

TOPIC 11: AGENCY & LIABILITY - QUESTIONS & ANSWERS

1. What is agency?

An agency relationship is one in which a party acts on behalf of another party. The “principal” hires the “agent” to act on her behalf. Thus, she is responsible for the actions of the agent done in furtherance of the her duties. The agent will interact with “third parties” on behalf of the principal. The agency relationship requires an understanding of the relationship (role, responsibilities, and rights) between principal and agent, agent and third parties, and principal and third-parties.

- *Example:* I hire Betty to negotiate a business deal on my behalf. I am the principal and Betty is my agent for this purpose. Betty will act as my representative in dealing with the third parties to this business deal.

2. What is the scope of the agency relationship?

The principal will lay out the “scope of the agency”, including the responsibilities and limitations of the agent. Agent are generally fall into two categories:

- *Limited Agent* - A limited agent has a special purpose and limited authority to act on behalf of the principal. Unless specifically limited by the principal, actions done in furtherance of that purpose are within the scope of the agent’s authority.
 - *Example:* I hire a **real estate agent** to represent me in the purchase of a business. She is my limited agent for that purpose. Her authority to act on my behalf is limited to this situation.
- *General Agent* - A general agent has broad authority to act on behalf of the agent. The scope of the agency is not limited to a special purpose; rather, it is limited to function of the agent for the principal.
 - *Example:* Arthur is my **employee**. He serves a operations manager. As such, he is my general agent with regard to all aspects of operations falling under his responsibility. His authority to act as my agent is not limited to a specific task; rather, it is pursuant to his responsibilities in his position.

- **Discussion:** Why do you think that there is a distinction between a general and limited agent? How should the authority of a limited agent be interpreted? What should be the limits placed upon the authority of the general agent?
- **Resource Video:** <http://thebusinessprofessor.com/what-is-the-scope-of-the-principal-agent-relationship/>

3. What are the duties of an agent?

Agents generally have the following duties to the principal:

- *Loyalty* - An agent has the duty of loyalty to act for the principal’s advantage and not to act to benefit the agent at the principal’s expense. An agent is expected to refrain from undertaking

actions personally that would conflict with the purpose of the agency. A employee has a lower duty of loyalty with regard to opportunities that are outside of the employee's duties or responsibilities to the employer.

- *Note:* Employees are agents of the employer. An employer violates a duty of loyalty by undertaking activities which are the type of activities carried on by the employee in the agency relationship. This is seen as competing with the employer. If, however, performs services unrelated to or not the type of services the employer would seek to provide to the client, it is not a breach of duty to provide those services. This is true even if the employee provides those services to a client of the employer.
- *Example:* I work for ABC Corp as a professional service provider. A potential client comes in to seek the services of ABC Corp. I cannot compete with ABC Corp by trying to convince the client to pay me serve them personally rather than hire ABC Corp. I also have a side job selling supplies to construction contractors. This is a completely different line of business from ABC Corp. If it does not conflict with ABC Corp's services, I can offer my supplies for sale to the client without violating my duty of loyalty.
- *Duty of Care* - An agent has a duty to exercise due care and diligence when carrying out the responsibilities of the agency.
 - *Example:* I work for ABC Corp as an accountant. I represent ABC Corp in every action I undertake as part of my employment, such as preparing client taxes. I have a duty to ABC Corp and the client to exercise reasonable care in carrying out my job duties.
- *Information* - The agent has a duty to keep the principal fully informed of all material information about or acquired as a result of the agency relationship.
 - *Example:* I am a sale agent for ABC Corp. I receive an offer from a customer to undertake a joint venture with ABC Corp. I have a duty to transmit this information to ABC Corp. I acquired this information as a result of the agency relationship, and it is obviously outside of my unilateral decision-making authority.
- *Obedience* - The agent has a duty to obey instructions from the principal.
 - *Example:* I work for ABC Corp selling insurance. ABC provides me detailed training and instructions on what types of policies to write and the client area that I can serve. I have a duty to obey these instructions as agent of my employer.
- *Accounting* - The agent has a duty to account to the principal for monies handled.
 - *Example:* I am a financial advisor for ABC Corp. I am responsible for reporting and keeping accurate records regarding all money or value transferred or received in carrying out my job duties.
- *Note:* The principal-agent relationship is a fiduciary or trust-based relationship. The agent may have any other duties as established in the agency agreement.
- **Discussion:** Should the duty of loyalty and care be the same for an agent in every situation? Why or why not? Should these duties vary depending upon whether the agent is a limited or general agent? Why or why not?

- **Practice Question:** Carol is an employee of Rob's accounting firm. She is a CPA has been thinking of breaking away from the firm and starting her own practice. One day, a representative from a large corporation walks into the CPA firm and inquires about accounting services. Carol is strongly considering offering her personal services to the representative's firm? Are there any issues in this situation?
- **Resource Video:** <http://thebusinessprofessor.com/principal-and-agent-relationship/>

4. What is the agency status of an employee as compared to an independent contractor.

Employee - An employer hires an employee to work on behalf of the employer as part or in support of the business's core functions. The employee generally works exclusively for the business in the functions for which she is hired. The employer exercises extensive control over the nature, time, and manner of work carried out by the employee. As such, the employee is a general agent of the business to the extent of her authority in the position.

- *Example:* ABC Corp hires me as an internal accountant. I report to ABC Corp from 8:00 - 6:00 on 5 days per week. I work on any and all accounting functions assigned to me by my supervisor.

Independent Contractor - An independent contractor is not an employee; rather, it is a separate business that is hired to perform services for another person or business. on behalf of another individual or business. The independent contractor is not an employee; rather, she has her own business that services the employer as a client or customer. The employer does not directly control the independent contractor. And the independent contractor generally has more than one customer or client. As such, the independent contract is only a limited agent of the principal-employer.

- *Example:* I have my own professional accounting practice. I prepare the tax returns for any business or individual who pays me to do so. I do not have any employees. ABC Corp hires me to prepare its annual tax return. I promise to have the return completed within 1 month. I will invoice ABC Corp for my services. I am not an employee of ABC Corp. I am an independent contractor who is hired to perform a specific function for a limited amount of time. While I have a projected deadline, ABC Corp does not control the nature, time, and manner of the services I perform.

- **Discussion:** Why do you think employees have a different agency status from independent contractors? Is there any reason or justification for treating employees and independent contractors similarly for agency purposes?
- **Practice Question:** Donald drives for Super, a company that provides a network for drivers to pick up and drop of customers who need a ride. The service is very similar to a taxi service. The individuals driving for Super have their own cars and their own insurance. They work whenever they like. The driver logs into an application that notifies them when a Super customer needs a ride. They confirm that they will provide the ride and they are off. The customer pays Super directly and Super later remits payment to the driver. What factors in this scenarios would be used to determine whether Donald is an employee or an independent contractor?
- **Resource Video:** <http://thebusinessprofessor.com/employer-vs-independent-contractor/>

5. To what extent is a principal bound in contract by the actions of the agent?

A principal is generally bound by the contracts entered into by the agent on behalf of the principal. This means that the principal is responsible for any obligations incurred by the agent that are within her authority. An agent has varying sources of authority when dealing with third parties.

- **Actual Authority** - Actual authority is the express authority from the principal for the agent to enter into obligations (contracts) on her behalf. Basically, it is either instruction to do so or it is specifically stated in their job duties.
 - *Example:* Arnold is an employee of ABC Corp. He signs an employee agreement indicating that he will sell products manufactured by ABC Corp directly to retailers. He has express authority to enter into any contracts for the sale of ABC-manufactured goods with retailers.
- **Implied Authority** - Implied authority concerns the level of authority to enter into obligations that a reasonable person would imply from the agent's position, title, or past course of dealings. If an employee has the title of vice president, it implies a great deal of authority to act on behalf of the business. Further, if an employee entered into a previous contract on behalf of the principal, it may be implied that they can enter into similar contracts.
 - *Example:* Beth is hired by ABC Corp with the title of Senior Sales Manager. 123 Corp seeks to purchase a shipment of supplies manufactured by ABC Corp. Even if Beth is expressly prohibited in her employment agreement from entering into direct sales agreements, it is reasonable for a retailer to believe that a person with her title has that authority. If a retailer is unaware of Beth's limitations and Beth signs a sales contract on behalf of ABC Corp, ABC Corp will be bound by the contract. Beth may be liable to ABC Corp, but her title implies this authority to transact with third parties in this manner.
- **Apparent Authority** - Apparent authority arises from the reasonable representations of the agent to third parties. That is, when the agent represents that she has authority to enter into a contract on behalf of the principle, her actions will bind the principle if a reasonable person would believe those representations.
 - *Example:* Gina works for ABC Corp. She has a generic title of manager. She is limited in her ability to sign purchase agreements on behalf of ABC Corp. She does, however, routinely negotiate the terms of purchase agreements with vendors. She then transmits the purchase agreements to her boss who signs them. The vendor never deals with anyone other than Gina. If Gina decides to start signing the purchase agreement herself, ABC Corp will likely be bound by the contracts. By signing the agreements, she is representing to vendors that she has authority to do so. It is likely reasonable for vendors to believe that she has this authority, as Gina is the primary point of contact for negotiating the agreements.

While an agent may bind the principal to the extent of her authority, the principal is also bound if she ratifies the conduct of the agent. That is, if the principal accepts or takes advantage of the agent's actions, she impliedly ratifies those actions as taken on behalf of the principal. In such situation, this expands the implied and apparent authority of the agent when undertaking future actions.

- **Discussion:** How do you feel about the doctrines of implied and apparent authority? Should an agent have the ability to bind an agent in contract when the agent does not have actual authority to do so? Why or why not? Should the standard be different for limited and general agents? Why or why not? Should the onus be on the employer to protect itself by informing third parties of the

limited authority of the agent, or should the onus be on the third-parties to verify the authority of the agent? What is your justification for this opinion?

- **Practice Question:** Kristy is an operations manager for ABC Corp. She has authority to enter into agreements for operational supplies. She does not, however, have authority to enter into sales agreements with retailers of ABC Corp products. In a couple of instances she is called upon to assist in putting together custom sales orders for large retailers. In these situations, Kristy was the primary point of contact with the retailers. 123 Corp learns about ABC Corps products through one of the retailers who previously worked with Kristy. 123 Corp contacts Kristy about putting together a custom sales package. What is Kristy's authority to deal with 123 Corp.? If Kristy enters into an unauthorized agreement with 123 Corp, under what theory might ABC Corp be bound by the contract? Why?
- **Resource Video:** <http://thebusinessprofessor.com/agent-authority-to-contract-for-business/>

6. To what extent are agents liable to third parties and to the principals they represent?

An agent acting within the scope of their authority is not liable to third parties on obligations entered into on behalf of the principal. Even if the agent exceeds her express authority, her implied authority may bind the principal to the agreement and relieve her from any contractual liability to the third party. The important point is that the agent must act on behalf of the principal and disclose that relationship to the third party. If the agent is acting on behalf of a principal, but fails to disclose her agency status, it may subject her to liability to the third party. In some cases, it may also serve to bind the principal once the agency relationship is determined.

- **Note:** If the agent goes beyond her express authority, she may be liable to the principal for any obligations binding the principal to third parties. That is, the principal may be able to recover damages suffered because of the agent exceeding her authority.
- **Example:** I work for ABC Corp. I enter into an agreement with 123 Corp on behalf of ABC Corp. I am not personally obligated to perform the contract. If I fail to tell 123 Corp that I work for ABC Corp (123 Corp believes that I have my own business), then I am liable to 123 Corp if ABC Corp does not perform the contract. ABC Corp is obligated to perform the contract if my entering the contract was in my express, implied, or apparent authority. If I did not have express or implied authority, ABC Corp may be liable if I had apparent authority, but ABC Corp may be able to sue me for any losses suffered.

- **Discussion:** Should an agent who exceeds her express authority be liable to the principal? Why or why not? Should she be liable to the third-party? Why or why not?
- **Practice Question:** Agnes is an agent of Emory Corp, a technology company that sells subscriptions to its cloud-based software. Agnes has the general title of manager, but has no express authority in her employment agreement. Agnes routinely negotiates sales agreements with large companies that are clients of Emory Corp. Agnes enters into an agreement with Tech, LLC that is far larger than any deal Agnes previously negotiated. The agreement is very poorly negotiated and it will cause a huge loss for Emory Corp. What is Emory Corps obligation? What are Agnes's potential obligations and liabilities?
- **Resource Video:** <http://thebusinessprofessor.com/agent-liability-to-third-parties/>

7. To what extent are principals liable for the torts committed by agents?

Whenever an individual is held liable for the actions of another, this is known as “vicarious liability”. In the context of agency, the agent is acting vicariously for the principal. A principal is responsible for the tortious acts of an agent pursuant to a doctrine known as “*respondeat superior*”. More specifically, an agent may create legal liability for the principal for actions taken by the agent “within the scope of the agency”. An act is within the scope of the agency if the purpose behind the action taken is to advance the interests of the principal. As such, if any act taken by an employee to advance the employer’s interest or as part of her effort to advance the employer’s interest is a tort, then the employer may be liable for that conduct.

- *Example:* I am an employee of a corporation. While carrying out my duties, I act negligently and harm some third party. The third party sues me and the corporation. The corporation will be liable for my negligent act because I was acting within the scope of my job responsibilities when I committed the tort.

- **Discussion:**
- **Practice Question:** Mitchell is an employee of Big Corp. His primary responsibilities are to deliver company goods to retailers. When out driving to a retailer’s location, Mitchell is following too closely and accidentally rear ends Bertha. Bertha sues Mitchell for negligence. What is the likely result for Big Corp?
- **Resource Video:** <http://thebusinessprofessor.com/principal-labile-for-torts-of-an-agent/>

8. What is a frolic and detour?

A “frolic and detour” is a general defense to vicarious liability. It states that the principal should not be liable for the tortious acts of the agent when the agent is acting outside the scope of her employment and for the benefit of someone other than the employer. Plainly stated, an employee who is on a frolic or detour is no longer acting for the employer.

- *Example:* An employee providing services at the location of a client for her employer is an agent acting within the scope of her employment. If, however, the employee takes the company vehicle and goes on a personal errand that is not authorized, the employee is likely outside the scope of her employment. Suppose while running these errands she gets into an automobile accident that is her fault. The employer would be able to argue the the deviation from her duties as employee was a frolic and detour and relieved the principal of liability for her tort.

- **Discussion:** How do you feel about the doctrine of *respondeat superior*? Should a principal be held liable for the tortious acts of an agent if committed within the scope of employment? Why or why not? How would you define scope of employment? Does it matter to you if the agent was also acting in her personal interest when committing the tort? In your opinion, how much of a deviation from her job duties must an employee vary in order for it to be considered a frolic and detour?
- **Practice Question:** Mitchell is an employee of Big Corp. His primary responsibilities are to deliver company goods to retailers. When out driving to a retailer’s location, Mitchell decides to

stop by his house and have lunch. Big Corp has a strict policy against taking work trucks home or using company trucks for any purpose other than delivering Big Corp products to retailers. When backing out of his driveway, Mitchell hits Tom who is out jogging. Tom suffers injuries and sues Mitchell and Big Corp. What will Big Corp have to show to defend the action for Mitchell's negligence? What facts in this situation may hinder Big Corp's defense?

- **Resource Video:** <http://thebusinessprofessor.com/vicarious-liability-for-torts-of-agent/>

9. When and how does the agency relationship terminate?

The establishment, duration, and termination of the agency relationship is generally governed by the agreement between the principal and agent. In the absence of an express agreement, several default rules apply regarding the point at which the agency relationship terminates. Below are common rules for terminating the agency relationship:

- *Withdrawal by Both Parties* – The parties can terminate the agency relationship upon mutual consent.
- *Termination by the Principal* – Either party may terminate the agency relationship as long it does not violate a contractual agreement between the parties.
 - *Note:* A principal cannot revoke the agency relationship if the agent's status is part of an agreement that is supported by consideration and terminating the agency relationship harm the agent's rights. This scenario commonly arises in an agency "coupled with an interest". An agency relationship is coupled with interest when the agent has a specific interest in the subject-matter of the agency, such as a consignment of goods for resale.
 - *Example:* I enter into a contract with Ernest to package and sell his products on the internet. In exchange for my effort, I will keep in percentage of the sale value. As such, the agency is coupled with an interest and cannot be revoked.
- *Renunciation by the Agent*– The agent can renounce the business of the principal and terminate her agency status and authority. This may, however, violate a contractual relationship between the parties.
 - *Example:* I enter into a contract to serve as your agent. I am terminate the agency by renouncing my duties. Unless I have a justification, my actions will likely violate my contractual obligations to you.
- *Duties of Agent Complete* – If the purpose of the agency ceases to exist, then the agency relationship terminates. This can be where the agent discharges all of her agency obligations. Further, it could be where the subject-matter of the agency no longer exists.
 - *Example:* You higher me to represent you in the sale of your real estate. The real estate is the subject of an eminent domain action and is taken by the government. The agency relationship terminates as the purpose of my agency is gone.
- *Death or Incapacity* – The agency relationship terminates upon the death or incapacity of either party.
- *Bankruptcy* – The agency relationship terminates upon the liquidation or reorganization of either

party.

Again, the above situations resulting in termination of the agency relationship are default rules. The parties may reserve any rights or restrictions on terminating the agency relationship within their agreement.

- **Discussion:** How do you feel about either party's right to terminate the agency relationship? What should the remedy be if termination of the agency relationship by a party violates a contract between the parties? Should a party have additional rights if her rights are harmed by the termination of the agency and the other party's rights are not? Why or why not?
- **Practice Question:** Earl runs a showroom for baby products. Gayle, the inventor of a new product, consigns a large quantity of goods with Earl. Earl agrees to display the goods and represent them to potential retailers. Earl earns a percentage of all future sales to the retailer as compensation for his services. Can Gayle cancel the agency relationship?
- **Resource Video:** <http://thebusinessprofessor.com/when-does-agency-relationship-terminate/>