rights were violated; and
- Date(s) of the alleged violation(s)

-See Appendix F for a copy of the EEOC's questionnaire.

3 29 C.F.R. Section 1614.105 provides that you must contact the counselor within 45 days of the date of the alleged discrimination. Your EEO counselor will inform you about the federal sector complaint process and may help you to resolve the dispute. After you contact the EEO counselor, this preliminary stage must be completed within 30 days. If the counselor does not successfully resolve your dispute within this period, you then have the right to file a formal complaint with the agency that allegedly discriminated against you.

Processing Your Complaint

Step 1: Filing the Complaint

All the federal laws explained in Section II, except the Equal Pay Act, require you to file your discrimination charge with EEOC before a private lawsuit may be filed in court. A charge must be filed with the EEOC in New York within **300 days** of date of the discriminatory incident. These time limitations do not apply to claims under the Equal Pay Act, because under that Act you do not have to first a file a charge with the EEOC in order to have the right to go to court. You should still try to file your complaint within the 300 day period because many Equal Pay Act claims also raise Title VII sex discrimination issues and these are still subject to the EEOC's time limitations. The EEOC will send a copy of the complaint to the employer at least 10 days after you file your claim.

Step 2: Investigation

After the complaint has been filed and sent to the employer, the EEOC will begin investigating your discrimination claim. If after investigation the EEOC concludes that there is no "reasonable cause" to believe that the discrimination occurred, your charge will be dismissed.

If the EEOC determines that there is in fact "reasonable cause" to believe that you are the victim of employment discrimination, the EEOC will try to resolve your dispute with the employer informally. In fact, you may be required to attend a pre-hearing conference or a mediation session.

If after 30 days (from the date the complaint was filed), the EEOC is unable to resolve your dispute and stop the unlawful discrimination, the EEOC may file a lawsuit against your employer. If, however, your employer is the government or a government agency, your case will be handed over to the Department of Justice who will sue the employer on your behalf in federal court.

Step 3: Mediation or Judicial Proceedings

The EEOC provides mediation as an alternative to traditional investigation or litigation. An EEOC representative will contact you and the employer and request that you come in for a mediation session. If you and the employer agree, you will meet together with a trained mediator. You do not need to have an attorney to participate in the EEOC's mediation program. The mediation is free of charge and ultimately may save you money if you and the employer resolve the dispute at this stage. You, the respondent, and the mediator will sign a confidentiality agreement and the information disclosed during your mediation session will be kept confidential. If your dispute is not resolved through

mediation, the EEOC will continue to investigate your charge of discrimination and pursue in rare instances your claim in federal court on your behalf. Even if the EEOC believes you were a victim of discrimination, it will not always pursue your claim. Furthermore, unlike the state and city agencies there is no administrative tribunal to seek relief.

Step 4: Remedies

As provided by Section 102 of the Civil Rights Act of 1990, if an employer or labor organization intentionally discriminated against you, you may potentially receive any relief authorized by section 706(g) of the Civil Rights Act of 1964 and the following damages:

If your employer violated Title VII:
- You may recover compensatory and punitive damages:

You may recover punitive damages against an employer (not including the government, government agency or political subdivision) if you prove that the employer engaged in discrimination towards you with malice or reckless indifference to your civil rights. You may also receive compensatory damages in addition to back pay, interest on back pay, reinstatement etc.

There is a maximum amount of compensatory damages and punitive damages you can receive for future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other non-pecuniary losses.

- If the employer has more than 14 but less than 101 employees every week for 20 weeks or more (in the current or preceding calendar year) you may receive up to $50,000.
- If the employer has more than 100 employees, but less than 201 employees every week for 20 weeks or more (in the current or preceding calendar year), you may receive up to $100,000.
- If the employer has more than 200, but less than 501 employees every week for 20 weeks or more (in the current or preceding calendar year), you may receive up to $200,000.
- If the employer has more than 500 employees every week for 20 weeks or more (in the current or preceding calendar year), you may receive up to $300,000.

NATIONAL LABOR RELATIONS BOARD

The National Labor Relations Board is an independent federal agency that investigates and remedies unfair labor practices committed by employers and unions in the private sector. The National Labor Relations Board enforces the National Labor Relations Act, the federal law described in Section II.

How do I file an unfair labor practice charge with the National Labor Relations Board?

An unfair labor practice charge may be filed by an employee, an employer, a labor organization, or any other person. Charge forms are available at the NLRB's Regional Offices, must be signed, sworn to or affirmed under oath, and filed with the appropriate Regional Office. The appropriate Regional Office is in the area where the unfair labor practice took place. See attached appendix for contact information. (See Appendix E for Regional Office contact information and copies of the appropriate charge forms.) You only have **6 months** from the date of the unfair labor practice to file your charge. Your charge will be dismissed if you try to file it after the 6 month period.

Your Unfair Labor Practice Charge

On the Charge form you must include:

- your name and current address
- the name and address of the employer or union against whom you are filing the charge
- A description of the unfair labor practice that your employer or union committed.
- See Appendix F for copies of the NLRB charge forms

Processing Your Charge

Step 1: Filing Your Complaint

After you have completed the charge form, the appropriate Regional Office will process your complaint. Although the charging party is responsible for the service of the charge, the Regional Office will process your charge and as a courtesy will send a copy of the charge to the employer or union who has allegedly committed the unfair labor practice.

Step 2: Intake

After your charge is filed, the NLRB will request evidence supporting your claim. "Evidence" usually will include sworn statements and other information gathered during interviews with the parties and witnesses.

Step 3: Investigation

If there is sufficient evidence supporting your charge, the NLRB will initiate an investigation of the alleged unfair labor practice. Generally, the Board agent will start the investigation within 7 days. The Regional Board agent will contact witnesses and others who may have information regarding your case.

The Regional Officer will seek to determine if there is "reasonable cause" to believe that an unfair practice has occurred. This determination is generally made within **45 days** from the time you file the charge.

If after the investigation and review of the evidence gathered, the Regional Office determines that no unfair labor practice has occurred, you will be asked to withdraw your charge. If you refuse to withdraw your charge, the Regional office will dismiss your complaint. If you wish to continue pursuing your claim, you can appeal the Region's dismissal to the General Counsel's Office of Appeals in Washington, D.C. (See appendix E for contact information.)

If the Regional Office finds that there is "reasonable cause" to believe that an unfair labor practice has occurred, they will first go to the employer or union and ask them to remedy your situation. At this point, you and the employer or union may be able to reach a voluntary settlement. If the charged employer or union refuses to provide a remedy, the Regional Office will issue a formal complaint against the charged party.

Step 4: The Hearing

After the Regional Office issues the complaint, your case will be scheduled for a formal hearing before an Administrative Law Judge. An NLRB lawyer will represent your interests at the hearing. The Administrative Law Judge will then issue a decision and determine whether the discrimination occurred and if so, what remedy you are entitled to.

You may then appeal the ALJ's decision to National Labor Relations Board's Main Office in Washington D.C. (See Appendix E for contact information) The Board's decision may then be appealed to the U.S. Court of Appeals.

SECTION IV: WHAT OTHER STATUTES GOVERN EMPLOYMENT

Although we cannot cover them all, some other statutes governing employment are worth noting:

A. The Family Medical Leave Act

Employers of 50 or more employees are required to grant employees who have 1,250 hours of service during the previous 12 months, up to 12 work weeks of unpaid leave during any 12 month period for one or more of the following reasons:

(i) for the birth and care of the newborn child of the employee;
(ii) for placement with the employee of a son or daughter for adoption or foster care;
(iii) to care for an immediate family member (spouse, child or parent) with a serious health condition; or
(iv) to take medical leave when the employee is unable to work because of a serious health condition.

If the employer violates this provision, an employee may commence an action in State or Federal Court or file a charge with the United States Department of Labor.

B. Fair Labor Standards Act

Workers covered by the United States Fair Labor Standards Act are entitled to a minimum wage of $5.15 an hour. However, workers in New York State are entitled to a minimum wage of $6.75 an hour. (In New York the minimum wage will increase to $7.15 an hour as of January 1, 2007. Any increase in the federal wage above the state rate will result in an increase in the state's minimum.)

Under the FLSA, employees covered by the statute are entitled to overtime pay at a rate of not less than one and a half times their regular rate of pay after 40 hours of work in a work week. Determining who is covered by the FLSA can be very complicated. The Department of Labor has issued a series of regulations concerning workers to determine if they are covered by the statute or not. Generally, professional, management and supervisory employees are exempt from the coverage of the act and may be required to work over 40 hours a week without additional compensation.

If you believe your employer has violated the FLSA you may file a charge with the US Department of Labor Wage and Hour Division or the New York State Department of Labor or file a lawsuit in the US District Court or State Court.

C. Occupational Safety and Health Act of 1970

The Occupational Safety and Health Act of 1970 (OSH Act) requires your employer to provide you with a workplace that is "free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees." The Occupational Safety and Health Administration (OSHA) is the federal agency that establishes and enforces the OSHA. Under OSHA, your employer must establish a "written communication program," to provide you with extensive information about the chemicals that you are exposed to at work and train you how to protect yourself from harm. Furthermore, you have the right to request and review information and specific records from your employer pertaining to OSHA's standards, worker injuries and illnesses, job hazards and workers' rights. You also may ask your employer to fix hazardous working conditions, even if they are not violations of OSHA's specific standards.

If you believe that your employer is violating OSHA's standards or you are working in hazardous conditions, you may file a complaint with OSHA and request that OSHA inspect your workplace. You can file your complaint online, in writing, by fax or phone. To request a field inspection, please send your request in writing to New York's Regional office.

Office of Occupational Safety and Health Administration, Region 2
Regional Office
201 Varick Street, Room 670
New York, New York 10014. (212) 337-2378(212) 337-2371 FAX

If OSHA inspects your workplace, you are entitled to be involved in the inspection process. You have the right to have an authorized employee representative, like a union steward, escort the OSHA compliance officer during the workplace investigation. The OSHA officer, however, cannot select the employee representative. If there is no union representative or employee representative present, the OSHA official must speak confidentially with a "reasonable number of workers during the course of the investigation." If you know of workplace hazards and illnesses and injures that have occurred as a result, you have the right to approach the officer and inform him during the inspection. After the investigation is conducted, you are entitled to find out what the results are and request a review of the inspection if OSHA chooses not to issue a citation. You can also file an appeal of the deadlines that OSHA establishes for your employer to remedy any workplace hazards. Finally, you may file a discrimination complaint with OSHA if you are punished or discriminated against for exercising your safety and health rights. You can also file a complaint if you are discriminated against or penalized for refusing to work due to imminently hazardous working conditions, but this right is not guaranteed by the OSHA. You should be aware that under the OSHA you do not have the right to walk off the job because of unsafe conditions. OSHA may not be able to

protect you if you decide to walk off the job and you are subsequently fired or disciplined.

D. Unemployment

You may be eligible for temporary unemployment insurance if you are unemployed through no fault of your own and you are "ready, willing and able to work." The New York State Department of Labor will determine whether you qualify for unemployment benefits. For more information about how to file a claim for unemployment insurance in New York, please see http://www.labor.state.ny.us/ or see below information the New York State Department of Labor's contact information.

NYS Department of Labor
W. Averell Harriman State Office Campus
Building 12 Albany, NY 12240
Phone: 518-457-9000
e-mail:nysdol@labor.state.ny.us
TTY/TDD 1-(800)-662-1220Voice 1-(800)-421-1220

Appendix A

Public Employees

A. Employees of the United States Government Certain employees of the United States Government are given the right to bargain collectively. The agency that administers labor management relations in the Federal Government is the Federal Labor Relations Authority ("FLRA"). The Regional Office is located at:

Federal Labor Relations Authority
99 Summer Street
Suite 1500
Boston, MA 02110
Telephone: (617) 424-5730

The main office is located at:

Federal Labor Relations Authority
1400 K Street NW
Washington, DC 20424
Telephone No.: (202) 218-7770

Employees of the Unites States who are disciplined may challenge their discipline and the Merit Systems Production Board (MSPB). In New York, the field office is located at:

Merit Systems Production Board
3137A Federal Building
26 Federal Plaza
New York, New York 10278
(212) 264-9372

The main office is located at:

Merit Systems Production Board
1615 M Street NW
Washington, DC 20036
(202) 653-7200

Employees of the United States who believe they are victims of discrimination may have recourse through the procedures of the Equal Employment Opportunity Commission.

B. Employees of the State of New York

Certain employees of the State of New York are given the right to bargain collectively. The Public Employment Relations Board ("PERB") resolves disputes involving union representation, and improper practices. PERB is located at:

Public Employment Relations Board ("PERB")
80 Wolf Road, 5th Floor
Albany, New York 12205
(518) 457-2578

Disciplinary and Promotional Examination matters are also covered in part by the Department of Civil Service which is located at:

Department of Civil Services,
W.A. Harriman State Office Building Campus,
Building 1, Albany, New York 12239
(518) 457-9375

Employees of New York State who believe they are victims of discrimination may utilize the U.S. Equal Employment Opportunity Commission (See Appendix D) or the New York State Division of Human Rights. (See Appendix C).

C. Employees of the City of New York

Certain employees of the City of New York are given the right to bargain collectively. The New York City Office of Collective Bargaining provides procedures including certification of collective bargaining representatives, mediation, impasse panels and arbitration for the resolution of labor relations disputes and controversies between the City and its employee organizations and employees. The Office of Collective Bargaining is located at:

Office of Collective Bargaining
40 Rector Street, 7th Floor
New York, New York 10006
(212) 306-7160

Civil Service Rules and Regulations for New York City Employees including the scheduling of examinations are administered by the Department of Citywide Administrative Services ("DCSA") which is located at:

Department of Citywide Administrative Services
Municipal Building
One Centre Street, 17th Floor
New York, New York 10007
(212) 669-7000

New York City employees who are disciplined may contest their discipline at the Office of Administrative Trials and Hearings ("OATH"):

Office of Administrative Trials and Hearings
40 Rector Street, 6th Floor
New York, New York 10006
(212) 422-4900

New York City employees who believe they are victims of discrimination may file charge with the U.S. Equal Employment Opportunity Commission, the New York State Division of Human Rights, or the New York City Commission on Human Rights. (See Appendix B).

D. Employees of Public Authorities

Employees of public authorities such as Port Authority of New York and New Jersey or the Metropolitan Transit Authority should refer to the relevant regulations of their employers.

Appendix B

New York City Commission on Human Rights

http://www.nyc.gov/html/cchr/

Manhattan
40 Rector Street, 10th Floor
New York, NY 10006
Phone: (212) 306-5070

Brooklyn
275 Livingston Street, 2nd Floor
Brooklyn, NY 11217
Phone: (718) 722-3130

Bronx
1932 Arthur Avenue, Room 203A
Bronx, NY 10457
Phone: (718) 579-6900

Queens
136-56 39th Avenue, 3rd Floor
Flushing, NY 11354
Phone: (718) 886-6162

Staten Island
60 Bay Street, 7th Floor
Staten Island, NY 10301
Phone: (718) 390-8506

Appendix C

New York State Division of Human Rights Offices

www.dhr.state.ny.us/

Headquarters
New York State Division of Human Rights
One Fordham Plaza, 4th Floor
Bronx, New York 10458
Phone: (718) 741-8400

Albany
New York State Division of Human Rights Empire State Plaza, Agency Building #2, 18th Floor, Albany, New York 12220, Phone: (518) 474-2705

Binghamton
New York State Division of Human Rights, 44 Hawley Street, Room 603, Binghamton, New York 13901, Phone: (607) 721-8467

Brooklyn
New York State Division of Human Rights, 55 Hanson Place, Room 304, Brooklyn, New York 11217, Phone: (718) 722-2856

Buffalo
New York State Division of Human Rights, The Walter J. Mahoney State Office Building, 65 Court Street, Suite 506, Buffalo, New York 14202, Phone: (716) 847-7632

Manhattan
New York State Division of Human Rights, 20 Exchange Place, 2nd Floor, New York, New York 10005, Phone: (212) 480-2522
New York State Division of Human Rights, Adam Clayton Powell State Office Building, 163 West 125th Street, 4th Floor, New York, New York 10027, Phone: (212) 961-8650

Long Island
New York State Division of Human Rights
175 Fulton Avenue, Hempstead, New York 11550, Phone: (516) 538-1360

New York State Division of Human Rights, State Office Building, Veterans Memorial Building, Hauppauge, New York 11787, Phone: (516) 952-6434

Rochester
New York State Division of Human Rights, One Monroe Square, 259 Monroe Avenue, 3rd Floor, Rochester, New York 14607, Phone: (585) 238-8250

Syracuse
New York State Division of Human Rights, 333 E. Washington Street, Room 401, Syracuse, New York 13202, Phone: (315) 428-4633

Peekskill
New York State Division of Human Rights, 8 John Walsh Blvd., Suite 204, Peekskill, New York 10566, Phone: (914) 788-8050

Office of Sexual Harassment
New York State Division of Human Rights, Office of Sexual Harassment, 55 Hanson Place, Suite 347, Brooklyn, New York 11217, Phone: (718) 722-2060

Office of AIDS Discrimination
New York State Division of Human Rights, Office of AIDS Discrimination, 20 Exchange Place, 2nd Floor, New York, New York 10005, Phone: (212) 480-2522

Office of Case Review and Special Projects
New York State Division of Human Rights, Office of Case Review and Special Projects, One Fordham Plaza, 4th Floor, Bronx, New York 10458, Phone: (718) 741-8400

Appendix D

Equal Opportunity Employment Commission

www.eeoc.gov

EEOC National Headquarters
U.S. Equal Employment Opportunity Commission, 1801 L Street,
N.W.Washington, D.C. 20507 Phone: (202) 663-4900

EEOC's National Contact Center (NCC) customer service
Mail to:

U.S. Equal Employment Opportunity Commission,
P.O. Box 7033, Lawrence, Kansas 66044
Phone: 1-800-669-4000
TTY: 1-800-669-6820
Fax: 703-997-4890

E-mail: info@ask.eeoc.gov (include your zip code and/or city and state so that the EEOC NCC will send your information to the appropriate office.)

New York Regional Offices

New York District Office
33 Whitehall Street
New York, NY 10004
Phone: (212) 336-3620
TTY: (212) 336-3622
Director: Spencer H. Lewis, Jr.
Regional Attorney: Elizabeth Grossman

Federal Sector Information
Contact: Kenneth W. Chu, Supervisory Administrative Judge
Phone: (212) 336-3740
TTY: (212) 336-3622
E-mail: Kenneth.chu@eeoc.gov

Mediation Contact Information
Michael Bertty, ADR Program Coordinator
Phone: (212) 336-3645
TTY: (212) 336-3622
E-mail: michael.bertty@eeoc.gov

Newark, NJ area Office
One Newark Center, 21st Floor
Raymond Blvd at McCarter Hwy (Rt.21)
Newark, NJ 07102-5233
Phone: (973) 645-6383, TTY: (973) 645-3004
Director: Corrado Gigante
Regional Attorney: Elizabeth Grossman

Buffalo Local Office
6 Fountain Plaza, Suite 350
Buffalo, NY 14202
Phone: (716) 551-4441
TTY: (716) 551-5923
Director: Elizabeth Cadle
Regional Attorney: Elizabeth Grossman

Federal Sector Information
Contact: Kenneth W. Chu, Supervisory Administrative Judge
Phone: (212) 336-3740
TTY: (212) 336-3622
E-mail: Kenneth.chu@eeoc.gov

Mediation Contact Information
David Ging, Mediator
(716) 551-3035
TTY: (716) 551-5923
E-mail: david.ging@eeoc.gov

Appendix E
National Labor Relations Board Contact Information

www.NLRB.gov

NLRB Headquarters:

Washington, D.C. - Main Office
National Labor Relations Board
1099 14th Street, N.W.
Washington, D.C. 20570-0001
Phone: (202) 273-1000

New York City Headquarters
Joel P. Biblowitz, Associate Chief Administrative Law Judge
120 West 45th Street, 11th Floor
New York, New York 10036-5503
Phone: (212) 944-2940

New York's Regional Offices:

Manhattan – Region 2
26 Federal Plaza, Room 3614
New York, NY 10278-0104
Phone: (212) 264-0300

Buffalo – Region 3
111 West Huron Street, Room 901
Buffalo, NY 14202-2387
Phone: (716) 551-4931

Brooklyn - Region 29
One Metro Tech Center (North)
Jay Street and Myrtle Avenue, 10th Floor
Brooklyn, NY 11201-4201
Phone: (718) 330-7713

Newark, NJ – Region 22
20 Washington Place, 5th Floor
Newark, NJ 07102-3110
Phone: (973) 645-2100

Appendix F
Forms

U.S. EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
New York District Office

INTAKE QUESTIONNAIRE

Investigator: [Please enter Investigator name]	**Date:** 10/24/06

General

(Filling out this form does not constitute filing a charge.)

You have alleged that you were illegally discriminated against by your employer. We need the following information from you. Please note that whatever basis you are alleging in your charge, show that same basis for other individuals and your witnesses. For example, if you allege that you were discriminated against because of your sex, identify the sex of other individuals and witnesses. If you allege that you were discriminated against because of your age and race, identify the age and race of other individuals and witnesses. **If you need more space to answer any of these questions, you may attach additional sheets. Please print or type all information.**

(Please think carefully before answering each question because you are asked at the end of the questionnaire to declare under penalty of perjury that your answers are correct. A false statement on any part of this questionnaire may be grounds for the Commission to dismiss your charge.)

*This form is affected by the Privacy Act of 1974; see Privacy Act statement on the last page before completing this form.

Your name:_____ Date:
Address: _____ City:
County: _____ State: ___ Zip Code:
Home phone: ( ) _____ Best time to call:
Work phone: ( ) _____ Best time to call:

Social Security No: _____
Email_____
Name of employer or organization that discriminated against you:
Name:
Address: _____ City:
State: ___ Zip Code: _____ Phone (with area code):

Name of the head of the organization:
Title of the head of the organization:
Your date of birth:_____ Age:_____ Sex:_____Race:
National origin:_____Religion:
What type of business does the employer engage in?
_Number of employees: ( ) 1 to 14 ( ) 15 to 100
( ) 101 to 200 ( ) 201 to 500 ( ) More than 500

Provide the name of an individual at a different address who we can contact if we are unable to reach you:

Name:_____ Relationship:
Phone:
Address:

1. How have you been harmed?

( ) Not hired	( ) Discharge	( ) Demotion
( ) Promotion	( ) Layoff	( ) Other terms of
( ) Transfer	( ) Retirement	employment (specify)
( ) Leave	( ) Benefits	
( ) Pay	( ) Harassment	( ) Accommodation
( ) Discipline	( ) Sexual harassment	of a disability

2. Date of Harm:

3. What was the thing about you that motivated the employer or union to take whatever action it took against you?

( ) Race ( ) Pregnancy ( ) National Origin
( ) Color ( ) Religion ( ) Age
( ) Sex ( ) Disability
( ) Retaliation for having complained about discrimination.

4. If you believe you were discriminated against because of a disability, indicate:

Brief description of disability:
How long the disability will last:
How the disability limits you in important daily activities (such as breathing, concentrating, sleeping, seeing, walking, lifting, and so on)

5. Explain the facts that lead you to believe that your employer or union discriminated against you:

_____6.
(Attach copies of any documents which you believe would support your discrimination claim.)

*****ATTACH ADDITIONAL SHEETS AS NECESSARY*****

(Complete as many of the following questions as apply)
Job title: _____ Date hired:
Salary:
Name of immediate supervisor:
Supervisor's Title:
Unit, department or division:
Number of employees in department or division:

Number of employees with the same job title:

Provide the following information for any witnesses who will provide evidence to support your allegations:

Name:_____	Name:
Home phone: ( ) _____	Home phone: ( )
Work phone: ( ) _____	Work phone: ( )
Address:_____	Address:
Nature of the evidence they will provide:_____	Nature of the evidence they will provide:

_____

Have you sought assistance from any other government agency, union, attorney or other source? ( ) yes ( ) no
Name of source of assistance:
Results, if any:

Have you filed an EEOC charge in the past? No ___ Yes
If yes, provide: Date filed _____ Charge number
Organization charged

How did you hear about the EEOC? _____
[E.g., newspaper article, attended EEOC seminar, radio/t.v. story (when, what station), friend/relative, my lawyer, my union, another agency referred me: _____ (give agency name), etc.]

I declare (certify, verify or state) under penalty of perjury that the foregoing is true and correct to the best of my knowledge. (Filling out this form does not constitue filing a charge.)

Date: _____ Signature:

PRIVACY ACT STATEMENT

(This form is covered by the Privacy Act of 1974, Public Law 930579. Authority for requesting the personal data and the uses thereof are given below.)

FORM NUMBER/TITLE/DATE:EEOC FORM 233, INTAKE QUESTIONNAIRE, AUGUST 1987

AUTHORITY:42 U.S.C. 2000e-5(b), 29 U.S.C. Section 626.

PRINCIPAL PURPOSE: The purpose of this questionnaire is to solicit information to enable the Commission to avoid the intake of matters not within its jurisdiction.

ROUTINE PURPOSES: Information provided on this form will be used by Commission employees to determine the existence of facts relevant to a decision as to whether the Commission has jurisdiction over potential charges, complaints or allegations of employment discrimination and to provide such pre-charge filing counseling as is appropriate. Information provided on this form may be disclosed to other state, local and federal agencies as may be appropriate or necessary to carry out the Commission's functions. This would include employment practices laws. Information may also be disclosed to Charging Parties in consideration of or connection with litigation.

WHETHER DISCLOSURE IS MANDATORY OR VOLUNTARY AND EFFECT ON INDIVIDUAL FOR NOT PROVIDING INFORMATION: The providing of this information is voluntary but the failure to do so may hamper the Commission's investigation of a charge of discrimination. It is not mandatory that this form be used to provide the requested information.

NYSDHR

THIS FORM IS NOT A DHR VERIFIED COMPLAINT
FOR INFORMATIONAL PURPOSES ONLY

TIME ARRIVED _____ TIME TAKEN _____ DATE _____

INFORMATION ABOUT YOU

NAME _____

SOCIAL SECURITY NO. _____

ADDRESS _____

_____

TELEPHONE NO. HOME ( ) _____ WORK ( ) _____

EMAIL ADDRESS: _____

DATE OF BIRTH: _____

SEX: MALE_____ FEMALE_____

MARITAL STATUS: MARRIED___ UNMARRIED___ DIVORCED___
SEPARATED___ WIDOWED___

ETHNICITY: BLACK (NON-HISPANIC)___ HISPANIC___ ASIAN PACIFIC___
AMERICAN INDIAN OR ALASKAN___ WHITE (NON-HISPANIC)___

EDUCATION (CIRCLE HIGHEST YEAR COMPLETED) PRIMARY 1 2 3 4 5 6 7 8

HIGH SCHOOL 1 2 3 4 COLLEGE 1 2 3 4 GRADUATE SCHOOL 1 2
MASTER___ DOCTORATE___ OTHER SPECIFY___ _____

IF EMPLOYMENT RELATED, CURRENT OCCUPATION_____

TITLE HELD AT TIME OF DISCRIMINATION_____

APPROXIMATE NUMBER OF EMPLOYEES_____

DATES OF EMPLOYMENT: FROM_____ TO_____

*MOST RECENT DATE OF VIOLATION/DISCRIMINATION_____

HAVE YOU FILED A COMPLAINT WITH ANOTHER AGENCY? IN COURT? IF SO, NAME AGENCY OR COURT_____

PERSON OF ANOTHER ADDRESS WHO WILL KNOW YOUR WHEREABOUTS (THIS IS VERY IMPORTANT)

NAME:_____

ADDRESS:_____

PHONE NUMBER:( ) _____

INFORMATION ABOUT RESPONDENT

WHO DISCRIMINATED AGAINST YOU? _____

NAME OF EMPLOYER, LABOR ORGANIZATION, HOUSING OWNER, REAL ESTATE AGENCY OR PUBLIC ACCOMMODATION_____
(COMPANY NAME)

NAME AND TITLE OF CONTACT PERSON_____
(DIRECTOR OF PERSONNEL, GENERAL COUNSEL OR EEO OFFICER)

ADDRESS OF WORK SITE _____

_____

TELEPHONE NUMBER ( ) _____

ADDRESS OF MAIN OFFICE _____

_____

TELEPHONE NUMBER ( )

FAX NUMBER ( ) _____

TYPE OF INDUSTRY_____

NAME AND TITLE OF PERSON(S) WHO DISCRIMINATED AGAINST YOU_____

TYPE OF DISCRIMINATION

EMPLOYMENT____ HOUSING____ PUBLIC ACCOMMODATIONS____
(RESTAURANTS, HOTELS, STORES,ETC.)

BASIS OF DISCRIMINATION (CHECK THE REASON(S) YOU BELIEVE YOU WERE DISCRIMINATED AGAINST)

RACE/COLOR___ NATIONAL ORIGIN___ SEX___ AGE___

DISABILITY___ MARITAL STATUS___ CREED___ RETALIATION___

SEXUAL ORIENTATION___ MILITARY STATUS____

PRIOR ARREST OR CONVICTION RECORD___

*INITIAL DATE OF VIOLATION/DISCRIMINATION_____

*MOST RECENT DATE OF VIOLATION/DISCRIMINATION_____

*SITE/COUNTY OF ALLEGED DISCRIMINATION_____

PROVIDE A BRIEF EXPLANATION OF THE ACT OF DISCRIMINATION: (DESCRIBE WHAT HAPPENED TO YOU AND THE REASON GIVEN FOR THE ACT OF DISCRIMINATION, AND THE NAME(S), TITLE(S), EMPLOYER(S) OF INDIVIDUAL(S) WHO COMMITTED ACT OF DISCRIMINATION, AND GIVE THE DATE (S) OF OCCURRENCE(S).

SUPPLEMENTAL INFORMATION FOR INVESTIGATION OF COMPLAINT

DATE _____

COMPLAINANT NAME_____ _____

1. INTERESTED IN CONCILIATION (AMICABLE RESOLUTION OF COMPLAINT)?
   YES____ NO____

2. REMEDY YOU SEEK____ _____

3. WITNESSES TO DISCRIMINATION:

NAME	TEL. NO.
_____	(____)_____
_____	(____)_____
_____	(____)_____

EXPLAIN WHAT THE WITNESS(ES) WOULD TESTIFY TO

_____ _____ _____

_____ _____ _____

_____ _____ _____

_____ _____ _____

_____ _____ _____

_____ _____ _____

(NOTE: IF MEDICAL RECORDS ARE TO BE SECURED OR PRESENTED AS EVIDENCE, YOU WILL NEED TO SIGN A HIPAA FORM)

4. SIMILAR ACTS DONE TO OTHER WORKERS?

NAME	TITLE	TEL. NO.
_____	_____	(____)_____
_____	_____	(____)_____
_____	_____	(____)_____
_____	_____	(____)_____

5. COMPARATIVE DATA

LIST WORKERS IN YOUR DEPARTMENT

NAME	TITLE	COMPARATIVE BASIS (EXAMPLE: BLACK, IF YOU ARE CLAIMING DISCRIMINATION BASED ON YOUR RACE/COLOR)

6. WHAT RESPONDENT RECORDS WOULD BE USEFUL IN INVESTIGATING YOUR COMPLAINT?

NYSDHR

TO BE COMPLETED BY DHR STAFF ONLY

NAME:_____ _____ _____

NATURE OF CONTACT: PHONE CALL:_____ WALK IN:_____

APPOINTMENT GIVEN:_____ ___ ACCEPTED:_____ NOT ACCEPTED:_____

REFERRED TO:_____ _____

SUPERVISOR ASSISTANCE:___ _____ HRS:____ _____

INTERNET
FORM NLRB-508
(6-90)

FORM EXEMPT UNDER 44 U.S.C. 3512

UNITED STATES OF AMERICA
NATIONAL LABOR RELATIONS BOARD

CHARGE AGAINST LABOR ORGANIZATION OR ITS AGENTS

DO NOT WRITE IN THIS SPACE	
Case	Date Filed

INSTRUCTIONS: File an original and 4 copies of this charge and an additional copy for each organization, each local, and each individual named in item 1 with the NLRB Regional Director of the region in which the alleged unfair labor practice occurred or is occurring.

1. LABOR ORGANIZATION OR ITS AGENTS AGAINST WHICH CHARGE IS BROUGHT

a. Name	b. Union Representative to contact

c. Telephone No.	d. Address *(street, city, state and ZIP code)*

e. The above-named organization(s) or its agents has *(have)* engaged in and is *(are)* engaging in unfair labor practices within the meaning of section 8(b), subsection(s) *(list subsections)* _____ of the National Labor Relations Act, and these unfair labor practices are unfair practices affecting commerce within the meaning of the Act.

2. Basis of the Charge *(set forth a clear and concise statement of the facts constituting the alleged unfair labor practices)*

3. Name of Employer	4. Telephone No.

5. Location of plant involved *(street, city, state and ZIP code)*	6. Employer representative to contact

7. Type of establishment *(factory, mine, wholesaler, etc.)*	8. Identify principal product or service	9. Number of workers employed

10. Full name of party filing charge

11. Address of party filing charge *(street, city, state and ZIP code)*	12. Telephone No.

13. DECLARATION

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

By _____ _____
(signature of representative or person making charge) *(title or office, if any)*

Address _____ _____ _____
(Telephone No.) *(date)*

WILLFUL FALSE STATEMENTS ON THIS CHARGE CAN BE PUNISHED BY FINE AND IMPRISONMENT (U. S. CODE, TITLE 18, SECTION 1001)

*U.S. GPO: 2000-464-540/29074

INTERNET
FORM NLRB-501
(11-94)

FORM EXEMPT UNDER 44 U.S.C. 3512

UNITED STATES OF AMERICA
NATIONAL LABOR RELATIONS BOARD

CHARGE AGAINST EMPLOYER

DO NOT WRITE IN THIS SPACE	
Case	Date Filed

INSTRUCTIONS:

File an original and 4 copies of this charge with NLRB Regional Director for the region in which the alleged unfair labor practice occurred or is occurring.

1. EMPLOYER AGAINST WHOM CHARGE IS BROUGHT

a. Name of Employer		b. Number of Workers Employed
c. Address *(street, city, State, ZIP, Code)*	d. Employer Representative	e. Telephone No. Fax No.
f. Type of Establishment *(factory, mine, wholesaler, etc.)*	g. Identify Principal Product or Service	

h. The above-named employer has engaged in and is engaging in unfair labor practices within the meaning of Section 8(a), subsections (1) and *(list subsections)* _____ of the National Labor Relations Act, and these unfair labor practices are unfair practices affecting commerce within the meaning of the Act.

2. Basis of the Charge *(set forth a clear and concise statement of the facts constituting the alleged unfair labor practices.)*

By the above and other acts, the above-named employer has interfered with, restrained, and coerced employees in the exercise of the rights guaranteed in Section 7 of the Act.

3. Full name of party filing charge *(if labor organization, give full name, including local name and number)*

4a. Address *(street and number, city, State, and ZIP Code)*	4b. Telephone No. Fax No.

5. Full name of national or international labor organization of which it is an affiliate or constituent unit *(to be filled in when charge is filed by a labor organization)*

6. DECLARATION

I declare that I have read the above charge and that the statements are true to the best of my knowledge and belief.

By _____ _____
(Signature of representative or person making charge) *(Title,if any)*

Fax No. _____

Address _____ _____ _____
(Telephone No.) *Date*

WILLFUL FALSE STATEMENTS ON THIS CHARGE CAN BE PUNISHED BY FINE AND IMPRISONMENT (U.S. CODE, TITLE 18, SECTION 1001)

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The Committee gratefully acknowledges Rebecca G. Fischer for her major contribution to the drafting of the Handbook and Patricia Simpson for her assistance in the preparation of the Handbook.

The employment-at-will doctrine: three major exceptions

In the United States, employees without a written employment contract generally can be fired for good cause, bad cause, or no cause at all; judicial exceptions to the rule seek to prevent wrongful terminations

Charles J. Muhl

Work joyfully and peacefully, knowing that
right thoughts and right efforts will
inevitably bring about right results
—James Allen

See only that thou work and thou canst
not escape the reward
—Ralph Waldo Emerson

Like Allen and Emerson, many workers in the United States believe that satisfactory job performance should be rewarded with, among other benefits, job security. However, this expectation that employees will not be fired if they perform their jobs well has eroded in recent decades in the face of an increased incidence of mass layoffs, reductions in companies' workforces, and job turnover. In legal terms, though, since the last half of the 19th century, employment in each of the United States has been "at will," or terminable by either the employer or employee for any reason whatsoever. The employment-at-will doctrine avows that, when an employee does not have a written employment contract and the term of employment is of indefinite duration, the employer can terminate the employee for good cause, bad cause, or no cause at all.[1]

Traditionally and as recently as the early 1900s, courts viewed the relationship between employer and employee as being on equal footing in terms of bargaining power. Thus, the employment-at-will doctrine reflected the belief that people should be free to enter into employment contracts of a specified duration, but that no obligations attached to either employer or employee if a person was hired without such a contract. Because employees were able to resign from positions they no longer cared to occupy, employers also were permitted to discharge employees at their whim.

The Industrial Revolution planted the seeds for the erosion of the employment-at-will doctrine. When employees began forming unions, the collective bargaining agreements they subsequently negotiated with employers frequently had provisions in them that required just cause for adverse employment actions, as well as procedures for arbitrating employee grievances.[2] The 1960s marked the beginning of Federal legislative protections (including Title VII of the 1964 Civil Rights Act) from wrongful discharge based on race, religion, sex, age, and national origin.[3] These protections reflected the changing view of the relationship between employer and employee. Rather than seeing the relationship as being on equal footing, courts and legislatures slowly began to recognize that employers frequently have structural and economic advantages when negotiating with potential or current employees. The recognition of employment as being central to a person's livelihood and well-being, coupled with

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the fear of being unable to protect a person's livelihood from unjust termination, led to the development of common-law, or judicial, exceptions to the employment-at-will doctrine beginning in the late 1950s. The bulk of the development of these exceptions did not take place until the 1980s, but as we enter the new millennium, the employment-at-will doctrine has been significantly eroded by statutory and common-law protections against wrongful discharge.

This article focuses on the three major exceptions to the employment-at-will doctrine, as developed in common law, including recognition of these exceptions in the 50 States. The exceptions principally address terminations that, although they technically comply with the employment-at-will requirements, do not seem just. The most widespread exception prevents terminations for reasons that violate a State's public policy. Another widely recognized exception prohibits terminations after an implied contract for employment has been established; such a contract can be created through employer representations of continued employment, in the form of either oral assurances or expectations created by employer handbooks, policies, or other written assurances. Finally, a minority of States has read an implied covenant of good faith and fair dealing into the employment relationship. The good-faith covenant has been interpreted in different ways, from meaning that terminations must be for cause to meaning that terminations cannot be made in bad faith or with malice intended. Only six western States—Alaska, California, Idaho, Nevada, Utah, and Wyoming—recognize all three of the major exceptions.[4] Three southern States—Florida, Georgia, and Louisiana—and Rhode Island do not recognize *any* of the three major exceptions to employment at will. (See exhibit 1.)

Public-policy exception

Under the public-policy exception to employment at will, an employee is wrongfully discharged when the termination is against an explicit, well-established public policy of the State. For example, in most States, an employer cannot terminate an employee for filing a workers' compensation claim after being injured on the job, or for refusing to break the law at the request of the employer. The majority view among States is that public policy may be found in either a State constitution, statute, or administrative rule, but some States have either restricted or expanded the doctrine beyond this bound. The public-policy exception is the most widely accepted exception, recognized in 43 of the 50 States. (See map 1.)

Although the significant development of exceptions to employment at will occurred in the 1980s, the first case to recognize a public-policy exception occurred in California in 1959. In *Petermann* v. *International Brotherhood of Teamsters*,[5] Peter Petermann was hired by the Teamsters Union as a busi-

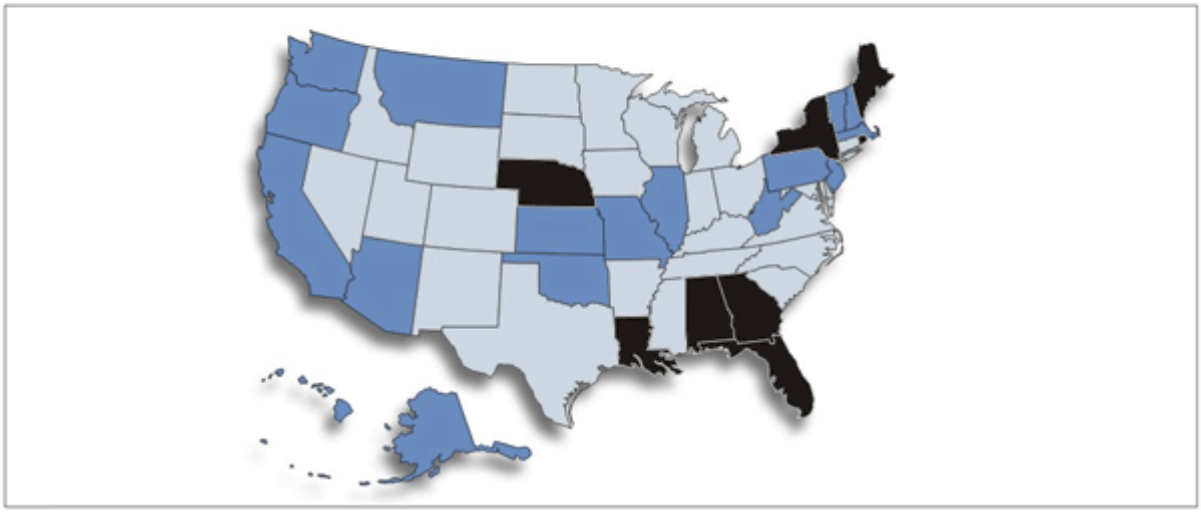
Exhibit 1. Recognition of employment-at-will exceptions, by State, as of Oct. 1, 2000

State	Public-policy exception	Implied-contract exception	Covenant of good faith and fair dealing
Total	43	38	11
Alabama	no	yes	yes
Alaska	yes	yes	yes
Arizona	yes	yes	yes
Arkansas	yes	yes	no
California	yes	yes	yes
Colorado	yes	yes	no
Connecticut	yes	yes	no
Delaware	yes	no	yes
District of Columbia	yes	yes	no
Florida	no	no	no
Georgia	no	no	no
Hawaii	yes	yes	no
Idaho	yes	yes	yes
Illinois	yes	yes	no
Indiana	yes	no	no
Iowa	yes	yes	no
Kansas	yes	yes[1]	no
Kentucky	yes	yes	no
Louisiana	no	no	no
Maine	no	yes	no
Maryland	yes	yes	no
Massachusetts	yes	no	yes
Michigan	yes	yes	no
Minnesota	yes	yes	no
Mississippi	yes[1]	yes	no
Missouri	yes	no[1]	no
Montana	yes	no	yes
Nebraska	no	yes	no
Nevada	yes	yes	yes
New Hampshire	yes	yes	no[1]
New Jersey	yes	yes	no
New Mexico	yes	yes	no
New York	no	yes	no
North Carolina	yes	no	no
North Dakota	yes	yes	no
Ohio	yes[1]	yes	no
Oklahoma	yes	yes	no
Oregon	yes	yes	no
Pennsylvania	yes	no	no
Rhode Island	no	no	no
South Carolina	yes	yes	no
South Dakota	yes	yes	no
Tennessee	yes	yes	no
Texas	yes	no	no
Utah	yes	yes	yes
Vermont	yes	yes	no
Virginia	yes	no	no
Washington	yes	yes	no
West Virginia	yes	yes	no
Wisconsin	yes	yes	no
Wyoming	yes	yes	yes

[1] Overturned previous decision that was contrary to current doctrine.

SOURCE: Data are from David J. Walsh and Joshua L. Schwarz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am. Bus. L.J.* 645 (summer 1996). Case law was shepardized (verified) to update the recognition of exceptions through Oct. 1, 2000.

Map 1. Public-policy exception to employment at will



Yes, based on public policy from State constitution and statutes, as well as broader notions of public good and civic duty

Yes, based strictly on public policy from State constitution and statutes

No

SOURCE: Based on data from David J. Walsh and Joshua L. Schwartz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am.Bus.L.J. 645* (summer 1996).

ness agent and was told by its secretary-treasurer that he would be employed for as long as his work was satisfactory. During his employment, Petermann was subpoenaed by the California legislature to appear before, and testify to, the Assembly Interim Committee on Governmental Efficiency and Economy, which was investigating corruption inside the Teamsters Union. The union directed Petermann to make false statements to the committee during his testimony, but he instead truthfully answered all questions posed to him. He was fired the day after his testimony.

In recognizing that an employer's right to discharge an employee could be limited by considerations of public policy, the California appellate court found that the definition of public policy, while imprecise, covered acts that had a "tendency to be injurious to the public or against the public good."[6] The court noted that, in California as elsewhere, perjury and the solicitation of perjury were criminal offenses and that false testimony in any official proceeding hindered the proper administration of both public affairs and justice. Even though employer and employee could otherwise be prosecuted under the criminal law for perjury or solicitation of perjury, the court found that applying the public policy exception in this context would more fully effectuate California's declared policy against perjury. Holding otherwise would encourage criminal conduct by both employer and employee, the court reasoned.

Courts in other States were slow to follow California's lead. No other State considered adopting such an exception until after 1967, and only 22 States had considered the exception by the early 1980s.[7] Courts clearly struggled with the meaning of the phrase "public policy," with some finding that a policy was public only if it was clearly enunciated in a State's constitution or statutes and others finding that a public policy could be inferred from a statute even where the statute neither required nor permitted an employee to act in a manner that subsequently resulted in the employee's termination. The courts that refused to recognize the exception generally found that, given the vagueness of the term "public policy," such exceptions to employment at will should be created by legislative, not judicial, act.[8]

In 1981, one of the broadest definitions of "public policy" was adopted by the Illinois Supreme Court in *Palmateer* v. *International Harvester Company*.[9] In this case, Ray

Palmateer alleged that he was fired from his job with International Harvester after he provided information to local law enforcement authorities about potential criminal acts by a coworker and indicated that he would assist in any criminal investigation and subsequent trial. The court noted that the traditional employment-at-will rule was grounded in the notion that the employment relationship was based on reciprocal rights, and because an employee was free to end employment at any time for any condition merely by resigning, the employer was entitled to the same right in return. Rejecting this "mutuality theory," the court pointed to the rising number of large corporations that conduct increasingly specialized operations, leading their employees' skills to become more specialized in turn and, hence, less marketable. These changes made it apparent to the court that employer and employee are not on equal footing in terms of bargaining power. Thus, the public-policy exception to the employment-at-will doctrine was necessary to create a "proper balance...between the employer's interest in operating a business efficiently and profitably, the employee's interest in earning a livelihood, and society's interest in seeing its public policies carried out."[10]

The Illinois court found that matters of public policy "strike at the heart of a citizen's social rights, duties, and responsibilities" and could be defined in the State constitution or statutes.[11] Beyond that, when the constitution and statutes were silent, judicial decisions could also create such policy, the court said in creating a broad scope for its exception. In this case, nothing in the Illinois Constitution or statutes required or permitted an employee to report potential criminal activity by a coworker. However, the court found that public policy favored citizen crime fighters and the exposure of criminal activity. Thus, Palmateer brought an actionable claim for retaliatory discharge.

Two years after *Palmateer*, the Wisconsin Supreme Court rejected such an expansive definition of public policy and limited the application of this employment-at-will exception in its State to cases in which the public policy was evidenced by a constitutional or statutory provision. In *Brockmeyer* v. *Dun & Bradstreet*,[12] the court found that the public-policy exception should apply neither to situations in which actions are merely "consistent with a legislative policy" nor to "judicially conceived and defined notions of public policy."[13]

In *Brockmeyer*, the plaintiff worked for Dun & Bradstreet from August 1969 to May 1980, the last 3 years as district manager of the Credit Services Division in Wisconsin. Brockmeyer had an above-average performance record, but in February 1980, his immediate supervisors learned that he was vacationing with his secretary when it was understood by others that he was performing his normal duties as district manager. The supervisors also learned that Brockmeyer had smoked marijuana in the presence of other employees. The supervisors confronted him with the allegations and stated unequivocally that he would be terminated or reassigned if his performance did not improve. They also suggested that either he or his secretary would have to find a reassignment within Dun & Bradstreet so that they would not continue to work together. When Brockmeyer tried unsuccessfully to find another position for his secretary, the supervisors sought and obtained her resignation. After leaving, the former secretary filed a sex discrimination claim against Dun & Bradstreet; Brockmeyer indicated to his supervisors that he would tell the truth if called to testify at a trial regarding this complaint. Dun & Bradstreet settled the sex discrimination suit, and Brockmeyer was fired 3 days later.

Brockmeyer contended that his termination violated Wisconsin statutes that prohibited (1) perjury, (2) willful and malicious injuring of another in his or her reputation, trade, business, or profession, and (3) the use of threats, intimidation, force, or coercion to keep a person from working. Rejecting these claims, the Wisconsin Supreme Court found that Dun & Bradstreet did not engage in any behavior that violated these statutes. Dun & Bradstreet had legitimate reasons for terminating Brockmeyer, and no evidence demonstrated that Dun & Bradstreet had asked him to lie in the event that the sex discrimination action by his secretary went to trial. The court held that it was not the State's public policy to prevent discharge of an employee because the employee may testify in a manner contrary to his employer's interests.

The court in *Brockmeyer* decided to limit the application of the public-policy exception to "fundamental and well-defined public policy as evidenced by existing law" and held that a wrongful-discharge claim should not be actionable merely because an "employee's conduct was praiseworthy or because the public may have derived some benefit from it."[14] The court justified its limitation by saying that it would safeguard employee job security interests against employer actions that undermine fundamental policy preferences, while still providing employers with flexibility to make personnel decisions in line with changing economic conditions. Later, the court issued a clarification to the effect that public policy could support a wrongful-termination suit in cases where an explicit constitutional or legislative statement did not evidence that policy, as long as the policy was evident from "the spirit as well as the letter" of the constitutional and legislative provisions.[15] The court also now permits public policy to be evidenced by administrative rules and regulations.[16]

Seven States have rejected the public-policy exception in its entirety: Alabama, Florida, Georgia, Louisiana, Nebraska, New York, and Rhode Island.[17] In *Murphy* v. *American Home Products Corporation*,[18] the Court of Appeals of New York (the State's highest court) forcefully argued that such exceptions to the employment-at-will doctrine were the province of legislators, not judges. While recognizing that many other jurisdictions had created a public-policy exception, the court

found that legitimacy of the principal justification for such adoption—namely, inadequate bargaining power on the part of employees—was better left to the New York legislature to evaluate. The court found that legislators have "greater resources and procedural means to discern the public will" and "elicit the view of the various segments of the community that would be directly affected".[19] Because the recognition of such an exception requires some sort of principal scheme for its application, the configuration of that scheme must be determined by the legislature after the public has had its opportunity to communicate its views, according to the court. Finally, the court found that any such change in the employment-at-will doctrine would fundamentally alter rights and obligations under the employment relationship and thus should be applied prospectively by the legislature, rather than retrospectively by the court.[20]

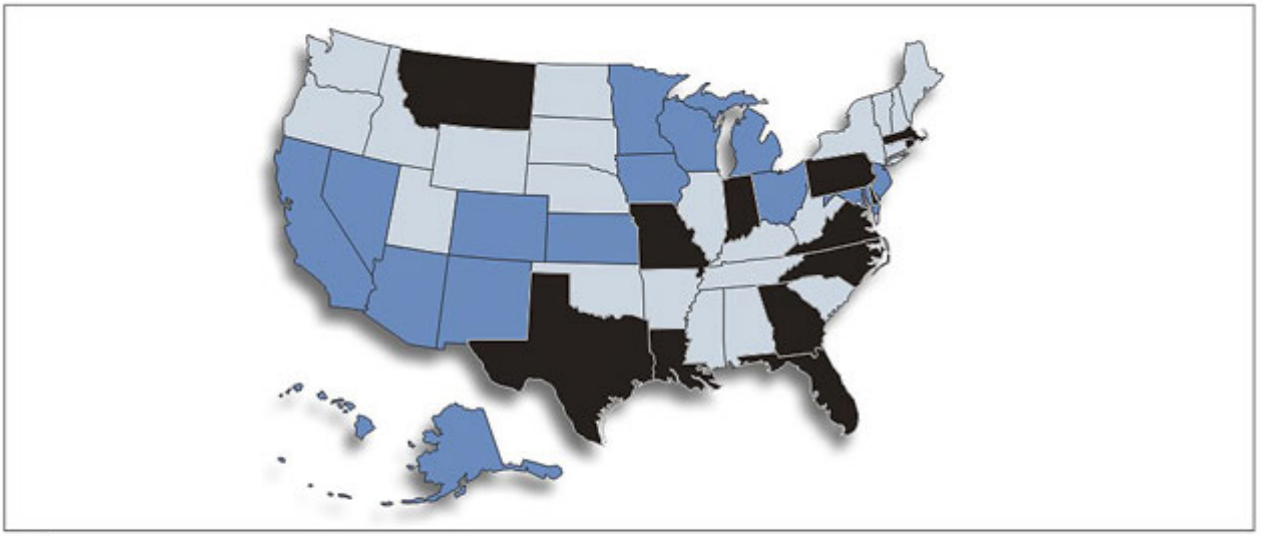
To summarize, the vast majority of States do recognize some form of a public-policy exception to the employment-at-will doctrine. Such a regulation prevents employees from being terminated for an action that supports a State's public policy. The definition of public policy varies from State to State, but most States either narrowly limit the definition to clear statements in their constitution or statutes, or permit a broader definition that enables judges to infer or declare a State's public policy beyond the State's constitution or statutes.

Implied-contract exception

The second major exception to the employment-at-will doctrine is applied when an implied contract is formed between an employer and employee, even though no express, written instrument regarding the employment relationship exists. Although employment is typically not governed by a contract, an employer may make oral or written representations to employees regarding job security or procedures that will be followed when adverse employment actions are taken. If so, these representations may create a contract for employment. This exception is recognized in 38 of the 50 States. (See map 2.)

A common occurrence in the recent past was courts finding that the contents and representations made in employee handbooks could create an implied contract, absent a clear and express waiver that the guidelines and policies in such

Map 2. Implied-contract exception to employment at will, oral assurances and written assurances (handbook)



Yes, including oral and written assurances by employers; disclaimers not per se defense

Yes, limited to written assurances; disclaimers nullify employer representation if unambiguous and prominent

No

SOURCE: Based on data from David J. Walsh and Joshua L. Schwartz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am.Bus.L.J. 645* (summer 1996).

handbooks did not create contract rights. The typical situation involves handbook provisions which state that employees will be disciplined or terminated only for "just cause" or under other specified circumstances, or provisions which indicate that an employer will follow specific procedures before disciplining or terminating an employee.[21] A hiring official's oral representations to employees, such as saying that employment will continue as long as the employee's performance is adequate, also may create an implied contract that would prevent termination except for cause.

The leading case having to do with the implied-contract exception is *Toussaint* v. *Blue Cross & Blue Shield of Michigan*, decided by the Supreme Court of that State in 1980.[22] Charles Toussaint had been employed in a middle management position with Blue Cross for 5 years before his employment was terminated. When he was hired, he asked his hiring official about his job security and was told that his employment would continue "as long as [he] did [his] job." Toussaint also was provided with a manual of Blue Cross personnel policies some 260 pages long; within the manual were statements that disciplinary procedures would be applied to all Blue Cross employees who completed their probationary period and that it was Blue Cross' policy to terminate employees only for "just cause."

The court ruled that, even if employment is not for a definite term, a provision indicating that an employee would be fired only for just cause was enforceable and that such a provision could create an implied contract if it engendered legitimate expectations of job security in the employee. If the employee is arbitrarily fired thereafter, then a claim for wrongful discharge is actionable. The court noted that Blue Cross could have established a policy giving it the right to terminate employees for no cause at all, but chose instead to follow a "just cause" termination policy. The court argued that employer policies and practices create a "spirit of cooperation and friendliness" in the workforce, making employees "orderly, cooperative, and loyal" by giving them peace of mind regarding job security and the belief that they will be treated fairly when termination decisions are made.[23] If an employer's actions lead an employee to believe that the policies and guidelines of the employer are "established and official at any given time, purport to be fair, and are applied consistently and uniformly to each employee," then the employer has created an obligation.[24] That obligation is created even though the parties may not have mutually agreed that contract rights would be established by the policies.

An implied contract for employment cannot be disregarded at the employer's whim, but the employer can prevent the contract from being created by including in its policies and provisions a clear and unambiguous disclaimer stating that its policies and guidelines do not create contractual rights.[25] If a company does this, no employee could reasonably expect that the policies and guidelines provided a contractual right to job security or any other benefit described therein.

In *Pine River State Bank* v. *Mettilee*,[26] the Minnesota Supreme Court agreed with the rationale behind *Touissant*. In *Pine River*, an employee handbook was given to an employee after he had been working for the bank for several months. The handbook contained two sections that the employee claimed created contract rights. The first was a section titled "Job Security" that described employment in the banking industry (though not the specific bank) as secure. The second involved the bank's "Disciplinary Policy," which outlined specific procedures, including reprimands and opportunities to correct one's behavior, that would be followed if an employee was alleged to have violated a company policy. The court found that the "Job Security" section was insufficient to create contract rights, but that the "Disciplinary Policy" section was sufficient. The court analyzed that provision according to traditional requirements for the creation of a contract: offer, acceptance, and consideration for the contract. The court found that the employer offered employment subject to the terms in the employee handbook; the employee accepted the employment offer by showing up for work. The employee's labor was the consideration in support of the contract. Thus, argued the court, the employer breached the employment contract by terminating the employee without following the specific procedures outlined in the handbook that created the implied contract. The court reasoned that, when an employer chooses to prepare and distribute a handbook, the employer is choosing to "implement or modify its existing contracts with all employees covered by the handbook."[27]

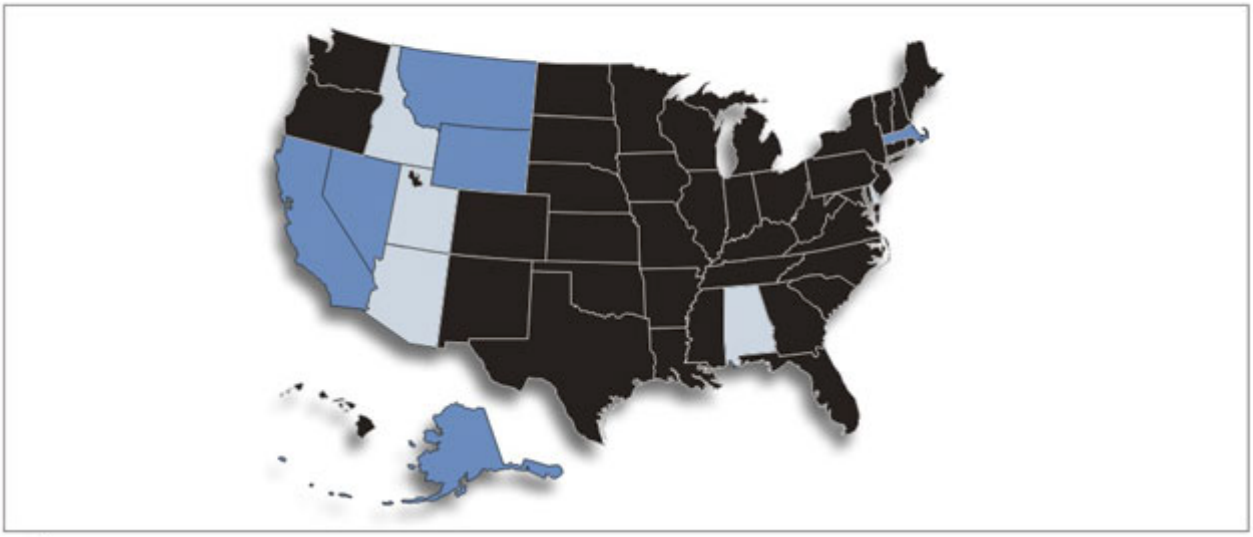
Among the States rejecting the application of an implied-contract exception to employment at will are Florida, Pennsylvania, and Texas. In *Muller* v. *Stromberg Carlson Corporation*,[28] a Florida appellate court rejected the exception because of fear that it would lead to uncertainty in the application of the law. Walter H. Muller sued Stromberg Carlson following his termination and alleged that, pursuant to the company's merit pay plan that required an annual review of an employee's performance and a recommendation as to pay increases based on that performance, he had an annual implied-employment contract. The Florida court rejected Muller's claim, finding no justification to depart from the "long established principles that an employment contract requires definiteness and certainty in its terms."[29] The court reasoned that, if indefinite terms or assurances were used to imply an employment contract, the courts in Florida would be "flooded with claims that judicial discretion be substituted for employer discretion."[30] Addressing the arguments made by the Michigan Supreme Court in *Toussaint*, the court said that the longstanding view in Florida, contrary to that in Michigan, was that beneficial social or economic policy should not be advanced by judicial decisions. The Florida court believed the judicial function to

be advancing certainty in business relationships by providing meaningful criteria that lead to predictable consequences. The court had "serious reservations as to the advisability of relaxing the requirements of definiteness in employment contracts considering the concomitant uncertainty which would result in the employer-employee relationships."[31] The court added that the inequality of bargaining power between employers and their employees was not a sufficient basis to create implied contracts of employment based on oral or written assurances.

Texas refused to recognize the implied-contract exception in the 1986 case *Webber* v. *M. W. Kellogg Company*.[32] In that case, the court found that a letter offering a position of employment, the classification of an employee as "permanent" rather than "temporary," and the identification in company documents of a scheduled retirement date for the employee some 22 years after employment was initiated were insufficient in sum to create an implied contract of employment for a specific duration. Likewise, in *Richardson* v. *Charles Cole Memorial Hospital*,[33] the Supreme Court of Pennsylvania rejected the implied-contract exception, finding that policies published in an employee handbook did not create a "meeting of the minds," one of the traditional standards for evaluating whether a contract has been created between two parties. Because the terms of the handbook were not bargained for in the traditional sense, the court reasoned, the benefits conferred upon the parties by the handbook were mere gratuities and not rights that were contracted for.

To summarize, then, employers' oral or written assurances regarding job tenure or disciplinary procedures can create an implied contract for employment under which the employer cannot terminate an employee without just cause and cannot take any other adverse employment action without following such procedures. Employers can prevent written assurances from creating an implied contract by including a clear and unambiguous disclaimer characterizing those assurances as

Map 3. Covenant-of-good-faith-and-fair-dealing exception to employment at will



Yes, plaintiff can sue in tort or contract, or otherwise broader application

Yes, limited to contractual remedies or narrower application

No

SOURCE: Based on data from David J. Walsh and Joshua L. Schwartz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am.Bus.L.J. 645* (summer 1996).

company policies that do not create contractual obligations. Oral assurances must create a reasonable expectation in the employee in order for an implied contract to be created.

Covenant-of-good-faith exception

Recognized by only 11 States (see map 3), the exception for a covenant of good faith and fair dealing represents the most significant departure from the traditional employment-at-will doctrine.[34] Rather than narrowly prohibiting terminations based on public policy or an implied contract, this exception—at its broadest—reads a covenant of good faith and fair dealing into *every* employment relationship. It has been interpreted to mean either that employer personnel decisions are subject to a "just cause" standard or that terminations made in bad faith or motivated by malice are prohibited.[35]

As with the public-policy exception, California courts were the first to recognize an implied covenant of good faith and fair dealing in the employment relationship. In *Lawrence M. Cleary* v. *American Airlines, Inc.*,[36] an American Airlines employee who had worked satisfactorily for the company for 18 years was terminated without any reason given. A California appellate court held that, in virtue of the airline's express policy of adjudicating personnel disputes *and the longevity of the employee's service*, the employer could not fire the employee without good cause. The court stated that "Termination of employment without legal cause after such a period of time offends the implied-in-law covenant of good faith and fair dealing" and that, from the covenant, "a duty arose on the part of...American Airlines…to do nothing which would deprive…the employee…of the benefits of the employment...having accrued during [the employee's] 18 years of employment."[37] This California appellate case was decided in 1980, and the factual situation included an implied employment contract. However, the court did not hold that a covenant of good faith and fair dealing was actionable only if an employee had an express or implied employment contract from which the covenant could arise. Rather, the appellate court found that a tort action could be maintained for breach of the covenant of good faith and fair dealing in every employment relationship, not just those covered by an express or implied contract. The California Supreme Court subsequently rejected this formulation and eliminated the tort action.[38]

Later, however, in *Kmart Corporation* v. *Ponsock*, the Supreme Court of Nevada permitted a cause of action in tort for breach of an implied covenant of good faith and fair dealing in every employment relationship.[39] Ponsock was a tenured employee at Kmart, hired until retirement or as long as economically possible. At trial, the jury found that Kmart terminated Ponsock to avoid having to pay him retirement benefits. As part of his case, he claimed that Kmart's discharge was in "bad faith" and that, even without a contract,[40] such a termination gave rise to tort liability. The court agreed, citing the employer-employee relationship as one of the "rare and exceptional cases that the duty [of law] is of such a nature as to give rise to tort liability."[41]

In its opinion, the court recognized the changes that many feel have occurred in the employment relationship:

> We have become a nation of employees. We are dependent upon others for our means of livelihood, and most of our people have become completely dependent upon wages. If they lose their jobs they lose every resource except for the relief supplied by the various forms of social security. Such dependence of the mass of the people upon others for all of their income is something new in the world. For our generation, the substance of life is in another man's hands.[42]

The court found that Ponsock was dependent on Kmart's commitment to extended employment and to retirement benefits based on that employment and that the "special relationships of trust" required a tort remedy in addition to any available contractual remedy if the employer conducts an "abusive and arbitrary" dismissal. Providing such a remedy, the court reasoned, would deter employers from engaging in such malicious behavior. Because the termination in *Ponsock* was motivated by the company's desire to serve its own financial ends, the employee was entitled to recover for a bad-faith agreement.

The vast majority of courts have rejected reading such an implied covenant into the employment relationship. The reasoning used by a Florida appellate court in *Catania* v. *Eastern Airlines, Inc.*,[43] is representative. Four employees alleged that Eastern had wrongfully discharged them and claimed, among other things, that they were entitled to a good-faith review of the discharge. The court summarized the plaintiffs' argument as follows:

> To require employers to demonstrate valid grounds and methods for an employee's discharge does not unduly restrict employers; it merely provides some balance of power. It is apparent that there is not truly freedom of contract between an employer and employee; the individual employee has no power or ability at all to negotiate an employment contract more favorable to himself. And the traditional common law [the employment-at-will doctrine] totally subordinates an interest of the employee to the employer's freedom.

Rejecting the "plaintiff's invitation to be a 'law giver'" and applying reasoning that had been accepted by the Nevada Supreme Court, the Florida court found that the burden on courts of having to determine an employer's motive for terminating an employee was too great an undertaking.

THE EMPLOYMENT RELATIONSHIP IS FOREVER EVOLVING. Additional statutory and common-law exceptions to the employment-at-

will doctrine may be developed in the future, but the traditional doctrine has already been significantly eroded by the public-policy and implied-contract exceptions. In addition to the three exceptions detailed in this article, other common-law limitations on employment at will have been developed, including actions based on the intentional infliction of emotional distress, intentional interference with a contract, and promissory estoppel or detrimental reliance on employer representations. Suits seeking damages for "constructive discharge," in which an employee alleges that he or she was forced to resign, and for "wrongful transfer" or "wrongful demotion" have increased in recent years. Accordingly, nowadays employers must be wary when they seek to end an employment relationship for good cause, bad cause, or, most importantly, no cause at all. □

Notes

[1] Shane and Rosenthal, *Employment Law Deskbook*, § 16.02 (1999).

[2] Jeanne Duquette Gorr, *The Model Employment Termination Act: Fruitful Seed or Noxious Weed?* 31 DUQLR 111 (fall 1992); see also Robert W. Fisher, "When workers are discharged—an overview," *Monthly Labor Review*, June 1973, pp. 4–17.

[3] 42 U.S.C. § 2000e *et seq.* This article does not address statutory exceptions to employment at will. Many such exceptions have been enacted at both the Federal and State level. For example, Federal law prevents employment discrimination, including termination for engaging in lawful union activities (see National Labor Relations Act, 29 U.S.C. § 201–219, 1978) and for safety and health violations at the workplace (see Occupational Safety and Health Act, 29 U.S.C. § 651–678, 1985), among others. Certain States have laws preventing employers from terminating employees for whistle-blowing (reporting potential violations of law committed by the employer); other State laws prohibit employers from terminating employees who file a worker's compensation claim or serve on a jury. (See, generally, Shane and Rosenthal, *Employment Law Deskbook*.) However, only two States—Arizona and Montana—have enacted comprehensive wrongful termination legislation. Montana passed the Wrongful Discharge from Employment Act in 1987, and Arizona enacted its Employment Protection Act in 1996. Of the two, the Montana statute is broader in the scope of its protections for employees.

[4] Courts in Arizona had recognized all three exceptions until passage of the Employment Protection Act.

[5] 174 Cal.App.2d 184 (1959).

[6] 174 Cal.App.2d at 188.

[7] Deborah A. Ballum, "Employment-at-will: The Impending Death of a Doctrine," 37 *Am. Bus. L.J.* 653, 660 (summer 2000).

[8] See, for example, *Pacheo* v. *Raytheon*, 623 A.2d 464 (R.I. 1993); and *Murphy* v. *American Home Products Corp.*, 58 N.Y.2d 293, 448 N.E.2d (1983).

[9] 85 Ill.2d 124, 421 N.E.2d 876 (1981).

[10] *Id.* at 878.

[11] *Id.*

[12] 113 Wis.2d 561, 335 N.W.2d 834 (1983).

[13] *Id.* at 839–40.

[14] *Id.* at 840, citing *Palmateer* v. *International Harvester Co.*, 421 N.E.2d at 883.

[15] See *Wandry* v. *Eye Credit Union*, 129 Wis.2d 37, 384 N.W.2d 325 (1986).

[16] See *Winkelman* v. *Beloit Memorial Hosp.*, 168 Wis.2d 12, 483 N.W.2d 211 (1992).

[17] At this time, it is unclear how Maine views the public-policy exception, as no decision has addressed it directly.

[18] 58 N.Y.2d 293, 448 N.E.2d 86 (1983).

[19] *Id.* at 302.

[20] One year after the decision was rendered, the New York legislature enacted the Retaliatory Action by Employers Act, amending the State's labor law so that it would protect whistle-blowers from wrongful termination. See N.Y. LAB. LAW § 740 (*Gould's New York Consolidated Laws Unannotated*, 1988).

[21] Shane and Rosenthal, *Employment Law Deskbook*, § 16.03[5].

[22] 408 Mich. 579, 292 N.W.2d 880 (1980).

[23] *Id.* at 644.

[24] *Id.*

[25] The following is a sample disclaimer, which must be clear and unambiguous in the handbook or policy in order to be effective: "This policy is not intended as a contractual obligation of the company. The company reserves the right to amend this policy from time to time at its discretion and in accordance with applicable law."

[26] 333 N.W.2d 622 (1983).

[27] *Id.* at 626–27.

[28] 427 So.2d 266 (1983).

[29] *Id.* at 268.

[30] *Id.* at 269.

[31] *Id.* at 270.

[32] 720 S.W.2d 124 (1986).

[33] 320 Pa.Super. 106, 466 A.2d 1084 (1983).

[34] Shane and Rosenthal, *Employment Law Deskbook*, § 16.03[8].

[35] *Id.*

[36] 111 Cal.App.3d 443 (1980).

[37] *Id.* at 455.

[38] See *Foley* v. *Interactive Data Corp.*, 47 Cal.3d 654, 765 P.2d 373 (Cal. 1988).

[39] 103 Nev. 39, 732 P.2d 1364 (1987).

[40] In the trial, the court did find that an employment contract existed that Kmart had breached.

[41] *Id.* at 49.

[42] *Id.* at 51, quoting F. Tannenbaum, *A Philosophy of Labor* (1951).

[43] 381 So.2d 265 (1980).