

Chapter 7

Agency

Marvin H. Firestone, MD, JD, FCLM

The Law of Agency
Parties and the Relationship

Rights and Duties between Principal and Agent
Liabilities of Parties Based in Tort

THE LAW OF AGENCY

An agency is a consensual relationship between two persons whereby one person (the agent) is given a varying degree of authority to act for and on behalf of another (the principal). The *Restatement of the Law of Agency* defines the relationship as follows:

Agency is a fiduciary relationship that 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.¹

The liabilities, duties, benefits, and remedies attained through the agency relationship develop from both tort and contract law. Most agency relationships are formed by agreement, so that the usual defenses to the formation of a contract will, if successful, also negate the existence of an agency. However, other agencies arise as a result of the status of the parties or by operation of law and must be analyzed under other legal principles.

PARTIES AND THE RELATIONSHIP

The Parties

To form an agency, the parties involved must have legal capacity. The power to act through another depends on the capacity of the principal to do the act himself or herself. For example, contracts entered into by a minor or an insane person are considered “voidable,” that is, cancelable by or on behalf of the minor or insane party. Consequently the appointment of an agent by a minor or an insane person and any contracts resulting thereby are likewise voidable.

Capacity to be an agent is somewhat different from capacity required for contract formation or the execution of a will. An adult principal can appoint a minor agent. The fact that the agency agreement itself may be voidable does not in and of itself disqualify the agent from making a contract binding on the principal. An adult acting on behalf of a minor who could not make a binding contract directly may create such obligations, but they will be enforceable as against the adult agent rather than as against the minor principal.

Types of Agencies, Agents, and Principals

Agencies may be classified in different ways. The relationship may be one of actual agency, in which valid authority, express or implied, has been given by the principal to the agent to act on the principal’s behalf. An example of this is the retaining of a real estate broker to represent a seller in a particular transaction. Often, actual agencies are defined and created by the use of a written agency agreement (in this example, the listing contract).

An ostensible (or “apparent”) agency arises when, in the absence of an actual agency, the conduct of the principal induces others to reasonably infer that an agency exists.² Most often an ostensible agency arises when the scope of an actual agency is exceeded by the agent, causing a third party to assume that the agent has authority where he or she does not. For example, P may appoint A to act on his or her behalf to sell a parcel of land to any buyer who qualifies and is willing to pay the asking price. A, in negotiating with buyer B, is unable to make a sale of the property in question but offers to sell another parcel, also owned by P, which is more to B’s liking. By appointing A as his or her agent to sell one property, P may have created a reasonable assumption that A can act on his or her behalf to sell any property that P owns. If P fails to take reasonable precautions to limit the scope of A’s actual authority, the resulting contract to sell the second property may be enforced in B’s favor. This so-called agency by estoppel exists when a person by his or her conduct clothes another with indicia of authority by which a third party inferred that an agency relationship existed and relied on that inference when dealing with the agent.³ The conduct of the principal leading to the creation of such an agency may be intentional or merely negligent, and the inference must be reasonable.⁴ It is not a true agency because the consent element is lacking, but on equitable grounds the law prohibits the principal from denying the existence of the agency so as to cause harm to the party who acted in reliance.

An agent may act on behalf of a principal whose existence and identity have not been revealed to a third party. The “undisclosed principal” is bound by contracts forged by the agent with a third party despite the secrecy of the agency relationship, but unlike an actual agent the agent of an undisclosed principal is also bound. An agent who

44 Agency

acts on behalf of a principal whose existence (but not identity) has been revealed to the third party serves a “partially disclosed” principal, rendering both the principal and the agent contractually liable to the third party. Some cases have held that, once the third party learns the identity of the principal, he or she must make an election as to whether the agent or the principal will be held responsible for the contractual obligations.

Agents are also commonly classified as *general* or *special*.⁵ A general agent is authorized to transact all business or at least all business of a particular kind at a particular locale for its principal. A special agent is authorized to act for the principal only in a particular transaction. A subagent is appointed by an agent, with the express or implied consent of the principal, to assist the agent in the conduct of its agency duties. This subagent is the agent of the agent, and because the agent has the authority to make such an appointment, the subagent also has authority to bind the principal. Moreover, the subagent is in a fiduciary relationship with both the agent and the principal.

One common characterization of agency is the “master-servant” relationship. A “servant” generally has limited authority, such as performing physical or ministerial tasks assigned by the “master.” The master has the right to direct what is to be done, as well as how it is to be done. In most cases it is doubtful whether a servant could enter into a contract that would bind the principal without the presence of some expression of intent that the servant be clothed with such authority. So, in carrying out his duties, a delivery clerk is certainly the agent of the grocer, but no one would assume that he has authority to purchase a new truck on the grocer’s behalf. On the other hand, the clerk’s negligent handling of the old truck, causing accidental injury, will be imputed to his master based on the existence of the agency relationship under the doctrine of *respondeat superior* (“let the master answer”).

The master-servant relationship is distinguished from that of the independent contractor. Like the servant, the independent contractor is hired to perform a specific task. However, the master or principal exercises less control over the performance of the act, allowing the agent to determine the means and methods of carrying out the purpose of the agency. Independent contractors commonly fall into a professional category. As such, this concept is important for the medical practitioner. The physician practicing medicine encounters numerous situations in which the status of being an independent contractor effects legal rights, duties, and liabilities. For example, a physician usually is considered an independent contractor to the hospital or other facility where he or she treats patients even if the hospital has the right to determine which patients the physician treats, where and when he or she treats them, and what equipment or facilities will be made available for such treatment. The hospital, it is claimed, neither controls the manner in which physicians apply their skills and knowledge to the patients’ care nor assumes responsibility for errors in their judgment or technique.

An agency exists when individuals form partnerships, corporations, or any combination thereof. A general partner

acts as agent for the partnership and for all the other general partners, with regard to partnership business. A corporate officer acts as agent for the corporation. A corporation or partnership may act as agent for an individual.

Formation of the Agency

An agency may be formed by an oral or written contract.⁶ An agency also may result by implication from the circumstances (an “implied” agency). However, unlike an ordinary contract, in which consideration is required for formation, an agency may be gratuitous (lacking in any promise of compensation for the agent). Such a gratuitous agency does not affect the validity of contracts formed by the agent for the benefit of the principal.

Ratification is an affirmation by the principal of an unauthorized act of an agent, or purported agent, after the fact. Ratification relates back in time to the commission of the act, thus binding the principal just as if the agency had been authorized at the time.⁷

Termination of the Agency

An agency, once created, continues until terminated. Termination may occur in a number of ways. The time of termination may be specified in the agency agreement itself, where the relationship terminates as of a stated time. In the absence of a specified time, the agency is deemed terminable at will, and a reasonable time limitation may be implied from the facts and circumstances.

The agency agreement also may specify that the relationship is to terminate on the occurrence of a particular event or may be terminated by a material change in the circumstances underlying the agency agreement. Destruction of the subject matter of the authority, insolvency or bankruptcy of the agent or the principal, a drastic change in pertinent business conditions, and changes to the law that substantially affect the purposes of the agency may terminate the agency. A breach of the agent’s fiduciary duty may effectively terminate the agency. When either the agent or the principal unilaterally acts to terminate the agency, the principal is best advised to take reasonable steps to notify potential third parties that the agent no longer holds authority to bind the principal.

Finally, an agency may be terminated by operation of law, such as upon the death of either the agent or the principal or the loss of either party’s legal or mental capacity. Where a partnership or corporation holds the position of agent or principal, dissolution of the partnership or corporation effects a termination.

RIGHTS AND DUTIES BETWEEN PRINCIPAL AND AGENT

Duties Imposed on the Agent

The law of agency attaches certain duties of performance to the agent. First, the agent is responsible to the principal

as a fiduciary.⁸ A fiduciary duty arises out of a relationship of trust and confidence. Fiduciary duties define many common agency relationships, including those of trustee and beneficiary, corporate directors and shareholders, attorney and client, and employee and employer. Breach of one's fiduciary duty often results in legal sanctions for the party at fault.

The agent owes the principal the utmost in loyalty and good faith. Therefore an agent must act only in the interests of the principal and not in the interests of himself, herself, or another. Thus an agent may not represent the principal in any transaction in which the agent has a personal or financial interest. To do so would be a conflict of interest.⁹ This duty prevents an agent from competing with the principal concerning the subject matter of the agency. Moreover, an agent may not use information obtained during the course of the agency for his or her own benefit or retain a secret profit gained in the course of the agency; all profits belong to the principal. The principal's legal remedies include the right to demand an accounting and the right to force the agent to disgorge profits.

The fiduciary duty also requires an agent to use reasonable efforts to notify the principal of developments or information reasonably calculated to be relevant to the affairs of the agency.¹⁰ Knowledge of the agent is expected to include all information gained during the conduct of transactions for the principal, as well as information that (by the exercise of reasonable inquiry) the agent should have attained. Moreover, knowledge of facts material to the agency gained through transactions unrelated to the agency also may be imputed to the principal if this knowledge was present in the mind of the agent and used to the advantage of the principal during the agency. However, the agent is not required to notify his or her principal of facts gained while dealing for another principal (provided those facts were not acquired for the benefit of the first principal). With certain exceptions, knowledge gained by the agent after the termination of the relationship is not imputed to the principal unless it was gained from a third party who previously dealt with the agent during the pendency of the agency and who had no knowledge of the termination (there being an apparent authority). Moreover, the imputed knowledge of the principal is constructive knowledge and not actual; a principal cannot, for example, be held liable for a crime for which actual knowledge is an essential requirement, solely on the basis of imputed or constructive knowledge.

Violation of the fiduciary duty may be both a breach of contract (agency) and a tort (fraud).¹¹ Thus an injured principal has a choice of remedies. The agent may be held accountable for all damages proximately suffered by his or her principal. In tort situations in which malice or bad faith is proved, punitive damages also may be awarded. When the agent is found to have gained personally from the breach, the principal may void any transactions made with third parties that emanate from the violation of the fiduciary duty. For property held by the agent in violation of the fiduciary duty, the law may impose a constructive trust on the property for its transfer to the principal.

The agency relationship imparts other duties on the agent as well. One is the duty to perform. This duty requires the agent to act for the principal only as authorized and to obey all reasonable instructions and directions. The agent also must act with reasonable care, diligence, and skill in the completion of tasks.

Duties Imposed on the Principal

The principal also is subject to certain duties in the agency relationship. For example, the agent is owed reasonable compensation (unless of course it is a gratuitous agency) for services in the conduct of the agency. Furthermore, the agent is due indemnification from the principal for all reasonable expenses and losses incurred by the agent during discharge of authorized duties.¹²

A principal also owes the agent the duty of cooperation. To this end a principal must assist and provide to the agent any and all known information that is relevant to the conduct of the agency. More important, this duty prohibits the principal from interfering in a way that would hinder or prevent performance by the agent. Consider the example of the physicians' group practice that contracts with a search firm to find a qualified ophthalmologist and the contract with the search firm is one of an exclusive agency. Furthermore, the search firm will be paid a finder's fee in the amount of a percentage of the hired specialist's compensation package. Later, certain members of the group, while at a medical seminar, locate and hire an ophthalmologist for the group. Under these circumstances, most courts would find for the search firm and award damages for the lost profits it would have made if it had located the new specialist. Such remedy is likely to be specified in the firm's contract as well.

If the principal breaches the contract of agency, the agent's remedies lie in an action in contract. Therefore most of the remedies available to a contracting party are likewise available to the agent. In addition, the agent may have the right to claim a retaining lien against the property of his or her principal that is in the lawful possession of the agent, as well as any other liens provided by law. Such liens usually extend also to a subagent as to property lawfully in the subagent's possession, but only to the extent of the primary agent's rights in the property. Further remedies available to an agent include the rights to withhold performance, claim a setoff in any action brought by the principal, or demand an accounting by the principal. However, because the agency relationship is consensual in nature, there is generally no right by either the agent or the principal to the remedy of specific performance of the agency contract.

Powers Vested in the Agent

The power vested in an agent, if any, is to be strictly construed. As such, an agent is deemed to possess those powers that were expressly given or are reasonably required for the agent to perform his or her duties. Powers inherent in the agency, such as the power to sell land for a realty agent, are included.

46 Agency

In cases in which authority is present, an agent may provide warranties. Such warranties may be express or implied. A most important warranty of the implied type is the warrant of authority. An agent is deemed to impliedly warrant that he or she has the authority to act on behalf of the principal.

An agent is deemed to hold all powers that a reasonable third party would believe he or she holds. This principle is known as *inherent agency power* and holds true even if the principal expressly denied the agent such a power. The rationale behind this policy is the protection of innocent third parties. An example of such a power is the agent's power to make representations concerning the subject matter of the agency.

LIABILITIES OF PARTIES BASED IN TORT

Liability of the Principal for the Agent's Acts

One who commits a tort is usually held liable to those harmed. This rule is true for an agent acting within the scope of his or her agency, and a principal may be held liable to third persons for the torts committed by the agent. This principle is called the doctrine of *respondeat superior*. *Respondeat superior* (Latin meaning, "let the master answer") is simply one form of vicarious liability. This doctrine developed in early common law when the servant was treated as property of the master. Because the master was deemed to have absolute control over the acts of the servant, the master might properly be held to answer for those acts, both rightful and wrongful. The basis for a finding of vicarious liability against the principal is based upon whether the servant's act or omission occurred in the course and scope of employment of the agent. The tortious act must have been committed while the agent was engaged in work of the type that he or she was appointed to perform for the principal.

Today this doctrine has been retained in the law on the rationale of at least two theories. The first is based on the premise that, because the employer has the right of control and termination of the employee, the threat of holding the employer liable will cause the employer to act more prudently in the selection, guidance, and supervision of employees. Moreover, it is the employer who profits from the acts of the employee. This rationale justifies placing the ultimate responsibility for the safety of others on the principal.

The second theory holds that public policy requires that an injured third person be afforded the most effective relief available. This doctrine assumes that the employer is generally wealthier than the employee and therefore more likely to be able to pay damages. First-year law students learn this as the "deep pocket" theory of recovery. In modern times probably nothing has encouraged our litigious society more than this doctrine. Plaintiffs seeking large recoveries have little chance of doing so against a mere

employee. But the huge coffers of business, professional, and government treasuries or their insurance companies lie for the taking. A plaintiff may seek recovery against the principal, the agent, or both, when injured.

Respondeat superior imposes on the principal a "strict liability" (i.e., liability without fault on the part of the principal), and it attaches notwithstanding the principal's due care in the selection of the agent or employee and in the subsequent supervision thereof. Such liability is both joint and several with that of the agent or employee. Of course, the plaintiff is not entitled to a double recovery. Recovery against either defendant bars recovery against the other.¹³ When the principal is found to be vicariously liable, he or she is usually entitled to seek indemnification against the agent or employee for damages paid to the victorious third party.

Hospital as Principal of the Physician

Increasingly, plaintiffs injured by malpractice are bringing actions against both the negligent physician and the hospital where care was provided. Several legal theories support such a suit, including direct negligence in the operation of the hospital and insufficient supervision of residents who are employees of the institution. All jurisdictions hold that there is hospital liability for the negligent acts of a physician employed by the hospital. Thus, under the doctrine of *respondeat superior*, the hospital may be liable for the acts or omissions of a physician in training but not for those of an attending physician because the latter is an independent contractor not subject to such control.¹⁴

In addition, if there is a showing that the professional in question is an employee rather than an independent contractor, the act in question must be shown to have occurred within the scope of employment. Among other requirements, to meet this showing, the act must be reasonably foreseeable by the employer.¹⁵ When supervision and control are provided by a hospital or an attending physician over a resident, the suit will likely turn on the degree of control available. Presumably the more senior the resident, the less control may be exercised by the hospital and its employees. Nurses and other providers who are employed by the hospital or who answer to administrators are almost always considered agents for purposes of imputing liability. However, when the provider is beyond the control of the institution in performing his or her duties, employment alone may not sustain a charge of liability against the hospital.¹⁶

An important exception to the doctrine of *respondeat superior* is known as the *fellow servant rule*. This rule holds that a principal is not liable for injury done to one employee by another employee of the same principal in the same general enterprise. The rationale behind this doctrine is that a person who accepts appointment by a given principal assumes any risk that he or she might be injured by another appointed by the same principal and that he or she is in at least as good a position as the principal to discover such risks and protect himself or herself from them.

These are poor justifications for such a rule, and the courts are not in favor of it, seeking generally to avoid its application. Today there are many exceptions to the applicability of the fellow servant rule (e.g., where the plaintiff seeks recovery based on the employer's negligence in hiring a fellow employee or where the plaintiff is injured by a superior employee who is acting within his or her authority in supervision of an inferior employee).

Acknowledgment

The author gratefully acknowledges work previously contributed by Robert Schur, JD.

Endnotes

1. Restatement (Second) of the Law, Agency, §1, American Law Institute (1957).
2. See Restatement, Agency §267.
3. See Restatement, Agency §8B. The result is an agency created by operation of law. Such an agency also may be created by statute, such as where the law of state A directs that an out-of-state corporation doing business in state A automatically appoints the Secretary of State as its agent for service of process within state A.
4. There are some exceptions to this relation back doctrine, namely (1) where the principal, on the date of ratification or the date of the unauthorized act, lacked the capacity to do so; (2) where to do so would now be illegal; or (3) most important, where to do so would prejudice innocent third persons who have acquired rights in the transaction during the interim period.
5. See Restatement, Agency §3.
6. Agency agreements made orally may be invalidated by the state's statute of frauds, whereby certain contracts are required to be in writing to be enforceable. Many states have enacted what generically may be called *equal dignity laws* providing that when the statute of frauds requires an agreement be made in writing the agent's authority also must be in writing. A written agency agreement is often in the form of a "power of attorney" appointing the agent as the principal's attorney-in-fact for a specific purpose (or in general to conduct the principal's business).
7. *Adamski v. Taco General Hospital*, 579 P. 2d 970, at 978 (Wash. App. 1978). Note that the term *reasonable* connotes an objective rather than a subjective standard. The proper test is what a reasonable person under the circumstances would believe.
8. See Restatement, Agency §13.
9. Full disclosure of the conflict and written authority to act despite the conflict may relieve the agent from liability for breach of the agency agreement; however, this entails some risk for the agent, whose position as a fiduciary is not defeated by the disclosure.
10. See Restatement, Agency §11, 381. The effect of this rule is that notice of all matters coming to the agent is imputed to the principal. Thus, as to third persons who dealt with the agent, the principal is deemed to know or have constructive knowledge of all that the agent should have told him or her. It would then seem useless for a principal to instruct his or her agent with the admonition, "I don't want to know of it!" See also Restatement, Agency §272.
11. See Restatement, Agency §399.
12. The scope of this right is usually defined by contract. Absent this, the courts will indemnify the agent where it is just to do so, considering the nature of the relationship, the transaction entered into, and the costs and losses involved. Note that there is no right of indemnification for unauthorized acts. Furthermore, there is likewise no right for costs and losses incurred for the commission of illegal acts.
13. Note that where the plaintiff entertains a suit against only the agent and is denied recovery by the court, this action will generally operate to release the principal as well because there can be no vicarious liability without primary liability. Still, the principal may be sued for his or her own negligence, such as in the hiring or supervision of the agent or employee.
14. See, e.g., *Kirk v. Michael Reese Hosp.*, 513 N.E. 2d 387 (Ill. 1987); *Gregg v. National Medical Health Care*, 699 P. 2d 925 (Ariz. App. 1985). See also Chapter 12 below for discussion of other theories of liability of health care entities besides *respondeat superior*.
15. *Fock v. U.S.*, 597 F. Supp. 1325 (D.C. Kan. 1982).
16. *Foster v. Englewood Hospital Association*, 19 Ill. App. 3d 1055, 313 N.E. 2d 255 (1974).

