Chapter 17

**Agency Relationships in Business**

Answers to Learning Objectives/

Learning Objectives Check Questions

at the Beginning and the End of the Chapter

**Note that your students can find the answers to the even-numbered *Learning Objectives Check* questions in Appendix E at the end of the text. We repeat these answers here as a convenience to you.**

**1A.** ***What is the difference between an employee and an independent contractor?*** The difference between employees and independent contractors is that those who hire independent contractors have no control over the details of their physical perform­ance.

**2A.** ***How do agency relationships arise?*** Agency relationships normally are consensual—that is, they arise by voluntary con­sent and agreement between the parties.

**3A.** ***What duties do agents and principals owe to each other?*** Generally, the agent owes the principal five duties—performance, notification, loyalty, obedience, and accounting. The principal owes an agent duties that re­late to compensation, reimbursement and indemnification, cooperation, and safe working conditions.

**4A.** ***When is a principal liable for the agent’s actions with respect to third parties? When is the agent liable?*** A disclosed or partially disclosed principal is liable to a third party for a con­tract made by an agent who is acting within the scope of her or his authority. If the agent exceeds the scope of authority and the principal fails to ratify the contract, the agent may be liable (and the principal may not).

When neither the fact of agency nor the identity of the principal is disclosed, the agent is liable, and if an agent has acted within the scope of his or her authority, the undis­closed princi­pal is also liable. Each party is liable for his or her own torts and crimes. A principal may also be liable for an agent’s torts committed within the course or scope of employment. A principal is liable for an agent’s crime if the principal participated by conspiracy or other action.

**5A.** ***What are some of the ways in which an agency relationship can be terminated?*** An agency may be terminated by an act of the parties through, as specified in the original agreement, a lapse of time, the achievement of the purpose of the agency, or the occurrence of a specific event, or by a later mutual agreement, or a renunciation or revocation of authority. An agency may also be terminated by operation of law through the death or insanity of either party, the loss or de­struction of the subject matter of the agency, changed circumstances, bank­ruptcy, or war.

## Answers to Critical Thinking Questions

**in the Features**

**Adapting the Law to the Online Environment—Critical Thinking**

***If an employee accesses Facebook at work even though personal use of a workplace computer is against the employer’s stated policies, can the employee be criminally prosecuted? Why or why not?*** Only under special circumstances could an employee be criminally prosecuted. Violation of an employer’s stated policies is almost always a civil action.

# Beyond Our Borders—Critical Thinking

***How would U.S. society be affected if employers could not be held vicari­ously liable for their employees’ torts?*** Employers might condone more reckless behavior, or even encourage it, on the part of their employees. Employees might be less willing to take risks, however, if they were more aware of their potential liability.

Answers to Critical Thinking Questions

in the Cases

**Case 17.1—Critical Thinking—Economic Consideration**

***Why did ACS contend that Johnson was not its employee? Discuss.*** ACS contended that Johnson was not its employee to avoid the imposition of liability for the harm caused to Perry by Johnson’s negligence while driving a truck on the job. Under the doctrine of *respondeat superior*, an employer may be liable for the harm that an employee causes to a third party in the course or scope of employment.

**Case 17.2—Critical Thinking—Legal Consideration**

***What duties to Church might Bagley have violated in this situation?*** Bagby may have violated his duty of notification or duty to inform Church of the modifications to the contract. In addition, he may have violated his duty of obedience if he had ever received instructions related to the contracts for breeding.

**Case 17.3—Critical Thinking—Legal Consideration**

***The court ruled that Sussman was personally liable on the contract with Stonhard. Is the principal, Blue Ridge Foods, also liable? Explain.*** Yes, assuming Sussman was acting within the scope of his authority, Blue Ridge Foods is liable on the contract that Sussman entered into with Stonhard.

The court concluded that “at best \*  \*  \* Sussman was acting as an agent for a partially disclosed principal, in that the agency relationship was known, but the identity of the principal remained undisclosed.” A partially disclosed principal is liable to a third party for a contract made by an agent who is acting within the scope of his or her authority. When neither the fact of the agency nor the identity of the principal is disclosed, the undisclosed principal is bound to perform just as if the principal had been fully disclosed at the time the contract was entered into. Thus, in either circumstance, Blue Ridge Foods is liable on the contract that Sussman made with Stonhard.

Answers to Questions in the Reviewing Feature

at the End of the Chapter

**1A.** ***Doctrine***

The doctrine of *respondeat superior*, under which employers may be held liable for the actions of their agents or employees, may apply in this situation. The concept of *respondeat superior* is based on the assumption that employers are usually in a better position to absorb the costs that may result from agents’ or employees’ torts.

**2A.** ***Key factor***

Under the doctrine of *respondeat superior*, an employer is responsible for torts committed by agents or employees in the course and scope of their employment.

**3A.** ***Potential liability***

The employer in this problem may be liable in either situation under the doctrine of *respondeat superior.*

**4A.** ***Employer’s knowledge***

This circumstance would support an assessment of liability on the employer under the theory that the employee acted with the employer’s knowledge of a propensity for tortious behavior.

Answer to Debate This Question in the Reviewing Feature

at the End of the Chapter

***The doctrine of* respondeat superior *should be modified to make agents liable for some of their tortious (wrongful) acts.*** Because of the doctrine of *respondeat superior*, some agents may act more recklessly because they know that the principal will pay all damages for their irresponsible behavior.  If all agents knew that they would be financially liable for at least some of the damages their tortious conduct caused, they would behave in a more responsible manner.

Business owners and other principals take out sufficient insurance to cover damages owed due to their agents’ tortious acts.  It would be unfair to impose any liability on agents, who, in general, are not in a financial position to pay for any part of a damage award as a result of their tortious acts.

Answers to Issue Spotters

at the End of the Chapter

**1A.** ***Dimka Corporation wants to build a new mall on a specific tract of land. Dimka contracts with Nadine to act as its agent in buying the property. When Nadine learns of the difference between the price that Dimka is willing to pay and the price at which the owner is willing to sell, she wants to buy the land and sell it to Dimka herself. Can she do this? Discuss.*** No. Nadine, as an agent, is prohibited from taking advan­tage of the agency rela­tionship to obtain property that the principal (Dimka Corporation) wants to purchase. This is the *duty of loyalty* that arises with every agency relationship.

**2A.** ***Davis contracts with Estee to buy a certain horse on her behalf. Estee asks Davis not to reveal her identity. Davis makes a deal with Farmland Stables, the owner of the horse, and makes a down payment. Estee does not pay the rest of the price. Farmland Stables sues Davis for breach of contract. Can Davis hold Estee liable for whatever damages he has to pay? Why or why not?*** Yes. A prin­cipal has a duty to in­demnify an agent for liabilities in­curred because of authorized and lawful acts and transactions and for losses suf­fered because of the principal’s failure to per­form his or her duties.

Answers to Questions and Case Problems

**at the End of the Chapter**

**Business Scenarios and Case Problems**

**17–1A . *Ratification by principal***

Dubychek may very well be correct in his claim. Implied ratification by a prin­cipal of an agent’s unauthorized action occurs when a principal accepts the benefits of the unauthorized transaction and/or does not object to or repudiate the action within a reasonable time. It is essential, however, that the princi­pal be aware of all material facts; otherwise, the ratification will not be effec­tive.

If Springer knew that the printed materials had been ordered by his cam­paign workers without his authorization and used the materials in spite of this knowl­edge, such use would constitute ratification of the unauthorized pur­chase agreement. In such a case, Dubychek could successfully sue to recover the pur­chase price of the campaign materials.

If Springer was unaware that the ma­terials had been purchased without his authorization, his use of the ma­terials would not constitute ratification. A good point for discussion is whether the campaign worker was impliedly authorized or had apparent authority to con­tract for the printing of the promotional material. There is no question that there was no express authorization. Springer’s prohibition, unknown to Duby­chek, may not relieve Springer of liability, however. If the campaign worker is one who is placed in a position of a person who usually orders cam­paign print­ing, or if this campaign worker had previously ordered campaign materials from Dubychek, Dubychek can claim that the campaign worker had either im­plied authority to act or that previous conduct led Dubychek to believe that the worker had (apparent) authority to contract for the printing. If either is appli­cable, ratification is not necessary, as the worker’s contract is authorized, and the principal, Springer, is liable.

**17–2A. *Employee v. independent contractor***

A court might hold that Hemmerling and Happy Cab have an employment re­lationship primarily on the basis of control. Happy Cab clearly has the right to control the methods or means used by Hemmerling in the course of operating the taxicab by virtue of its exclusive control over the taxicab. Happy Cab exercises its control by es­tablishing and enforcing a variety of rules re­lating to the use of the cab, solicita­tion of fares, and so on. Other factors supporting the exis­tence of an employ­ment relationship include that Hemmerling was not en­gaged in a distinct oc­cupation or business from that of Happy Cab, and the type of work is that which can be done by em­ployees rather than specially skilled independent con­tractors. Also, Happy Cab supplied the instrumentality of the trade (the cab), and given that the rates were set by the state, Hemmerling’s ability to control his profit was limited. The only factor that supports an inde­pendent contractor relationship is that Happy Cab did not withhold taxes.

**17–3A. Spotlight on Taser International—*Loyalty***

Yes, Ward breached the duty of loyalty that he owed Taser, but there are steps he could have taken to form his own firm without breaching this duty. An agent must act solely for the benefit of the principal and not in the interest of the agent. Any information that is acquired through the agency relationship is considered confidential. It is a breach of loyalty for an agent to use the information for personal gain during the agency or after its termination.

Under this principle, an employee cannot actively compete with his or her employer during the period of employment. In the facts of this problem, Ward’s design and development efforts during his employment constituted direct competition with Taser’s business and violated Ward’s duty of loyalty.

Of course, Ward could have avoided this breach by resigning his employment based on no more than a desire to work for himself, but there are other legitimate steps that Ward could have taken towards starting his own firm. Taking steps that any businessperson might make before initiating a business could be permissible—investigating computer software, acquiring a line of credit, securing office space, or getting prices on equipment, for example. And any steps taken in furtherance of an enterprise that in no way would have competed with Taser would also likely have been acceptable, assuming that the activities did not involve the improper use any of Taser’s resources, including Ward’s work time.

**17–4A. *Liability for contracts***

Hall may be held personally liable. Hall could not be an agent for House Medic because it was a fictitious name and not a real entity. Moreover, when the contract was formed, Hall did not disclose his true principal, which was Hall Hauling, Ltd. Thus, Hall may be held personally liable as a party to the contract.

**17–5A. *Agent’s authority***

No, Rainbow cannot recoup the unpaid amounts from Basic. Express authority is authority declared in clear, direct, and definite terms. Express authority can be given orally or in writing. In most states, if the contract being executed is or must be in writing, then the agent’s authority must also be in writing. Otherwise, the contract may be avoided (or ratified) by the principal. If it is ratified, the ratification must be in writing. An agent has the implied authority to do what is reasonably necessary to carry out express authority. For example, authority to manage a business implies authority to do what is reasonably required to operate the business. But an agent’s implied authority cannot contradict his or her express authority. Thus, if a principal has limited an agent’s express authority, then the fact that the agent customarily would have such authority is irrelevant.

In this problem, Basic Research advertised its products on television networks owned by Rainbow Media Holdings through an ad agency, Icebox Advertising. Basic paid Icebox for the ads, but Icebox did not make all of the payments to Rainbow. Icebox filed for bankruptcy. Rainbow cannot recover what it was owed from Basic. As Basic's agent, Icebox had the express authority to buy ads from Rainbow on Basic's behalf, but that authority was limited to purchasing ads with cash in advance. Thus, Icebox did not have the authority—express or implied—to buy ads on Basic's credit. And Basic did not ratify the contracts that represented purchases on credit.

In the actual case on which this problem is based, on Basic’s appeal from a judgment in Rainbow’s favor, the U.S. Court of Appeals for the Tenth Circuit reversed that judgment and ruled in Basic’s favor.

**17–6A. *Agent’s duties to principal***

The Millers are referring to the duty of loyalty that an agent owes a principal. And yes, if the Millers can prove their allegations, Verchota was in breach of this duty. The Millers might also allege that Verchota breached the agent’s duty of notification. Under the duty of loyalty, an agent has the duty to act solely for the benefit of his or her principal. Under the duty of notification, an agent is required to notify the principal of all matters that come to her or his attention concerning the subject matter of the agency.

Here, William and Maxine Miller, Michael Harris, and Kenneth Hoxie were the shareholders of Claimsco International, Inc. John Verchota was the accountant who worked for all of them. The Millers filed a suit against Harris, Hoxie, and Verchota, alleging that Verchota followed Harris's instructions to adjust Claimsco's books to maximize the Millers' financial liabilities, falsely reflect income to them without actually transferring that income, and unfairly disadvantage them compared to the other shareholders. Assuming that the Millers prove these allegations, they show that Verchota breached the agent’s duty of loyalty that he owed to the Millers—none of these actions are for the benefit of the Millers as principals. And because Verchota did not likely inform the Millers of these actions, he also violated the agent’s duty of notification.

In the actual case on which this problem is based, the court dismissed the Miller’s claim against Verchota, but a state intermediate appellate court reversed the dismissal and remanded the case for further proceedings. Referring to the duty of notification, the appellate court stated, “The agent breaches this duty not only when he acts adversely to the principal's interest, but also when he conceals facts that involve the principal's advantage.”

**17–7A. Business Case Problem with Sample Answer—*Determining employee status***

No, Cox is not liable to Cayer for the injuries or damage that she sustained in the accident with Ovalles. Generally, an employer is not liable for physical harm caused to a third person by the negligent act of an independent contractor in the performance of a contract. This is be cause the employer does not have the right to control the details of the performance. In determining whether a worker has the status of an independent contractor, how much control the employer can exercise over the details of the work is the most important factor weighed by the courts.

In this problem, Ovalles worked as a cable installer for Cox under an agreement with M&M. The agreement disavowed any employer-employee relationship between Cox and M&M’s installers. Ovalles was required to designate his affiliation with Cox on his van, clothing, and an ID badge. But Cox had minimal contact with Ovalles and limited power to control the manner in which he performed his work. Cox supplied cable wire and other equipment, but these items were delivered to M&M, not Ovalles. These facts indicate that Ovalles was an independent contractor, not an employee. Thus, Cox was not liable to Cayer for the harm caused to her by Ovalles when his van rear-ended Cayer’s car.

In the actual case on which this problem is based, the court issued a judgment in Cox's favor. The Rhode Island Supreme Court affirmed, applying the principles stated above to arrive at the same conclusion.

**17–8A. *Agent’s authority***

As Rosie’s agent, Susan owed her a fiduciary duty to act in the utmost good faith on Rosie’s behalf and in her best interest. An agent’s duty of accounting requires an agent to keep and make available to the principal an account of all property and funds received and paid out on the principal’s behalf. The agent has a duty to maintain separate accounts for the principal’s funds and for the agent’s personal funds, and the agent must not intermingle these accounts. Susan violated both of these duties.

In this problem, Rosie executed a durable power of attorney appointing Susan as her agent. Susan opened a joint bank account with Rosie at Bank of America and deposited Rosie’s funds into the account. Susan used some of the money to pay for “household expenses.” The facts indicate that Susan did not account to Rosie for this use of her funds. After Rosie’s death, Charles, the executor of Rosie’s estate, filed a suit against Susan for an accounting. Susan breached her fiduciary duty to Rosie by spending Rosie’s funds for Susan’s own expenses. Susan breached the agent’s duty to account to the principal by not informing Rosie of the transactions involving her funds.

In the actual case on which this problem is based, in Charles’s suit against Susan for an accounting, the court ordered Susan to provide bank account summaries and transaction information. After review, the court ordered Susan to return all of Rosie’s funds deposited into their joint account to Rosie’s estate. A state intermediate appellate court affirmed the order.

**17–9A. A Question of Ethics—*Vicarious liability***

**1.** Yes, Paliath’s representations to Auer about the property were within the scope of her employment as a real estate agent for Home Town Realty (the real estate broker). Realtors cannot act except under the authority of their broker (who is the principal), and they are authorized by the broker to make representations concerning the properties that they are selling.

The court found that Paliath had acted within the scope of her employment under the factors listed in this text. Because “a real estate salesman has no independent status or right to conclude a sale and can only function through the broker with whom he is associated” and “a salesman is required to be under the supervision of a licensed broker in all of his activities related to real estate transactions,” the salesperson’s acts can only be authorized by the broker.

The fraud on which Auer based her suit was committed by Paliath when she was advising and assisting Auer in the purchase of certain rental properties—this advice and assistance was given within the time, place, and purpose of such acts commonly performed by real estate salespersons on behalf of their broker employers. The extent to which Home Town’s interests were advanced by Paliath’s acts was indicated by the broker’s receipt of a commission on each sale. Of course, Paliath’s private interests were also involved—she realized a commission on each sale, too, and profited from Auer’s paying for the work to be done on each property. But the fraud would not have been effective without the apparent approval of Home Town Realty, which acted as the broker to Paliath’s salesperson.

**2.** The ethical basis for imposing vicarious liability on a principal, or employer, for the tort of an agent, or an employee (and in some cases an independent contractor) is similar to the rationale for the doctrine of respondeat superior*.* Each is based on the social duty that requires every person to manage his or her affairs so as not to injure another. This duty applies even when a person acts through an agent (controls the conduct of another).

Public policy requires that an injured person be afforded effective relief, and thus liability is imposed on employers because they are usually in a better financial position than either the agent or employee, or the victim to bear the loss. This superior financial position carries with it the duty to be responsible for damages. Employers normally carry liability insurance to cover any damages awarded as a result of such lawsuits. They are also able to spread the cost of risk over the entire business enterprise.

**Critical Thinking and Writing Assignments**

**17–10A. Critical Legal Thinking**

The Copyright Act of 1976 provides that copyright ownership “vests initially in the author or authors of the work.” As a general rule, the author is the party who actually creates the work. This statute follows Congress’s declared policy of enhancing the predictability and certainty of copyright ownership.

Vesting the rights to works in the parties who create them—parties who include inde­pendent contractors—also supports such policies as the “work ethic.” A person who reaps the benefits of the “fruits of his or her labor” (the products of his or her effort) is arguably more likely to work harder and produce better products than one who receives no ownership of, or at least no benefit from, what he or she produces.

Vesting the rights to works in the parties who create them also preserves the “independence” of the independent contractor and the “independ­ence” of an employer, in the case of a work for hire, who can retain freedom from some types of potential liability by hiring independent contractors rather than employees.

**17–11A. Business Law Critical Thinking Group Assignment**

**1.** The plaintiff’s best argument that Dean is responsible for BSP’s actions may be that work such as BSP was hired to perform creates a peculiar risk of harm to others. When armed guards are hired to deter vandals and thieves it is foreseeable that someone might be injured by the inappropriate use of a weapon if proper precautions are not taken. Thus, in this case, such an injury is one that might have been anticipated as a direct or probable consequence of the performance of the work con­tracted for, if reasonable care had not been taken in its performance. Also, the risk created is not a normal, routine matter of customary human activity, such as driving an automobile, but is instead a special danger arising out of the par­ticular situation created and calling for special precautions. Under this reasoning, the plaintiff would argue that Dean could be liable even though the guard responsible was an employee of an independent contractor.

**2.** To the plaintiff’s best argument set out in the previous answer, Dean might respond that hiring armed guards to protect property does not create a peculiar risk of harm to others and, therefore, is not inherently dangerous work. On this conclusion, even if Gaines’s death were the result of BSP’s negligence, Dean would not be liable because BSP was an independ­ent contractor and an employer is not generally liable for the negligent acts of its independent con­tractor.