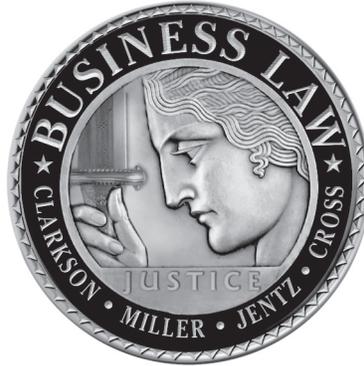


Chapter 31



Agency Formation and Duties

☞ See Separate Lecture Outline System

INTRODUCTION

Up to this point, most of the material has considered when a person may be liable for something that he or she did. With this chapter, the text goes a step further to ask when and under what circumstances a person may make another person liable. That is, when can the actions of an agent bind a principal? As importantly, when does the law consider a person an agent?

One of the most common, important, and pervasive legal relationships is that of agency. In an agency relationship between two parties, one party (the agent) agrees to represent or act for the other (the principal). A principal has the right to control an agent's conduct in matters entrusted to the agent. Generally, the law of agency is based on the maxim that "one acting by another is acting for himself."

ADDITIONAL RESOURCES—



AUDIO & VIDEO SUPPLEMENTS



The following **audio and video supplements** relate to topics discussed in this chapter—

PowerPoint Slides

To highlight some of this chapter's key points, you might use the Lecture Review PowerPoint slides compiled for Chapter 31.

South-Western's Business Law Video Series

The situational video *Employment Law* illustrates some of the material included in this chapter.

CHAPTER OUTLINE

I. Agency Relationships

An employee or an independent contractor may act in the capacity of an agent.

A. EMPLOYER-EMPLOYEE RELATIONSHIPS

An employee is one whose physical conduct is controlled, or subject to control, by an employer. The key feature is the employer's right to control the employee in the performance of tasks involved in the employment. An employee can be an agent if the employee has an appointment or contract for hire with authority to represent the employer.

ADDITIONAL BACKGROUND—

Restatement (Second) of Agency, Sections 2, 14N, 25

According to the *Restatement (Second) of Agency* employees are always agents. The following is the text of the **Restatement (Second) of Agency, Sections 2, 14N, and 25** with selected comments.

§ 2. Master; Servant; Independent Contractor

(1) A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.

(2) A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master.

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

Comment:

a. Servants and non-servant agents. A master is a species of principal and a servant is a species of agent.

§ 14 N. Agent and Independent Contractor

One who contracts to act on behalf of another and subject to the other's control except with respect to his physical conduct is an agent and also an independent contractor.

§ 25. Applicability of General Agency Rules

The rules applicable generally to principal and agent as to the creation of the relation, delegability and capacity of the parties apply to master and servant.

Comment:

a. As stated in Section 2, a servant is an agent of a special kind, over whose physical acts the principal has control or the right to control. Consequently, the master has special liabilities both to the servant *** and to third persons *** with reference to physical harm caused to or by a servant. But, aside from these features, the relation between master and servant is the same as between a principal and a non-servant agent and is created in accordance with the same rules, and the rules *** applicable to principals and agents are applicable to masters and servants.

B. EMPLOYER-INDEPENDENT CONTRACTOR RELATIONSHIPS

Independent contractors are not employees, because the person for whom they have agreed to perform has no control over the physical conduct of their performance. An independent contractor may or may not be an agent.

ENHANCING YOUR LECTURE—

HOW CAN AN EMPLOYER USE INDEPENDENT CONTRACTORS?



As an employer, you may at some time consider hiring an independent contractor. Hiring workers as independent contractors instead of as employees may help you reduce both your potential tort liability and your tax liability.

MINIMIZING POTENTIAL TORT LIABILITY

One reason for using an independent contractor is that doing so may reduce your susceptibility to tort liability. If, however, an independent contractor's words or conduct leads another party to believe that the independent contractor is your employee, you may not escape liability for the contractor's tort.

To minimize the possibility of being legally liable for negligence on the part of an independent contractor, you should inquire about the contractor's qualifications before hiring him or her. The degree to which you should investigate depends, of course, on the nature of the work. A more thorough investigation is necessary when the contractor's activities present a potential danger to the public (as in delivering explosives).

Generally, it is a good idea to have the independent contractor assume, in a written contract, liability for harms caused to third parties by the contractor's negligence. You should also require the independent contractor to purchase liability insurance to cover the costs of potential lawsuits for harms caused to third persons by the independent contractor's hazardous activities or negligence.

REDUCING TAX LIABILITY

Another reason for hiring independent contractors is that you need not pay or deduct Social Security and unemployment taxes on their behalf. The independent contractor is the party responsible for paying these taxes. Additionally, the independent contractor is not eligible for any retirement or medical plans or other fringe benefits that you provide for yourself and your employees, and this is a cost saving to you.

A word of caution, though: simply designating a person as an independent contractor does not make her or him one. Under Internal Revenue Service (IRS) rules, individuals will be treated as em-

employees if they are “in fact” employees, regardless of how you have classified them. For example, the IRS will not treat an office assistant as an independent contractor simply because you designate him or her as such. If the IRS determines that you exercise significant control over the assistant, the IRS may decide that the assistant is, in fact, an employee.

If you improperly designate an employee as an independent contractor, the penalty may be high. Usually, you will be liable for back Social Security and unemployment taxes, plus interest and penalties. When in doubt, seek professional assistance in such matters.

CHECKLIST FOR THE EMPLOYER

1. Check the qualifications of any independent contractor you plan to use to reduce the possibility that you might be legally liable for the contractor’s negligence.
2. It is best to require in any contract with an independent contractor that the contractor assume liability for harm to a third person caused by the contractor’s negligence.
3. Require that independent contractors working for you carry liability insurance. Examine the policy to make sure that it is current, particularly when the contractor will be undertaking actions that are more than normally hazardous to the public.
4. Make sure that independent contractors do not represent themselves as your employees to the rest of the world.
5. Regularly inspect the work of the independent contractor to make sure that it is being performed in accordance with contract specifications. Such supervision on your part will not change the worker’s status as an independent contractor.

C. DETERMINING EMPLOYEE STATUS

Factors for determining whether a person is an employee or an independent contractor are listed in the text. These include the criteria that the courts use and the criteria that the Internal Revenue Service uses. The text also notes that an employee’s work of intellectual property belongs to the employer, but an independent contractor’s similar effort is the employer’s only if the parties have agreed to an exchange of the rights.

CASE SYNOPSIS—

Case 31.1: *Alberty-Velez v. Corporacion de Puerto Rico*

Victoria Lis Alberty-Vélez (Alberty) co-hosted a television show, “Desde Mi Pueblo,” on WIPR in Puerto Rico. Alberty signed a new contract for each episode that obligated her to work a certain number of days. She was not obliged to do other work for WIPR, and WIPR was not obliged to contract with her for other work. Alberty provided her clothing and other services and materials. She was paid a lump sum for each episode. WIPR did not withhold income or Social Security taxes and did not provide health insurance, life insurance, a retirement plan, paid sick leave, maternity leave, or vacation. When Alberty became pregnant, WIPR stopped contracting with her. She filed a suit in a federal district court against WIPR’s owner, Corporación de Puerto Rico para la Difusión Pública, alleging in part discrimination on the basis of her pregnancy in violation of a federal statute. The court issued a judgment in the defendant’s favor. Alberty appealed.

The U.S. Court of Appeals for the First Circuit affirmed. “The parties structured their relationship through the use of set length contracts that permitted Alberty the freedom to pursue other opportunities and assured WIPR that it would not have to pay Alberty for the weeks that it was not

filming. Further, the lack of benefits, the method of payment, and the parties' own description of their relationship in tax documents all indicate independent contractor status." The court explained that "[u]nder the common law test, a court must consider *** the hiring party's right to control the manner and means by which the product is accomplished." This, however, "must be considered in light of the work performed and the industry at issue. Considering the tasks that an actor performs, we do not believe that the sort of control identified by *Alberty* necessarily indicates employee status."

Notes and Questions

Alberty collected unemployment compensation from the Puerto Rico Department of Labor, which apparently considered her WIPR's ex-employee. ***Why wouldn't the Puerto Rico Department of Labor's determination that Alberty was an "employee" eligible for unemployment compensation indicate conclusively that she had employee status under the federal discrimination statute?*** The court explained, "Determining employee status under [this discrimination statute] is a matter of federal law. As such, *Alberty's* status as an employee for purposes of the Puerto Rico unemployment compensation system is irrelevant to this analysis."

What are some advantages to being an independent contractor? What might be some disadvantages? The principal advantage of being an independent contractor is probably the degree to which the independent contractor controls the performance of his or her work. Among the disadvantages is the financial risk that an independent contractor takes compared to the relative financial security of an employee.

ANSWER TO "WHAT IF THE FACTS WERE DIFFERENT?" IN CASE 31.1

Suppose that Alberty had been a full-time, hourly worker and that such status was common among television hosts, but WIPR had manipulated the benefits and tax withholding to favor independent contractor status. How might the result have been different? Possibly. Control is generally the dispositive factor in determining whether workers are employees or independent contractors, and under the facts posed in this question, the television station would be in control. A failure to receive certain tax forms or benefits will not likely convert hourly, full-time workers in positions typically occupied by employees into independent contractors.

ANSWER TO "THE GLOBAL DIMENSION" QUESTION IN CASE 31.1

Would Alberty have been defined as an employee if she had been a foreign correspondent who reported on stories from international locations and WIPR had paid her travel and related expenses? Explain. No. It is unlikely that an employer's payment of travel and related expenses for an otherwise independent contractor would change that individual's status to "employee." If all of the other factors listed in the court's opinion were the same—particularly the terms of the parties' contracts allowing *Alberty* to seek other work—her status would likely also be the same..



ANSWER TO VIDEO QUESTION LTR. A



Recall from the video that Brad (Judge Reinhold) is told to deliver an order of Captain Hook Fish and Chips to IBM. Is Brad an employee or an independent contractor? Why? Brad is an employee of Captain Hook Fish and Chips. The single most important factor in determining whether a worker is an employee or an independent contractor is control. In the video, Brad is taking off his uniform when his supervisor tells him to put it back on, which Brad does. This indicates that Captain Hooks has a high degree of control over Brad. Moreover, it is likely that preparing food at Captain Hooks is not a position that requires a high degree of skill, that Brad receives a regular pay check (as do most employees at such restaurants), and that Brad does not supply any of his own tools (other than perhaps the car for delivery) to perform his job. All of these factors indicate employee status.

II. Formation of the Agency Relationship

An agency relationship must be based on an affirmative indication that the agent agrees to act for the principal and the principal agrees to have the agent so act. It is consensual, it may be created for any legal purpose, but the principal must have contractual capacity. The text notes two main exceptions to oral agency agreements: (1) under the equal dignity rule, in many states an agent's authority must be in writing if the agent is empowered to enter into a contract that the Statute of Frauds requires to be in writing; and (2) a power of attorney must be in writing.

A. AGENCY BY AGREEMENT

Generally, no formalities are required to create an agency relationship. Agency can be implied from conduct, or can be created by written contract or oral agreement.

B. AGENCY BY RATIFICATION

Agency is created by ratification when a principal affirms a contract made by a person who is not an agent, or who is an agent acting outside the scope of his or her authority.

C. AGENCY BY ESTOPPEL

Agency is created by estoppel when a principal causes a third person to believe that another is the principal's agent, and the third person deals with the other.

CASE SYNOPSIS—

Case 31.2: *Motorsport Marketing, Inc. v. Wiedmaier, Inc.*

Wiedmaier, Inc., owns and operates Wiedmaier Truck Stop in Missouri. The owners are Marsha Wiedmaier and her husband Jerry. Their son Michael worked for Wiedmaier as a fuel truck operator. Motorsport Marketing, Inc., sells racing collectibles and memorabilia to retail outlets. Michael faxed Motorsport a credit application, which Marsha signed as "Secretary-Owner" of Wiedmaier, after which Michael added himself to the list of owners. Michael formed Extreme Diecast, LLC, which he told Motorsport was part of Wiedmaier, and began ordering merchandise. When the payments ceased, Motorsport filed a suit in a Missouri state court against Wiedmaier to collect. The court entered a judgment in favor of Motorsport. The defendants appealed.

A state intermediate appellate court affirmed, concluding that Michael acted as Wiedmaier's apparent agent. Marsha signed the credit application, on which Michael was listed as an owner. Michael represented, and paid Motorsport with checks imprinted with, "Extreme Diecast" as "a

separate division with a separate name to handle [Wiedmaier's] diecast and other related merchandise." In good faith reliance on the application and Michael's representations, Motorsport filled Michael's orders.

Notes and Questions

How might the outcome of this case have been different if Motorsport had suspected that Wiedmaier would have disapproved of Michael's dealings with Motorsport? In this circumstance, it is likely that the defendants would not have been liable on the ground of Michael's apparent authority to act as an agent for Wiedmaier. In the actual facts of the case, Motorsport did not know that Wiedmaier would have disapproved of Michael's transactions. "Rather, Motorsport acted with a reasonable, good faith belief that Michael was acting as an agent for Wiedmaier, Inc."

Suppose that a bank officer proposes to a customer that the customer borrow a certain amount from the bank and give the proceeds to the officer, who promises to repay it within ninety days. ***If the customer agrees to keep the deal confidential and goes through with the loan, which the officer later refuses to repay, could the bank be liable to the customer on an agency theory?*** Probably not. There would be no ground to believe that a bank officer had authority from the bank to negotiate a loan to a customer and appropriate the funds. Besides, in this scenario, the customer would be a party to concealing from the bank that the officer was the actual beneficiary of the loan. The customer could not be said to have dealt in good faith with the officer or the bank.

ANSWER TO "WHAT IF THE FACTS WERE DIFFERENT?" IN CASE 31.2

Suppose that Motorsport's sales manager had telephoned Marsha Wiedmaier rather than just faxing the credit application. Further suppose that Marsha had vouched for Michael's creditworthiness but informed Motorsport that she and her husband owned Wiedmaier and that Michael worked for them. How might the outcome of this case have been different in that situation? If Marsha had made clear to Motorsport that Michael was not ordering merchandise on Wiedmaier's behalf, there would not have been a sufficient basis to support a theory of apparent agency. If, however, Marsha told Motorsport that she was an owner of Wiedmaier, vouched for Michael's credit, and said that he "worked" for Wiedmaier, without indicating that he was not its agent, the case might have had the same result.

ANSWER TO "THE E-COMMERCE DIMENSION" QUESTION IN CASE 31.2

Should the court have applied the law differently in this case if Michael had done business with Motorsport entirely online? Explain. No. Apparent authority results from a "direct communication" from a principal to a third party that causes the third party to reasonably believe another person has the authority to act for the principal. The communication need not be verbal and can consist of a combination of acts. Thus, the court should not have applied the law differently in that circumstance. There is no reason that the same principles of apparent agency could not have been applied to reach the same conclusion, even if the parties conducted their business entirely online, assuming all of the other circumstances and their legal effect were the same.

D. AGENCY BY OPERATION OF LAW

Agency may be created by operation of law. The text points out that courts have granted agents emergency power under unusual circumstances and that agency has been held to arise in family relationships.

ADDITIONAL BACKGROUND—**Designated Agents for Service of Process**

For businesses, some state statutes make state officials (a state's secretary of state) the businesses' agents for service of process. This is an agency created by operation of law. Most states require a corporation to **designate a registered agent for service of process** on the corporation. In some states, designation of the registered agent is by a separate instrument filed with the articles of incorporation. New York requires designation of the state's secretary of state as agent of the corporation for service of process. This designation must be in the articles of incorporation. In addition to this requirement, however, New York permits the articles of incorporation to designate a resident agent. The following is the text of the New York statutes spelling out this addition (New York Business Corporation Law Sections 304, 305, 402).

MCKINNEY'S CONSOLIDATED LAWS OF NEW YORK ANNOTATED
BUSINESS CORPORATION LAW
CHAPTER 4 OF THE CONSOLIDATED LAWS
ARTICLE 3—CORPORATE NAME AND SERVICE OF PROCESS

§ 304. Statutory designation of secretary of state as agent for service of process

(a) The secretary of state shall be the agent of every domestic corporation and every authorized foreign corporation upon whom process against the corporation may be served.

(b) No domestic or foreign corporation may be formed or authorized to do business in this state under this chapter unless in its certificate of incorporation or application for authority it designates the secretary of state as such agent.

(c) Any designation by a domestic or a foreign corporation of the secretary of state as such agent, which designation is in effect on the effective date of this chapter, shall continue. Every domestic or foreign corporation, existing or authorized on the effective date of this chapter, which has not designated the secretary of state as such agent, shall be deemed to have done so. Any designation prior to the effective date of this chapter by a foreign corporation of an agent other than the secretary of state shall terminate on the effective date of this chapter.

(d) Any designated post-office address to which the secretary of state shall mail a copy of process served upon him as agent of a domestic corporation or a foreign corporation, shall continue until the filing of a certificate under this chapter directing the mailing to a different post-office address.

§ 305. Registered agent for service of process

(a) In addition to such designation of the secretary of state, every domestic corporation or authorized foreign corporation may designate a registered agent in this state upon whom process against such corporation may be served. The agent shall be a natural person who is a resident of or has a business address in this state or a domestic corporation or foreign corporation of any type or kind formed, or authorized to do business in this state, under this chapter or under any other statute of this state.

(b) Any such designation of a registered agent may be made, revoked or changed as provided in this chapter.

(c) A registered agent may resign as such agent. A certificate, entitled “Certificate of resignation of registered agent of (name of designating corporation) under section 305 of the Business Corporation Law”, shall be signed, verified by him and delivered to the department of state. It shall set forth:

(1) That he resigns as registered agent for the designating corporation.

(2) The date the certificate of incorporation or the application for authority of the designating corporation was filed by the department of state.

(3) That he has sent a copy of the certificate of resignation by registered mail to the designating corporation at the post office address on file in the department of state specified for the mailing of process or if such address is the address of the registered agent, then to the office of the designating corporation in the jurisdiction of its formation or incorporation.

(d) The designation of a registered agent shall terminate thirty days after the filing by the department of state of a certificate of resignation or a certificate containing a revocation or change of the designation, whichever is filed earlier. A certificate designating a new registered agent may be delivered to the department of state by the corporation within the thirty days or thereafter.

§ 402. Certificate of incorporation; contents

(a) A certificate, entitled “Certificate of incorporation of (name of corporation) under section 402 of the Business Corporation Law”, shall be signed by each incorporator, with his name and address stated beneath or opposite his signature, acknowledged and delivered to the department of state. It shall set forth:

(8) If the corporation is to have a registered agent, his name and address within this state and a statement that the registered agent is to be the agent of the corporation upon whom process against it may be served.

III. Duties of Agents and Principals

An agency relationship is fiduciary.

A. AGENT’S DUTIES TO THE PRINCIPAL

An agent’s duties are implied from the agency relationship whether or not the identity of the principal is disclosed to a third party.

1. Performance

The degree of skill or care required of an agent is that expected of a reasonable person under similar circumstances (unless the agent has presented himself or herself as possessing special skills). If an agent fails to perform his or her duties, he or she will generally be liable for breach of contract and may also be liable in tort for careless or negligent performance. An agent who does not act for money may be subject to the same standards of care, but cannot be liable for breach of contract because there is no contract.

2. Notification

An agent must notify a principal of all material matters that come to his or her attention concerning the subject matter of the agency (although the principal is bound even if the agent says nothing).



ANSWER TO VIDEO QUESTION LTR. C



In the video, Brad throws part of his uniform and several bags of the food that he is supposed to deliver out of his car window while driving. Assuming Brad is an agent-employee of Captain Hook Fish and Chips, did these actions violate any of his duties as an agent? Explain. Yes, Brad violated several agency duties by throwing his uniform and the food that he was supposed to deliver out of the window. First, Brad violated the duty of performance, which required him to deliver the food for Captain Hook. Second, he had a duty to act solely for the benefit of his principal (Captain Hook), which he breached by throwing out the food and uniform—actions that clearly do not benefit his employer. Third, Brad violated his duty to be obedience, which required him to follow all lawful and clearly stated instructions of Captain Hooks.

3. Loyalty

An agent must act solely for the benefit of the principal. Thus, an agent cannot represent two principals in the same transaction unless both know of the dual capacity and consent; an agent who owns property cannot sell it to the principal without first disclosing the ownership; and an agent authorized to buy cannot buy from himself or herself, and an agent authorized to sell cannot sell to himself or herself, without the principal's consent. Knowledge acquired through an agency relationship is confidential.

4. Obedience

An agent must follow the principal's instructions (except during an emergency or when instructions are not clearly stated, in which case an agent must act in good faith and in a manner reasonable under the circumstances).

5. Accounting

An agent must account for all property and money received and paid out on behalf of the principal. The agent should keep personal funds separate.

CASE SYNOPSIS—

Case 31.3: *Gossels v. Fleet National Bank*

Peter Gossels presented a check for 85,071.19 euros, drawn on Dresdner Bank of Germany, to Fleet National Bank in Boston. The teller did not tell Gossels that Fleet paid international checks at a “retail exchange rate” lower than the “interbank spot rate” for foreign currency. Fleet collected payment on the check and on December 15, 1999, credited Gossels's account for \$81,754.77, according to Fleet's retail exchange rate for that day. On the day that Gossels had presented the check, the same number of euros would have been worth \$88,616.45 at Fleet's rate, or \$92,023.80 at the spot rate. Gossels filed a suit in a Massachusetts state court against Fleet. The court entered a judgment for Gossels on a ground of negligent misrepresentation. Both parties appealed.

A state intermediate appellate court affirmed the decision in Gossels's favor on the claim of negligent misrepresentation. The appellate court vacated the lower court's judgment, however, to remand for the entry of a judgment in Gossels's favor to include the ground of breach of fiduciary duty. “The principal has a right to be informed of all material facts known to the agent in reference to the transaction in which he is acting for his principal, and good faith requires a disclosure of such facts by the agent. Whenever facts known to the agent but not to the principal may affect the desires and conduct of the principal, the agent must communicate that information to the principal *** particularly if the agent is engaging in any arrangement *** adverse to the principal's interest.”

Furthermore an agent has “a duty to keep and render accounts and, when called upon for an accounting, has the burden of proving that he properly disposed of funds which he is shown to have received for his principal.”

Notes and Questions

Gossels based his suit on breach of contract and other claims, but not negligent misrepresentation. **Why does the particular theory matter?** “The usual argument, absent here, is whether a contract or a tort period of limitations is applicable to the action,” noted the court in the case. In other words, in some cases, though not in this one, the choice of a theory could determine how much time a plaintiff has to file a suit based on a particular set of facts.

How much should Gossels have been awarded in damages? “[T]he trial judge found that Gossels had been damaged in the amount of \$6,861.68, the difference between what the bank paid Gossels on December 15, 1999, and the amount he would have received on October 15, 1999, using Fleet’s internal retail rate sheet for that day.” Gossels argued that the amount should have been based on the spot rate for October 15, not the rate Fleet withheld from its customer. The appellate court agreed. “[H]ad the check been properly processed by Fleet, Fleet would have been obligated to pay Gossels in accordance with the spot rate at Dresdner Bank on October 15, less the service charge made by the correspondent bank and Fleet’s collection fee. So calculated, the difference between what Fleet should have paid Gossels and what it did pay him was \$10,269.03.”

Was the bank liable to its customer in conversion? Yes, according to the appellate court. “Fleet, as a fiduciary, retained a portion of the check proceeds based on its retail rate sheet differential and ..., failed either to account for the funds or to restore them to [Gossels’s] account, Fleet knowingly and purposefully deprived Gossels of his funds, and thereby committed the tort of conversion in addition to a breach of its fiduciary duties.”

ANSWERS TO QUESTIONS AT THE END OF CASE 31.3

1. **Was the specific exchange rate that the bank used important to the disposition of this case? Explain.** With respect to the exchange rate that the bank used in the *Gossels* case, the court emphasized that “nothing prevents the bank from using a retail exchange rate lower than the spot rate available on the day of collection or the interbank rate used between banks; the issue here is strictly one of the disclosure an agent owes its principal with respect to the terms of the transaction (and the principal’s agreement to those terms).”

2. **Should the court have considered whether the bank had a corrupt intent to deprive its customer of funds? Why or why not?** Even in the absence of a corrupt, criminal, or malicious intent on the part of the bank—which was of course the customer’s collecting agent—when an agent secures a profit without the knowledge of the principal in connection with a transaction undertaken on the principal’s behalf, the agent has an affirmative duty to account and pay over that profit to the principal, absent an agreement between the agent and the principal to the contrary..

B. PRINCIPAL’S DUTIES TO THE AGENT

A principal’s duties may be express or they may be implied by law.

1. Compensation

Except in a gratuitous agency, a principal must pay an agent for services rendered and to do so in a timely manner. The amount is the agreed-on value, the customary value, or, if no amount has been agreed on or established by custom or law, the reasonable value.

2. Reimbursement and Indemnification

A principal must reimburse an agent for sums disbursed at the principal's request or for necessary expenses in the agent's performance of his or her duties. A principal also must indemnify an agent for liability incurred in accord with the agency. A subagent can recover from the principal or the agent who hired him or her.

3. Cooperation

A principal must cooperate with and assist an agent in performing his or her duties.

4. Safe Working Conditions

A principal must provide safe premises, equipment, and conditions (and warn about unsafe areas).

**ANSWER TO VIDEO QUESTION LTR. B**

Assume that Brad is an employee and agent of Captain Hook Fish and Chips. What duties does he owe Captain Hook Fish and Chips? What duties does Captain Hook Fish and Chips, as principal, owe Brad? As an agent, Brad has a duty to perform the contract, to notify Captain Hook of any matter concerning the agency, to be loyal to Captain Hook and to act for its sole benefit, to follow instructions, and to keep sufficient accounting records for Captain Hook's benefit. As a principal, Captain Hook owes Brad compensation for his services, reimbursement for expenses Brad incurs in the course of a reasonable performance of his duties as an agent, and indemnification for any liabilities incurred through authorized and lawful acts and transactions. Captain Hook also has a duty to cooperate with Brad and assist him in performing his duties, and Captain Hook must provide safe working premises, equipment, and conditions for Brad.

IV. Rights and Remedies of Agents and Principals**A. AGENT'S RIGHTS AND REMEDIES AGAINST THE PRINCIPAL**

For every duty of a principal, an agent has a corresponding right.

1. Tort and Contract Remedies

Remedies follow normal contract and tort remedies.

2. Demand for an Accounting

An agent can withhold further performance and demand that a principal give an accounting.

3. No Right to Specific Performance

When an agency is not contractual, an agent can recover for past services and future damages but has no right to specific performance.

B. PRINCIPAL'S RIGHTS AND REMEDIES AGAINST THE AGENT

Remedies follow normal contract and tort remedies. Actions available include constructive trust, avoidance, and indemnification.

1. Constructive Trust

When an agent retains benefits or profits that belong to the principal, a court may impose a constructive trust.

2. Avoidance

If an agent breaches an agency agreement, a principal can avoid any contract entered into with the agent.

3. Indemnification

A third party can sue a principal for an agent's negligent conduct, and sometimes an agent must indemnify the principal for the damages. The same is true if an agent violates a principal's instructions.

TEACHING SUGGESTIONS

1. When an independent contractor is injured on the job, he or she is responsible for the loss. ***When an independent contractor is out of work, can he or she collect unemployment compensation?*** Call your state's unemployment office for information on state procedures for paying unemployment compensation when an independent contractor (and an employee who is labeled an "independent contractor") loses his or her job and applies for benefits. Students should find this interesting.

2. When considering an agency problem, students may find it helpful to determine first whether the parties are in an employer-employee relationship. To categorize the relationship, they should pay careful attention to its terms. Second, they should determine whether the identity of the principal is to be disclosed. As they will see in the next chapter, whether or not the identity of the principal is disclosed can be an important factor in assessing liability. Third, they should remember that an agent is responsible for his or her own actions (wrongs). The principal may be sued for the actions of the agent, but if that happens, the principal can seek indemnification from the agent.

3. It should be made clear, if it is not apparent from a reading of this chapter, that the legal term "agent" encompasses more individuals than those with the word "agent" as part of a job title (insurance agents, travel agents, literary agents, and so on) to include anyone who serves in a representative capacity, including virtually all employees.

4. You might explain that no area of the law is more pervasive than the law of agency, which affects virtually everyone everyday. When confronted with legal problems to analyze your students may find it helpful to remember how common agency relationships are. Agency law applies in the context of professional partnerships, for example. Also involved are banks involved in the check collection process, corporate shareholders, and gas stations, car dealers, and other franchisors and franchisees, as well as those for whom "agent" is part of their job title (insurance agents, travel agents, and so on).

Cyberlaw Link

Does the speed of communication via the Internet play have any effect on the duties of principals and agents?

DISCUSSION QUESTIONS

1. ***Why is agency law essential to the existence and operation of a corporation?*** An agent acts for a principal. Agency law is essential to the existence and operation of a corporate entity, because only through its agents can a corporation function and enter into contracts. Corporate officers, for example, are agents.

2. *What is a principal–agent relationship?* In a principal–agent relationship, the parties have agreed that the agent will act on behalf of and instead of the principal in transacting business with others. The agent is empowered to perform acts that are binding on the principal (a theatrical agent for a dance troupe, for example, can negotiate and sign contracts for the company to perform).

3. *Define an employer–employee relationship.* The details of an employee's conduct in employment are subject to an employer's control (for example, a retailer can authorize salespeople to sell and tell them how to do it, and in selling, because they have been given authority to sell, the salespeople are the retailer's agents).

4. *What are some of the factors that can determine whether an individual is considered an employee or an independent contractor?* The factors include: (1) the amount of control an employer exercises over the details of the work; (2) whether the individual is in an occupation or business distinct from that of the employer; (3) whether work is normally subject to the employer's direction or may be done by a specialist without supervision; (4) whether the employer supplies the tools; (5) the period for which the individual is hired; (6) the method of payment—by time period or at the completion of the job; and (7) the degree of skill required to do whatever it is the individual was hired to do. (Building contractors and truck drivers who own their equipment and hire out on a per job basis are independent contractors.)

5. *How is an agency relationship created?* An agency relationship can be created by oral agreement or by written contract, or can be implied from conduct (a hotel's permitting an individual to park its guests' cars manifests willingness that the individual do so, and the individual can infer authority to act as a valet, and as an agent for that purpose, from the hotel's conduct, for example). An agency relationship may be created by operation of law. State law often makes state officials agents for service of process, and in most states, a corporation must designate an agent for service (who sometimes must be the state's secretary of state). Courts have granted agents emergency power under unusual circumstances, when principals could not be reached, and failure to act would have caused the principals substantial loss. Agencies have also been held to occur in family relationships, when, for example, a spouse charged necessities to the other spouse. An agency relationship is created by ratification when a principal affirms a contract made by a person who is not an agent, or who is an agent acting outside the scope of his or her authority. An agency is created by estoppel when a principal causes a third person to believe that another is the principal's agent, and the third person deals with the other.

6. *What are the policy reasons for holding a principal liable on a theory of agency by estoppel?* Equity is the foundation for estoppel. If a principal could avoid liability by denying that a party he or she represented as an agent was not an agent, the principal could choose to fulfill only those obligations that were to his or her advantage and ignore other obligations. This would undercut the purposes of contract law.

7. *What are the general duties that agents and principals owe each other?* An agency relationship is fiduciary: each party owes the other a duty to act in good faith and to disclose material facts having a bearing on the relationship.

8. *What are an agent's rights and remedies against a principal?* For every duty of a principal, an agent has a corresponding right (a right to be compensated, reimbursed, and indemnified and to work in a safe environment). An agent also has a right to perform agency duties without the principal's interference. Remedies follow normal contract and tort remedies. An agent can recover for past services and future damages but has no right to specific performance unless the agency relationship was created by contract.

9. *What are a principal's rights and remedies against an agent?* A principal has general contract remedies (and may terminate an agency relationship) for an agent's breach of fiduciary duties. A principal has tort remedies for an agent's torts (fraud, misrepresentation, negligence, deceit, libel, slander, and trespass). Other remedies include: *Constructive trust*. If an agent breaches his or her fiduciary duty by retaining benefits or profits that belong to the principal, a court may impose a constructive trust, according to

which the agent is considered to hold the benefits or profits on the principal's behalf. *Avoidance*. If an agent breaches an agency contract, a principal can avoid the contract. *Indemnification*. A third party can sue a principal for an agent's negligent conduct, and sometimes an agent must indemnify the principal for the damages. The same is true if an agent violates a principal's instructions.

10. *Are there situations in which the duty of loyalty to one's employer could come into conflict with other duties?* The duty of loyalty is a fundamental duty in an agency relationship (like the duty to act in good faith), and it is difficult to imagine that it could conflict with other duties. There might be a circumstance in which an agent would need to choose between this duty and the duty to exercise his or her special skills, or a conflict might arise in which an agent would have to disobey a principal's instructions to follow the duty of loyalty

ACTIVITY AND RESEARCH ASSIGNMENT

Divide students into groups (four to five students per group) and have them compile lists of the jobs held by members of the group. Ask them to discuss with each other the rights and responsibilities of each job to determine whether the student is an agent and an employee or an independent contractor, or only an agent, an employee, or an independent contractor. Have each group share its conclusions with the class. Discuss with the class the difference between employees and independent contractors. ***Are there students with jobs in which they are referred to as "independent contractors," when in fact they are employees?***

EXPLANATION OF A SELECTED FOOTNOTE IN THE TEXT

Footnote 7: Don Cousins sought commercial real estate in Louisiana, for Eagle Ventures, Inc., to invest in. Cousins engaged the services of Leo Hodgins, a real estate agent, and owner of Realty Ventures, Inc. (RVI). On Eagle's behalf, Hodgins offered \$90,000 to Westinghouse Credit Corp. to buy an office building at 3330 Lake Villa Drive. Westinghouse would sell the building only with its neighboring property at 4141 Veterans Boulevard for \$425,000. Hodgins estimated the two properties' worth to be about \$1 million. Without telling Eagle, Hodgins, his brother Paul, and RVI formed 4141 Vets Limited Partnership to buy the buildings for \$420,000. Hodgins then offered to sell 3330 to Eagle for \$175,000. Cousins and others filed a suit in a Louisiana state court against RVI and others, alleging breach of fiduciary duties. A jury awarded plaintiffs damages of \$1.75 million. The defendants appealed. In *Cousins v. Realty Ventures, Inc.*, a state intermediate appellate court affirmed. "Cousins acted consistently with his belief that Leo Hodgins was acting as his agent with Westinghouse ***, while Leo Hodgins did nothing to dispel that belief. *** During some of that time, Leo Hodgins was armed with the information that 3330 Lake Villa was only for sale as a package with 4141 Veterans Boulevard and was covertly planning to acquire the property himself. *** Hodgins' failure to communicate the package sale to plaintiffs the moment he learned of it constituted a breach of his fiduciary duties to them. Leo Hodgins' duty was to give plaintiffs the information that Westinghouse rejected their offer for a single property sale and allow them to decide whether they wished to purchase both properties."

Suppose that the agent was not aware that his actions breached a fiduciary duty owed to his principal. Would the agent's lack of awareness have affected the outcome in this case? Why or why not? The agent's lack of awareness of his fiduciary duty would not likely have affected the outcome of this case because "ignorance of the law is no excuse." No one knows all of the details of all of the laws that he or she is subject to, and anyone may violate some prescription or fail to fulfill some prescription unawares. That rarely, if ever, excuses liability for wrongful acts, however

What steps do the facts in the Cousins case indicate that an investor might want to consider when dealing through an agent? Among the steps that the facts in this case suggest for a prospective investor might be to understand an investment and the procedure for its acquisition thoroughly before

dealing with, and through, an agent, and consider carefully the events that occur (or, as in this case, do not occur) as time passes. Information can be obtained from other sources—an agent is not an exclusive source. While an investor, or any principal, is legally entitled to rely on the good faith of an agent to act according to his or her fiduciary responsibilities, it seems practical for a principal to pay close attention to those actions

ANSWERS TO ESSAY QUESTIONS IN *STUDY GUIDE TO ACCOMPANY BUSINESS LAW, ELEVENTH EDITION* BY HOLLOWELL & MILLER

1. *What are the chief differences among the relationships of principal and agent, employer and employee, and employer and independent contractor? What are the factors that indicate whether an individual is an employee or an independent contractor?* Principal-agent. A principal and agent agree that the agent will act on behalf of and in place of the principal in dealings with others, using some of his or her own discretion. An agent has the power to bind the principal. Employer-employee. An employer controls the details of an employee's physical conduct in employment. An employee can be an agent if he or she has an appointment or contract for hire with authority to represent the employer. Employer-independent contractor. An independent contractor contracts with another (an employer) to do something for him or her. Independent contractors are not employees: an employer has no control over the physical conduct of an independent contractor's performance. Factors that a court may use to determine whether an individual is an employee or an independent contractor include: (1) the degree of control the employer exercises over the details of the work; (2) whether the person is in an occupation or business that is distinct from the employer's; (3) whether the work is subject to the employer's direction or may be done by a specialist without supervision; (4) whether the employer supplies the tools; (5) the time period for which the person is retained; (6) the method of payment—by time period or at the completion of the job; and (7) the skill required to do whatever it is the person was retained to do. An independent contractor may or may not be an agent.

2. *What are the ways in which a principal-agent relationship can be formed?* A principal-agent relationship can be created by agreement—oral or written—or can be implied from conduct. A principal-agent relationship may be created by ratification when a principal affirms, by act or agreement, a contract made by a person who is not an agent or who is an agent acting outside the scope of his or her authority. A principal-agent relationship may be created by estoppel when a principal causes a third person to believe that another person is the principal's agent, and the third person acts to his or her detriment in reasonable reliance on that belief (that is, deals with the other person). A principal-agent relationship may be created by operation of law. For example, state law may make state officials agents for service of process, and in most states, a corporation must designate an agent for service, who often must be the state's secretary of state. Courts have granted agents emergency power when principals could not be contacted, and failure to act would have caused the principals substantial loss. Agencies have also been based on social duties, such as arise from family relationships (the need to support a spouse, for example).

REVIEWING—



AGENCY FORMATION AND DUTIES



James Blatt hired Marilyn Scott to sell insurance for the Massachusetts Mutual Life Insurance Co. Their contract stated, "Nothing in this contract shall be construed as creating the relationship of employer and employee." The contract was terminable at will by either party. Scott financed her own office and staff, was paid according to performance, had no taxes withheld from her checks, and could legally sell products of Massachusetts Mutual's competitors. But when Blatt learned that Scott was

simultaneously selling insurance for Perpetual Life Insurance Corp., one of Massachusetts Mutual's fiercest competitors, Blatt withheld client contact information from Scott that would have assisted her insurance sales for Massachusetts Mutual. Scott complained to Blatt that he was inhibiting her ability to sell insurance for Massachusetts Mutual. Blatt subsequently terminated their contract. Scott filed a suit in a New York state court against Blatt and Massachusetts Mutual. Scott claimed that she had lost sales for Massachusetts Mutual—and her commissions—as a result of Blatt's withholding contact information from her. Ask your students to answer the following questions, using the information presented in the chapter.

1. Who is the principal, and who is the agent in this scenario? By which method was an agency relationship formed between Scott and Blatt? Since Blatt hired Scott to assist in sales, Blatt is the principal and Scott is his agent. Both represent Massachusetts Mutual Life, but that part of the relationship matters little here. Since Blatt hired Scott to assist in sales, Blatt is the principal and Scott is his agent. Both represent Massachusetts Mutual Life, but that part of the relationship matters little here.

2. What facts would the court consider the most important in determining whether Scott was an employee or an independent contractor? The *Restatement (Second) of Agency* focuses on if the worker is “controlled by the other.” The IRS also focuses on “the degree of control” the business has over the worker..

3. How would the court most likely rule on Scott's employee status? Scott is an independent contractor for Blatt. Since she is not under his direct supervision and control, she is not an employee. She operated her own office and staff and sold Massachusetts Mutual insurance and other insurance products..

4. Which of the four duties that Blatt owed Scott in their agency relationship has probably been breached? A principal has a duty to cooperate with an agent and to assist the agent in performing duties. The principal must not take actions that prevent performance. Blatt made it more difficult for Scott to sell Massachusetts Mutual Life policies.

