

Statutory  
Supplement to  
CASES AND MATERIALS ON  
**CORPORATIONS**  
INCLUDING PARTNERSHIPS  
AND LIMITED LIABILITY  
COMPANIES

Apple Tenth Edition

Robert W. Hamilton  
Jonathan R. Macey

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**STATUTORY SUPPLEMENT TO  
CASES AND MATERIALS ON  
CORPORATIONS  
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LIMITED LIABILITY COMPANIES  
Tenth Edition**

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## Preface

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This statutory supplement provides a basic compilation of statutes needed for use in connection with the Tenth Edition of our casebook, *Cases & Materials on Corporations (Including Partnerships and Limited Liability Companies)* [10th Ed. 2007]. The Supplement contains material on agency principles from Chapter 2 of Professor Hamilton's book, *Business Organizations: Unincorporated Businesses and Closely Held Corporations* (1997). The Supplement also includes verbatim and unedited copies of the current versions of the Uniform Partnership Act (1914), The Uniform Partnership Act (1997), the Uniform Limited Liability Company Act (1995), the Model Business Corporation Act (1984) with all amendments through December 31, 2006, and excerpts from the 1969 Model Business Corporation Act consisting of the financial provisions dealing with par value and legal capital. The Supplement also contains the full text of the Sarbanes-Oxley Act of 2002.

There have been numerous significant amendments to the Model Business Corporation Act since it was re-written in 1984. In a few instances, the casebook refers to provisions of the Model Act that have been withdrawn entirely. Where appropriate, the text of these sections is preserved in footnotes in this supplement. However, no effort has been made to identify all substantive amendments that have been made to this Act since 1984.

We believe that handling raw statutory material leads to a better understanding by students of the scope and limitations of the statutes themselves. We have included a list of section titles at the beginning of each statute so that students may obtain an overall view of the coverage of that statute if that is helpful to them. In general terms, this supplement is similar to the statutory supplements accompanying the earlier editions of this casebook. For the sake of brevity we have not included specific state corporate codes in this statutory supplement, although it was tempting to include the Delaware General Corporation Law. With the usual efficiency that characterizes the production of corporate law in Delaware, the Delaware G.C.L. is readily available online at: <http://www.delcode.state.de.us/title8/c001/index.htm#topofpage>. The California Corporations Code can be found at: <http://www.paralegal-plus.com/ca-codes.htm>. The New York Business Corporation Law can be found at: <http://www.law.cornell.edu/ny/statutes/busc corp.htm> (although we have found this site to be somewhat slow on occasion).

ROBERT W. HAMILTON  
JONATHAN R. MACEY

Austin, Texas  
New Haven, Connecticut  
June 2007

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**STATUTORY SUPPLEMENT TO  
CASES AND MATERIALS ON  
CORPORATIONS  
INCLUDING PARTNERSHIPS AND  
LIMITED LIABILITY COMPANIES  
Tenth Edition**

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# AN INTRODUCTION TO AGENCY PRINCIPLES

ROBERT W. HAMILTON, BUSINESS ORGANIZATIONS:  
UNINCORPORATED BUSINESSES AND CLOSELY  
HELD CORPORATIONS (1997)

Chapter 2.<sup>1</sup>

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## § 2.1 Introduction

Basic agency and employment relationships underlay virtually all commercial dealings in the modern world. Agency relationships by and large do not themselves create new business forms; rather they are the glue that holds \* \* \* businesses together. As such, they define the rights and responsibilities of individuals who work for or on behalf of businesses. It is surprising that this essential subject today receives relatively little attention, since modern business is conducted almost entirely by agents or employees. To take an obvious example, a corporation, an artificial legal construct that has no physical being of its own, can act only through agents for everything it does. Whenever one person performs services for, or acts on behalf of, someone else, the principles of agency define the relationships and the responsibilities of both participants and of persons who deal with them. The most common agency relationship is the employment relationship,<sup>2</sup> but agency law is applicable in many other situations as well.

1. Reprinted with permission of Aspen Law and Business.

2. [By the Author] Many aspects of employment law are of course governed by statutes or



Thirty years ago, virtually every law school in the country required a course in agency. \* \* \* Today, agency as a separate course has disappeared from virtually all law school curricula \* \* \* (and) there is usually no systematic treatment of the subject. \* \* \*

Because of the lack of systematic exposure to agency law, it is not uncommon for a newly minted lawyer to be unable to respond to relatively simple agency questions: for example, an employee acting within the scope of her employment violates specific instructions of her employer, leading to an injury to a third person. Is the employer liable? If the employer has a liability insurance policy that expressly excludes coverage for "intentional torts," and the act of the employee constitutes an intentional tort, (e.g., she falsely imprisons a customer on the belief he is a shoplifter), is the intention of the employee imputed to the employer so that the event is not covered by the employer's insurance? Answers to these questions are not intuitively obvious.<sup>3</sup> \* \* \* Agency law readily lends itself to illustration by example.

## § 2.2 Basic Concepts

The principal source of agency law today is probably the Restatement of Agency, Second, published in 1957. (A new edition, with Professor Deborah DeMott as reporter, is being prepared.) The Restatement is useful particularly because it provides a comprehensive set of definitions for the subject. It defines *agency* as the "fiduciary relation which 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."<sup>4</sup> The person who is acting for another is the *agent*; the person for whom the agent is acting is the *principal*.

An agency relationship is based on conduct by the principal and agent, the principal manifesting that he is willing to have another act for him and the agent manifesting a willingness to act. The relationship may be contractual, but it need not be. Persons acting as agents without compensation are still agents.<sup>5</sup> Thus, agency is basically a consensual relationship in which one person agrees to act for the benefit of another.

Artificial entities such as corporations, trusts, partnerships, or limited liability companies may act as principals or as agents. The relationships are not limited to natural persons. An artificial entity can in turn act only through agents. Thus, the law of agency is involved whenever a corporation acts, whether it be writing a check, selling a product, or entering into a multi-billion dollar merger. Partnerships similarly involve the law of agency, with each partner being an agent for the partnership.

common law principles independent of agency law. The employment at will doctrine is a common law doctrine that addresses a most basic characteristic of the employment relationship. Statutes of long standing govern such matters as minimum wages, overtime pay, pay periods, and the like. Other statutes govern matters relating to the workplace, e.g., safety, sexual harassment, and a variety of other subjects.

3. [By the Author] In case you are interested, the answer to the first question is clearly

yes. See Restatement, (Second) of Agency § 219(1) (1957). The answer to the second question is also yes, at least if the action was within the scope of employment and the employee was attempting to benefit the employer. See id. § 272.

4. [By the Author] Id. § 1.

5. [By the Author] These agents may be called "unpaid" or "gratuitous" agents.



### § 2.3 Fiduciary Duties

An agency relationship has the important characteristic of being a *fiduciary* relationship. The agent is a fiduciary with respect to matters within the scope of his agency.<sup>6</sup> Basically, this means that the agent is accountable to the principal for any profits arising out of the transactions he is to conduct on the principal's behalf<sup>7</sup> and that he breaches his duty to the principal if he acts either to benefit himself or someone else other than the principal.<sup>8</sup> This *fiduciary duty* also prevents an agent either from acting adversely to the interest of the principal<sup>9</sup> or assisting an adverse party to the principal in connection with the agency.<sup>10</sup> An agent also may not compete with his principal concerning the subject matter of the agency.<sup>11</sup> In addition, the agent must act to preserve and protect property entrusted to his care by the principal, and is liable for its loss if he disposes of the property without authority to do so, or it is lost or destroyed because of his neglect or because he intermingles it with his own property.<sup>12</sup> The agent may be required to account for his actions or for property of the principal entrusted to him.

The scope of the agency is usually determined by contract between the principal and agent or by the nature of the instructions given by the principal to the agent. The scope of the agent's fiduciary duty may be shaped by these terms, but the fiduciary obligation exists even though the contract is silent as to the duties of the agent or purports to abolish this duty.

When parties are dealing at arms-length, one party usually does not have a duty to volunteer information to the other. This is not true, however, if one owes the other a fiduciary duty.

**Example:** *M* is looking for a site for his plant. He learns that *O* has a site for sale. The asking price is \$250,000. *M* and *O* negotiate and agree upon a price of \$247,500. In this negotiation, *O* does not disclose that he purchased the site for \$150,000 a few days before, information that would have been relevant to *M*'s decision to agree to the \$247,500 price. *O*'s failure to disclose this information is not a breach of duty and *M* may not rescind the transaction.

**Example:** *P* retains *A* to purchase a suitable manufacturing site for him. *A* owns a suitable site which he offers to *P* for \$250,000, a fair price. *A* tells *P* all relevant facts except that a short time previously he purchased the site for \$150,000. *A* has breached his fiduciary duty and the transaction may be rescinded by *P*.<sup>13</sup>

### § 2.4 Other Duties of the Agent

In addition to the broad fiduciary duty, an agent must act with reasonable care in carrying out the agency and must meet at least the standard of competence and skill in the locality for work of the character he is obligated to perform. An unpaid agent may have a lesser duty than one who is paid.

6. Id. § 13.

7. [By the Author] Id. § 388.

8. [By the Author] Id. § 387.

9. [By the Author] Id. § 389.

10. [By the Author] Id. § 391.

11. [By the Author] Id. § 393.

12. [By the Author] Id. §§ 402-404A.

13. [By the Author] Id. § 390, illustration 2.



**Example:** X, a person in the community who does odd jobs for homeowners, agrees to construct a chimney for Y, a homeowner. X has not previously had experience building chimneys on his own, though he has assisted other masons in building chimneys. He places a row of bricks incorrectly in the chimney with the result that the chimney does not draw properly. X has breached his duty to Y.

Presumably, if Y knows that X has had no experience building chimneys, a different result would be reached. In that situation, Y reasonably can expect only that X will do the best he can.

### § 2.5 Duties of the Principal to the Agent

The principal owes duties to the agent. These duties are different from the agent's duties since the basic fiduciary duty only runs from the agent to the principal. A principal must perform his commitments to the agent, act in good faith, cooperate with the agent, and not interfere with or make more difficult the agent's performance of his duties. Implicit in the arrangement may be an obligation by the principal to give the agent work, an opportunity to earn a reasonable compensation, or an opportunity to find additional work.

\* \* \*

In addition, if the agent incurs expenses or spends his own funds on behalf of the principal, the principal may have a duty to repay or indemnify the agent.<sup>14</sup>

### § 2.6 The Right to Control: Independent Contractors and Servants

In general terms, the principal has the right to control the conduct of the agent with respect to matters entrusted to him.<sup>15</sup> The principal can determine what the ultimate goal is, and the agent must strive to meet that goal. The degree of control that the principal has over the acts of the agent, may vary widely within the agency relationship. In this respect, the Restatement distinguishes between a master/servant relationship and an independent contractor relationship.<sup>16</sup> A master is a principal who "employs an agent to perform service in his affairs *and who controls or has the right to control the physical conduct of the other* in the performance of the service." (Emphasis added.) A servant is an agent so employed by a master. In a way, the use of the words master and servant for this relationship is unfortunate, because those words may imply servility, household service, or manual labor. Under these definitions, most employment relationships are technically master/servant relationships.

**Example:** General Motors Corporation employs an individual to serve as head designer of a new automobile. His salary is \$300,000 per year. The designer is a "servant" in the Restatement terminology and General Motors is his "master."<sup>17</sup>

14. [By the Author] Id. §§ 432-469.

15. [By the Author] Id. § 12.

16. [By the Author] Id. § 2.

17. [By the Author] Do you have any doubt about the correctness of this conclusion? If you do, consider this possible scenario: The chief executive officer of General Motors comes to the designer and says, "John, the board of

directors liked your sketches for the new convertible. They feel, however, that it looks a little boxy and they think the headlights are too conspicuous. Please streamline it a little more and move the headlights into the front fenders." What should the head designer do? He makes the changes that are requested, thereby indicating clearly that he is a servant.

An *independent contractor* is a “person who contracts with another to do something for him but who is not controlled by the other nor subject to the other’s right to control with respect to his physical conduct in the performance of the undertaking.”<sup>18</sup> An independent contractor may or may not be agent.

**Example:** An attorney agrees to represent hundreds of persons on a contingency basis seeking to recover damages for injuries arising from exposure to asbestos. The attorney is an independent contractor, but not an agent.<sup>19</sup>

**Example:** A builder enters into a contract with the owner of a lot to build a house on the lot in accordance with certain plans and specifications prepared by an architect. The builder is an independent contractor, but he is not an agent. He is employed merely to accomplish a specific result and is not otherwise subject to the owner’s control.

**Example:** A broker enters into a contract to sell goods for a manufacturer. His arrangement involves the receipt of a salary plus a commission on each sale, but the broker has discretion as to how to conduct his business. He determines which cities to visit and who to contact. He uses his own automobile to visit prospects. The broker is an agent, but is not a servant. Rather, he is an independent contractor.

**Example:** A customer of a brokerage firm directs the firm to sell on the New York Stock Exchange at the best price obtainable 100 shares of XYZ Stock owned by the customer. The brokerage firm, when executing this instruction, is both an agent and an independent contractor.

**Example:** Acme Superstores, a chain of grocery stores, enters into a contract with Gene’s Pheasant Farm, Inc., by which Gene’s promises to supply Acme with killed and dressed pheasants for sale by Acme. The contract gives Acme the power to direct Gene’s operations to assure a continuing supply of fresh, high-quality pheasants. Acme is the principal and Gene’s is an agent. Gene’s may also be a servant if the degree of control maintained by Acme means that Acme may “control the physical conduct of” Gene’s.

The distinction between an independent contractor who is an agent and one who is not depends on the degree and character of control exercised over the work being done by the independent contractor. In some instances, there may be doubt as to whether an independent contractor is also an agent. Similarly, uncertainty may sometimes exist as to whether an agent is also a servant. The Restatement of Agency contains a somewhat dated provision that gives guidelines as to the latter issue.<sup>20</sup>

18. [By the Author] Id. § 2(3).

19. [By the Author] Do you agree that the attorney is not an agent in this situation? Does he “consent to act subject to the control of” the client? See § 2.2. The attorney may be an agent in other roles, e.g., when negotiating a contract on behalf of his client.

20. [By the Editor] In determining whether one acting for another is a servant or an independent contractor, the following matters of fact, among others, are considered:

(a) the extent of control which, by the agreement, the master may exercise over the details of the work;

(b) whether or not the one employed is engaged in a distinct occupation or business;

(c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

(d) the skill required in the particular occupation;

### § 2.7 The Responsibility of a Principal for His Agent's Torts

The classification of an agent as a servant or as an independent contractor is important primarily because different rules apply with respect to the liability of the principal for physical harm caused by the agent's conduct. A master is liable for torts committed by a servant within the scope of his employment, while a principal is not liable for torts committed by an independent contractor in connection with his work.

**Example:** *P*, the owner of a successful retail operation with two stores, hires *D* to drive her delivery truck and deliver goods to her two stores. Before doing so, *P* checks *D*'s driving record and arranges for him to go to a driving school for truck drivers. *D*'s record shows that he has had no accidents for 20 years, and he completes the driving school program without difficulty. Three weeks later, while driving *P*'s delivery truck, *D* is negligent and has a serious accident, injuring *X*. *P* is liable to *X* for his injuries.

In this example, *D* is a servant, and *P*'s liability is independent of whether *P* exercised due care in hiring *D*, or even whether she knew that *D* was her employee at all. *P*'s liability in this situation may be described as "vicarious liability" and the consequence of "respondeat superior." *Respondeat superior* is a Latin phrase that means "let the master respond." It is important to recognize that *P*'s liability only applies to actions within the scope of *D*'s employment, though nice questions about coverage may arise as to whether the specific trip was a "detour" that was nevertheless part of the agent's duties to the principal or a "frolic" by the agent on his own. \* \* \*

**Example:** The broker who is selling on commission in one of the above illustrations has an automobile accident while driving his own car to visit a prospect. The manufacturer is not liable for injuries to third persons arising from the accident. The same would be true of a person injured by the contractor in the above illustration while working on the owner's house.

Of course, the broker and the contractor would both be personally liable for the injuries in these illustrations. *D*, the servant in the above illustration, would also be personally liable for *X*'s injuries, since he too is a *tortfeasor*. The reason that respondeat superior is applied in numerous cases is because the chances are very good that the servant is judgment proof, has no insurance of his own, and therefore *X*'s only recourse is against *P*.

### § 2.8 The Power of an Agent to Affect the Principal's Legal Rights and Duties in General

An agent has power to affect the legal rights and duties of the principal in various ways. The tort liability of the principal for acts of the agent discussed in the previous section is one illustration. In other respects, to the extent the agent acts within the scope of his agency his acts are viewed as the acts of the principal and therefore affect the contractual or property rights and duties of

(e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;

(f) the length of time for which the person is employed;

(g) the method of payment, whether by the time or by the job;

(h) whether or not the work is a part of the regular business of the employer;

(i) whether or not the parties believe they are creating the relation of master and servant; and

(j) whether the principal is or is not in business.

the principal accordingly. However, the power of the agent is broader than this. An agent may also affect the principal's rights and duties to some extent even when the agent is acting in direct violation of the principal's instructions or beyond the scope of the agency relationship, or in some cases even when he is not really an agent at all.

The power of the agent to affect the principal's rights and duties is known as the agent's authority. The law of agency deals with three quite different, but interrelated, sources of authority that one person may have to bind another. These sources of power are discussed in the following sections.

### § 2.9 Actual Authority

*Actual authority* (often described as *express authority* or simply by the words "authority" or "authorized") arises from the manifestation of a principal to an agent that the agent has power to deal with others as a representative of the principal. An agent who agrees to act in accordance with that manifestation has actual authority to so act, and his actions without more bind the principal.

**Example:** *P*, the owner of two retail stores, employs *C* to serve as credit manager. *C* has authority to review and approve requests from customers for the extension of credit. *C* reviews the application of *Y* and approves him for the extension of credit. *P* is bound by *C*'s decision, though that decision may be revoked by *P* at any time.

When an agent acts within the scope of her authority, she is not personally liable to the third person on the obligation so created (though, of course, the parties may agree otherwise).

**Example:** *C* approves of a sale of a washing machine to *Z*, a customer, \$100 down and \$50 per month until a total of \$600 is paid. This action is within the scope of *C*'s authority. *P*, the owner, refuses to deliver the washing machine to *Z* unless *Z* pays the \$600 in cash immediately. *P* is liable for breach of contract, but *C* has no responsibility to *Z* and is not personally liable when *P* refuses to permit *Z* to purchase the machine on the terms agreed upon.

In this situation, *P* is bound by *C*'s decision even though *Z* is totally unaware of who *P* is, or erroneously believes that *C* is the owner of the stores.

**Example:** *T* knows that *P* owns a horse he is thinking of buying and which *A*, *P*'s agent is offering to sell him. *A* says, "This horse is only three years old and is sound in every respect." On these facts alone, *P* is liable if *A*'s warranty turns out to be false, but *A* is not.<sup>21</sup>

Different rules may be applicable if the principal is not known to the third person. These rules are considered briefly below.

### § 2.10 Apparent Authority

*Apparent authority* arises from the manifestation of a principal to a third party (directly or indirectly) that another person is authorized to act as an agent for the principal.<sup>22</sup> That other person has apparent authority and an act by him within the scope of that apparent authority binds the principal to a

21. [By the Author] Restatement (Second) of Agency § 320, illustration 1.

22. [By the Author] Id. § 27.

third party who is aware of the manifestation by the principal and believes the person is authorized to act on behalf of the principal. The person with power to act in this situation should perhaps be called an "apparent agent" but typically he is simply described as an agent, one with apparent authority to act.

Apparent authority arises when a person represents that someone else is his agent when that is not the case, or, more commonly, creates or permits the creation of the impression that broad authority exists when it in fact does not. The theory is that if a third person relies on the representation or appearance of authority, that person may hold the putative principal liable for the action of the putative agent. The principal is bound by the agent's act within the scope of his apparent authority in this situation even though the act was not in fact authorized by the principal.

**Example:** *P* gives *A*, an agent who is authorized to sell a piece of property on behalf of the principal, specific instructions as to the minimum price (\$300,000) *P* is willing to accept as well as other terms. *P* informs possible buyers that *A* is his agent but obviously does not communicate *A*'s specific instructions to anyone but *A* (since to do so would be a virtual blueprint to possible buyers as to how to buy the property as cheaply as possible). *A* has actual authority only to enter a contract to sell the property at a price equal to or higher than \$300,000 but he has apparent authority to sell the property at any price since the principal has represented to possible buyers that *A* is his agent.

**Example:** *A* actually signs a contract on behalf of *P* to sell *P*'s property to *TP* for \$275,000. *P* is bound on that contract because the action was within *A*'s apparent authority but *A* has violated his instructions and is liable to *P* for the loss incurred.

The difference between apparent and actual authority can be most easily envisioned in that actual authority flows directly from the principal to the agent while apparent authority flows from the impression created by (or permitted to exist by) the principal in the mind of a third person.

Apparent authority *cannot* be created by the mere representation of the putative agent. Not even the most convincing and persuasive person can create an agency or apparent agency relationship entirely on his own.

**Example:** *A* approaches John's Buicks, Inc., a new car dealer and falsely explains that he is *P*'s agent, and that *P* desires to test drive a new Buick. Since *P* has been a good customer of John's Buicks in the past, and *A* is unusually convincing, John's entrusts *A* with a new Buick automobile, which *A* misappropriates. *P* is not liable for *A*'s conduct.

**Example:** John is a smooth-talking con man. He becomes friends with *X* and represents to *X* that he is an agent for General Motors seeking possible owners of new car franchises. John is very convincing, showing forged letters on GM letterhead, a forged identification card, and so forth. He persuades *X* that he will obtain a franchise for *X* if *X* will post \$250,000. *X* does so. John converts the money to his own use, and disappears. General Motors is not liable for *X*'s loss.



While the conclusion reached in these two examples may seem self-evident, it is surprising in real life how often a third person relies upon representations by a putative agent of the scope of the agent's authority.

In many instances, the scope of apparent authority is as broad as an agent's actual authority—for example, where identical letters describing the scope of the agent's authority are sent both to the agent and to the third party. However, this is not necessarily so, and it is important to recognize that the power to affect the principal's legal rights and obligations may arise either from statements by the principal to the agent (actual authority) or statements made directly or indirectly by the principal to a third party (apparent authority). Apparent authority is related to concepts of estoppel based on the principal's conduct. In order to establish apparent authority, the third party must establish that it was reasonable for him to believe that the agent was authorized to act, based on what the principal said or on the impression that the principal created. If he can do so, the principal is bound even though he never intended to make *A* his agent or to enter into a contract with that third person.

In one aspect, apparent authority is broader than traditional estoppel. Liability arises under apparent authority even if the relying party has not changed his position in reliance on the representation. In other words, in the two examples in this section relating to the sale of land where *A* violates his instructions and sells the land for \$275,000 rather than \$300,000, *P* is bound to the contract with *TP* as soon as it is negotiated between *TP* and *A* even though *TP* has not relied in any material way on the contract and shortly thereafter learns that *A* was not authorized to sell the land for \$275,000.

### § 2.11 Inherent and Incidental Authority

*Inherent authority* arises from the *agency itself and without regard to either actual or apparent authority*. Inherent authority may be viewed as authority arising by implication from the authority actually or apparently granted.<sup>23</sup>

**Example:** *P* hires *A* to operate a branch store of *P*'s retail operations. *A* has authority to manage the store on a day-to-day basis but is told expressly that he has no authority to mark down the prices of goods without the prior approval of *P*. *A* nevertheless marks down slow-moving goods which are sold to third persons. There is neither actual nor apparent authority (because there was no manifestation of authority to the customers) but *P* is bound since a manager of a store has inherent authority based on his position to set prices of goods.

In many instances actual authority is coextensive with inherent authority based on the nature of the agency, but again this is not necessarily so.

*Incidental authority* is simply authority to do incidental acts that relate to a transaction that is authorized.<sup>24</sup>

**Example:** *P* authorizes *A* to purchase and obtain goods for him but does not provide him with funds to pay for them. It is implicit that *A* has authority to purchase goods on *P*'s credit.

23. [By the Author] Id. § 8A.

24. [By the Author] Id. § 35.



Obviously, the lines between apparent, inherent, and incidental authority may not always be clear-cut.

### § 2.12 Implied Authority

One complicating factor about the classification of authority as actual or apparent is that in either case the existence of authority may be implied rather than express. Indeed, the same conduct may often be relied upon to prove the existence of implied actual authority and implied apparent authority. Authority may be inferred from a prior course of conduct by the principal. Such conduct may be the basis for implying that the agent has continuing actual authority to act on the principal's behalf. If known to a third party, the very same conduct may lead to an inference that apparent authority exists.

**Example:** *P* is an elderly person living alone. He is befriended by *A*, a neighbor. *A* does errands for *P*, going to the store, helping *P* go to the doctor, and so forth. *P* has long had a charge account at the local grocery store that *A* has used frequently to charge groceries. Originally, the owner of the grocery store checked with *P* before accepting the charges but has stopped doing so since the relationship between *A* and *P* is well known to the owner. When *A* charges groceries, *P* is bound to pay for them. This result may be reached on the basis of either implied actual authority or implied apparent authority. The approval by *P* of *A*'s prior transactions justifies a conclusion that *A* has actual authority to buy groceries for *P* (implied actual authority). The holding out in the past by *P* of *A* as his agent to the grocer also justifies an inference by the grocer that authority exists no matter what the actual state of relations is between *P* and *A* (implied apparent authority).

Apparent authority is destroyed if the third party knows, or has reason to know that *A* is no longer authorized to act for *A*.

**Example:** *P* and *A* have an argument and *P* tells *A* that he wants nothing more to do with him. The grocer, knowing this, nevertheless sells groceries to *A* on credit. *P* is not obligated to pay for them.

### § 2.13 Disclosed and Undisclosed Principals

This section deals with the common situation in which an agent is dealing with a third party on behalf of a principal under circumstances in which the third party may not know that the agent is acting for someone else. There are basically three different situations: the disclosed principal, the partially disclosed principal, and the completely undisclosed principal.

A principal is disclosed if the third party knows the identity of the principal at the time the transaction is entered into. It may be, of course, that in a specific situation, a third person does not actually know who the principal is, but should be able reasonably to infer the identity of the principal from the information on hand. That is still a disclosed principal situation. All of the prior discussion in this chapter has assumed that the principal is disclosed. When a transaction is entered into on behalf of a disclosed principal, the principal becomes a party to that contract. Equally importantly, the agent does not become a party to such a contract unless there is an agreement to the contrary.

A *partially disclosed principal* is one whose identity is unknown but the third person is on notice that the agent is in fact acting on behalf of some principal.<sup>25</sup>

**Example:** A offers to sell goods to *TP*, truthfully advising him that he is the manufacturer's representative for a well-known manufacturer. The identity of the manufacturer is not disclosed. The manufacturer is a partially disclosed principal.

Typically, the partially disclosed principal becomes immediately bound to any authorized contracts entered into by the agent. However, the agent also becomes bound to the third party unless there is an agreement by the third party to look solely to the partially disclosed principal. The third party's right to hold the agent responsible on such contracts is based on the common sense notion that the third party normally would not agree to look solely to a person whose identity is not known for performance of the contract. Thus, in the above example, if A's representation accurately describes his instructions from P, and TP places an order with A, both A and the manufacturer are personally bound to fill that order. Generally, the agent is not released from liability if TP elects to sue the manufacturer for nonperformance—the agent and principal are both liable on the contract, though the third party obviously is entitled to only a single recovery, and in some situations may be required to make an election as to which defendant he prefers to pursue.

A principal is *undisclosed* if the third party is not aware that the agent is acting on behalf of anyone when in fact the agent is acting on behalf of a principal. In effect, the third party is dealing with the agent as though the agent is the sole party in interest.<sup>26</sup> Clearly, in this situation the agent is personally liable to the third person on any contracts negotiated by him since the third party believes he is dealing directly and solely with the agent as the real party in interest. In addition, the agent has the rights and remedies available to any party to a contract, and he may, for example, settle with the third party or release that party from the contract.<sup>27</sup>

The undisclosed principal is also liable on the contract to the third party if the agent was acting within the scope of his *actual* authority. This is because of the basic agency concept that the authorized act of an agent binds the principal. It may seem a bit odd that the third party may have entered into a contract with a person he is unaware of, and be able to enforce that contract against that person, but it really is not, since that person can ignore the undisclosed principal and hold liable the agent with whom he was actually dealing. On the other hand, the right of the undisclosed principal to directly enforce a claim against the third party is circumscribed: the principal has only the rights an assignee of the contract would have, though, of course, the agent may enforce the contract directly against the third party on behalf of the undisclosed principal.

There is generally no room in the same transaction for concepts of apparent authority and an undisclosed principal. However, an agent for an

25. [By the Author] Id. § 321.

26. [By the Author] Id. § 322.

27. [By the Author] Id. §§ 186, 205, et seq.  
If the agent violates his instructions when he

releases the third party from the contract, the principal is bound by the agent's action but has a claim against the agent for the loss thereby incurred.