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A PROBLEM IN THE LAW OF AGENCY

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It is fundamental that an agent subjects his principal to liability upon a contract made on behalf of the principal by the agent within the scope of his actual authority, either expressly given or implied in fact.

It is equally elementary that the agent of a disclosed principal may bind his principal upon a contract within the *apparent* scope of his authority. For instance, the principal will be liable where the agent exercises powers which are reasonably necessary and proper to carry into effect the main power conferred, or powers which usage and custom have added to the main power, even tho such additional or incidental powers were expressly withheld—provided the third party did not know that they were prohibited. In other words, the agent is said to possess such powers as the principal has by his direct act or by negligent omission or acquiescence caused or permitted persons dealing with the agent reasonably to believe that the principal had conferred. (See Mechem on Agency, Sec. 282, 705.)

What is the legal basis for saying that an agent can subject his principal to liability for contracts within the apparent scope of the agent's authority, but actually prohibited? The language used by the text writers and the courts in stating this rule usually includes all the elements of an estoppel, even tho that term is not used. Broadly speaking, an estoppel is nothing but a legal device to prevent a person from profiting by reason of having tricked another person into a course of action which he would not have followed had he not been misled by a false appearance. An agent to sell real estate usually has the implied power to sell by means of warranty deed. The third party who innocently takes such a deed from the agent, or contracts for it, can insist upon his warranty as against the principal, even tho this particular agent has been forbidden to give a warranty. The principal will not be allowed to profit at the expense of the third party by reason of secret instructions given to the agent which give the lie to the apparent extent of the agent's powers.

In the words of Judge Story, "where one of two innocent persons is to suffer, he ought to suffer who misled the other into the contract by holding out the agent as competent to act, and

as enjoying his confidence." (Story on Agency, 7th Ed., Sec. 443.)

Justice Holmes, of the Supreme Bench, used this language: "It is true that in determining how far authority extends, the question is of ostensible authority and not of secret orders. But this merely illustrates the general rule which governs a man's responsibility for his acts thruout the law. If, under the circumstances known to him, the obvious consequence of the principal's own conduct in employing the agent is that the public understand him to have given the agent certain powers, he gives the agent those powers." (5 Harvard Law Review, 1.)

It is immaterial whether or not we say that these authorities base the principal's liability for unauthorized contracts strictly upon the ground of estoppel: The significant thing is that they make him liable in order to prevent the consummation of fraud upon innocent third persons; — and it follows inevitably from all these authorities that, in the absence of the agent's actual authority, the principal can be subjected to liability *only where necessary to prevent fraud*. The fraud to be prevented in each case is this: That a third party is made to believe that he is making a valid contract with a principal thru the intermediation of an agent who appears to have authority to make that contract for his principal, when in fact he does not have authority to do so. Obviously, we cannot have such a case of fraud unless the third party believes that he is contracting with someone other than the agent, that is, unless it is a case where at least the fact of agency is disclosed, if not the principal's name.

Where, however, the third party is ignorant of any agency and believes that he is actually contracting with the person whom he is negotiating with (tho that person turns out to have acted merely as agent for an unknown principal), it can never be said that the third party relied upon the agent's apparent powers. Hence, the type of fraud above described is at once precluded and so there would seem to be no ground for holding the principal on a contract not actually authorized. The third party believes he is contracting with the man to whom he is talking, and the Law of Agency permits him to hold that man liable upon the contract even tho he was actually only an agent. The third party is therefore given, by the Law of Agency, the precise contract which he thot he was getting. The fact that the Law of Agency, in case the contract was authorized, also permits the

third party to sue the undisclosed principal, after learning of his existence, is only giving the third party two remedies, where he expected to have but one. The law gives him this second remedy against the undisclosed principal, because the contract was in fact made upon the latter's behalf, and, being authorized, was in truth the contract of the undisclosed principal. In other words, in cases of undisclosed principal, as in cases of disclosed principal, the law gives the principal and the third party reciprocal rights and imposes upon them reciprocal liabilities, on the theory that the agent, being duly authorized to do so, made a contract with the third party as representing and therefore binding his principal. But the only ground upon which the principal might be held for an unauthorized contract is necessarily absent where the principal's existence was unknown to the third party.

Nonetheless, the case of *Watteau vs. Fenwick*, (L. R. 1893, Q. B. D. 346), came to the opposite conclusion. The English court there held that "Once it is established that the defendant was the real principal, the ordinary doctrine as to principal and agent applies." In that case the defendants had purchased a beer-house from one Humble, but had retained Humble as their manager and left him in charge of the business as still the apparent owner thereof. Under the terms of the contract between defendant and Humble, the latter had no authority to buy any goods for the business except bottled ales and mineral waters; all other goods were to be supplied by the defendants themselves. Action was brought to recover the price of cigars and other articles delivered by the plaintiff at the defendants' beer-house, for which it was admitted the plaintiff gave credit to Humble alone.

This fact, that plaintiff gave credit to Humble alone, clearly negatives the idea that he could be deceived as to the extent of Humble's authority, because he thought he was dealing with Humble as principal and therefore the extent of his powers to bind defendant (principal) was nothing to plaintiff.

Apparently a similar argument was also made in the *Watteau case*, for the judge in his opinion, after laying down the rule that the principal is liable for the acts of the agent which are within the authority usually confided to an agent of that character, notwithstanding limitations upon that authority, says: "It is said that it is only so where there has been a holding out of authority—which cannot be said of a case where the person

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supplying goods knew nothing of the existence of a principal. But I do not think so."

That case was followed in this country by the case of *Brooks vs. Shaw*, 197 Mass. 376. In that case, as in the *Watteau case*, the defendant was the purchaser of a business which he left under the management of the former owner, and with the appearance that he was still the owner thereof. The manager or former owner made an unauthorized contract, but one which would have been within the apparent scope of his authority, if it had been known to the plaintiff that there was a principal other than the party with whom he was dealing. The court in that case says:

"The doctrine that an undisclosed principal may be charged with responsibility for and avail himself of the profits of the acts of his agent is well settled. * * * It follows from this that, where the relation of principal and agent is found to exist, the ordinary rules of responsibility of the principal to third persons for the act of his agent are established. The principal is responsible for all acts of the agent within the apparent scope of his authority."

It is submitted that there can be no *apparent scope* of authority where the delegation of authority itself is not apparent to the only person concerned, namely, the third party, the other party to the contract. Is it not a contradiction of terms to speak of the principal's responsibility for acts of the agent within the *apparent* scope of his authority, when the third party does not even know that the party in question is an agent? To say that the third person's rights are not affected by limitations placed by an undisclosed principal upon his agent's authority, is to say that an undisclosed principal cannot place any limitations upon his agent's authority so as to affect third parties; for, if he is obliged to acquaint third parties with such limitations, he must first tell them of the agency, and then, of course, he ceases to be an undisclosed principal.

The cases cited would have the result of giving third persons more extensive rights as against an undisclosed principal, than they would have against a disclosed principal; for if the principal is disclosed, they must show either that the agent acted within his actual powers, or that he acted within his apparent powers and that they (the third parties) were misled by the false appearance as to the actual extent of his powers. In the case of undisclosed principal the third party could always recover from the principal

by showing merely that the contract was either within the agent's actual authority, or within his apparent authority (that is, *apparent* from the viewpoint of some hypothetical, non-existent third person): Proof of fraud or of having been misled, would obviously not be required because the very possibility of fraud in that regard would be precluded by the facts.

But to give the third party greater rights against an undisclosed principal than against the disclosed principal, so far as unauthorized contracts are concerned, would be entirely without reason and logic. If the foregoing cases must be accepted as law, the rule as to the liability of a disclosed principal for unauthorized contracts will have to be changed so as to be brought into harmony with this new doctrine in the law of undisclosed principal. Liability in both cases should frankly be rested, not upon false appearances as to the extent of the agent's authority, but upon *the general proposition that when a man appoints an agent to make a certain class of contracts, the law will not allow him to limit that authority so as to exclude any of the reasonably necessary, convenient, or customary ways of executing that authority. The consequence would be to render it immaterial whether the third party knows of any attempted limitations upon the authority or not.* The law would then be expressed by changing the above quotation from Justice Holmes to read as follows: "It is true that in determining how far authority extends, the question is of ostensible authority. This illustrates the general rule which governs a man's responsibility for his acts throughout the law. *If the principal knowingly employs the agent to exercise a certain power, he ipso facto gives the agent all those powers which, in the majority of the same or similar cases, are usually connected with the power expressly given.*"

This resulting change in the law might indeed be avoided by giving the two cases cited a much narrower interpretation than the language of the courts warrants. In commenting upon the decision in *Watteau vs. Fenwick*, the Harvard Law Review said: "If the case can be supported it must be on the broad ground that one who entrusts the management of his business to another, remaining himself in the background, should be held responsible for the acts of his manager done in the conduct of the business." (7 Harvard Law Review, 49, 50.) The case of *Brooks vs. Shaw* could be supported on the same ground. The trouble, however, with this interpretation is that it is not in harmony with what

the courts deciding those cases obviously meant and expressly said. Nevertheless, courts having to deal with the subject in the future, and feeling bound by the English and Massachusetts decisions, might distinguish those cases on the ground stated.

As a matter of fact, the result reached in those cases is satisfactory and just if we abstract from the reasoning of the courts. On the familiar principles of estoppel, where a principal places his agent in his business, giving him its management and allowing him to appear as owner, and a third party deals with the agent in the belief that he is the owner of that business, the third party should at least not be in a worse position than he would be in if he had in fact dealt with the owner of the business. It is very commonly true that third persons having transactions with the established business of another, look to the business as a going concern rather than to the person of the owner. That this was true in both of the cases cited may be assumed from the facts stated. Hence the principal should be estopped from asserting his ownership of the business so as to defeat satisfaction by the third party of his just claims arising out of his dealings with the agent as the ostensible owner. However, this reasoning is valid only to the extent of the principal's interest in the business, and would not justify a recovery by the third party out of assets of the principal, outside of his investment in the business.

But, as stated, the language used by the courts in those cases hardly permits of such restrictive interpretation, and the implications thereof go beyond cases of undisclosed principal, and cause confusion in the rules applying to disclosed principal. Fraud being eliminated as an element of the third party's case, and he being allowed to recover upon an unauthorized contract from an undisclosed principal, he should also be allowed to recover in case the principal was disclosed, and even though he knew of the restrictions upon the agent's powers. To avoid this conclusion it might be argued, that where the agent of a known principal and the third party enter into a contract which both know to have been prohibited by the principal, it would amount to a conspiracy on their part, and that the third party's right to recover should be denied on that ground.

It is submitted that such reasoning is unsatisfactory. Hitherto the Law of Agency appears to have been, that a principal is liable upon the contracts made on his behalf by his agent, either because he actually authorized the contract in question or else to

avoid fraud, *not fraud upon the principal, but fraud upon the third party* (that is, virtually upon the ground of estoppel).

It has been the law that a man might appoint an agent for any lawful purpose, and define his powers in any way he saw fit; and that the extent of the agent's powers would be, not a question of law, but a question of fact as to what powers had indeed been conferred upon him by the principal. To say that the third party could hold the principal to all sorts of contracts incidental to the main purpose of the agency, even where those incidental powers were expressly withheld by the principal, except in those cases where the principal could show that it would be a fraud upon him, is putting the cart before the horse. It practically amounts to saying that the principal is not free to choose as he will what powers his agent may exercise and what powers he may not; but that whenever he appoints an agent for a given job, the law creates a penumbra of incidental powers conferred just as truly as those which are expressed in language or implied in fact. It is submitted that if this is the law, third persons should be allowed to avail themselves of it and should not be defeated in an action against the principal, simply because they knew that the principal had intended otherwise than the law decreed with regard to the extent of the agency.

In conclusion, it appears to the writer that, upon the theories of the common law antedating the Law of Agency, and upon the principles of the Law of Agency itself as hitherto accepted, the cases of *Watteau vs. Fenwick* and *Brooks vs. Shaw* should be rejected insofar as they hold that a principal can be liable other than for authority actually given to his agent, or in order to prevent fraud upon third persons. It may well be, however, that these cases will be followed and will become the established rule. In that event we should perhaps have another instance of the interesting virility and capacity for independent development of the Law of Agency. It would certainly not be the first time that the Law of Agency prevailed over older common law theory. It would then be futile, however, to try and explain the result by familiar analogies. It would then simply have to be accepted as a new phenomenon, and our conceptions, even of the Law of Agency itself, would have to be considerably modified and enlarged.