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LIABILITY OF PRINCIPALS FOR TORTS OF AGENTS: A COMPARATIVE VIEW

Michael Conant*

The primary purpose of this study is to review the trends of the law in England and in the United States concerning the vicarious liability of principals for torts of their agents. Hence, we here exclude from consideration the obvious liability of a principal for all torts which he directs or authorizes his agent to commit. Such liability can be found directly in the law of torts, which would hold the principal liable as a party, and need not be based on agency. All other torts of agents, the overwhelming majority of those which occur, are committed without the principal's consent. Since all representative authority in an agent, being a power on contract, is based on consent of the principal, none of these torts can be within the agent's actual or apparent authority. For this reason, the concept "scope of authority," the measure of the principal's liability for the agent's contracts, is totally inapplicable to test the principal's vicarious liability in tort.

The foundation of liability of employers for torts of employees is stated in the general maxim of respondeat superior, which originated in the law of master and servant. Society imposes vicarious liability on the employer because his selection and direction has put the employee in the situation where the wrong occurs and because he is the enterpriser who has assumed the risks of gain or loss from the employee's work activities. It is perhaps this common

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2 See Janeczko v. Manheimer, 77 F.2d 205, 207 (7th Cir. 1935); Johnson v. Monson, 183 Cal. 149, 190 P. 635 (1920); Graham v. McCord, 384 S.W. 2d 897 (Tex. Civ. App. 1964); Dyer v. Munday, [1895] 1 Q.B. 742, 746; Smith v. Martin, [1911] 2 K.B. 775, 782; Higgins v. Watervliet Turnpike Co., 46 N.Y. 23, 26-27 (Ct. App. 1871). Note the confusion of Professor Powell, who defines authority as based on consent and then writes of unauthorized torts as being within the agent's usual authority. R. Powell, LAW OF AGENCY 6, 189 (2d ed. 1961).

3 See Conant, Objective Theory of Agency: Apparent Authority and the Estoppel of Apparent Ownership (to be published).

4 Standard Oil Co. v. Anderson, 212 U.S. 215, 220 (1909); Laurie v. Mueller, 248 Minn. 1, 3, 78 N.W.2d 434, 437 (1956). See BATY, VICAR-
foundation of liability that causes great judges to confuse the terms servant and agent and in many cases use them interchangeably.\(^5\)

But the tort liabilities of masters and principals are not identical in all cases. The separate but overlapping rules for tort liability in the master-servant relationship and the principal-agent relationship require a preliminary digression into the definitions of servant and agent. The main sections divide the principal's liability for torts other than fraud from the special rules relating to misrepresentation.

I. DEFINITIONS OF SERVANT AND AGENT

Since the law of master and servant began first, it is not surprising that the early authorities spoke of agents as a special class of servants.\(^6\) But in the nineteenth century, the terms servant and agent developed separate meanings,\(^7\) and in some instances the tort liabilities of their employers were held to differ. This distinction in meaning did not prevent a single employee from being assigned some tasks as a servant and others as an agent. In the twentieth century, however, the committee for the Restatement (second) of Agency decided to go even further. In section 2, they define servants as a subclass of agents.\(^8\) Later in the same volume, however, they define servant independently and not as a subclass of agents.\(^9\)


\(^6\) Blackstone, Commentaries 427; O. W. Holmes, Jr., The Common Law 228 (1881); 1 F. Mechem, Law of Agency 5 (2d ed. 1914).


\(^8\) "A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right of control by the master." 1 Restatement (Second) of Agency 2 § 2 (2) (1957).

\(^9\) "A servant is a person employed to perform service in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control." Id. § 220 (1).
It is submitted that classing a servant as a type of agent makes for an awkward use of language and can impede communication. In order to separate the two classes for purposes of tort liability, the Restatement first considers agents who are servants. But then, in order to consider the lesser tort liabilities of some principals, it has to create a new class of "non-servant" agents. Since this latter class is what in ordinary legal parlance is an "agent," the new language of the Restatement only makes for semantic confusion.

It would seem to facilitate analysis of employment relationships to distinguish one who is primarily a servant from one who is primarily an agent. A useful definition of servant is the second one of the Restatement or the one in the California Civil Code, which states:

A Servant is one who is employed to render personal service to his employer, other than in the pursuit of an independent calling, and who in such service remains entirely under the control and direction of the employer, who is called the master.

The master-servant relationship is a bilateral one in which the servant engages in physical or mental work for the master, subject to the supervision of the master. A servant's employment centers on his assigned task, and any contact with third parties is merely incidental. Thus the driver of the delivery truck may hand over goods to consignees and the junior dentist employed on salary by his senior may work on patients, but both are legally servants.

The right to control, and not necessarily the exercise of that right, is the test of the relation of master and servant, and the right is not over merely what is to be done but also over how it is to be done. Although it is said that determinative test is the

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10 [Restatement (Second) of Agency § 219 (1957).]
11 Id. §§ 250-251.
12 See note 9 supra.
16 The existence of the right to control may be inferred from a combination of factors which usually varies according to the circumstances of each case. Thus, highly skilled cooks or gardeners who resent and even contract against interference are normally servants when regularly employed. The fact that a particular occupation may involve such technical skill that the employer is wholly incapable of supervising the details of performance does not preclude a master and
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complete right of the master to control the physical method of the servant, the presumptions of the law work in the opposite direction. The view of most courts is that if an employee is hired to do physical tasks and there is not clear evidence that the party who is hired is in business for himself as an independent contractor, then he is a servant. Once the employee is held to be a servant, the employer is presumed to exercise control of the physical details of his assigned tasks.\(^{17}\) One must conclude that the prime behavioral characteristic of a servant is a "legal presumption" that he has no discretion in choosing the physical method of performing his service.

The comprehensive liability of the master for the torts of his servant both in England and in the United States, as described in "committed while acting in the course of employment," is largely based on the right and power of the master to control the physical activities of the servant, which implies an assumption of risk of loss from injuries arising out of those activities.\(^{18}\) Since the master is presumed to control the details of the servant's physical method, he is held liable for the torts that occur in or arise out of its execution. Furthermore, the presumption is conclusive, not rebuttable. Even though the master grants the servant wide discretion in the choice of physical method or even forbids certain physical methods, he is still presumed to control.\(^{19}\) So long as the servant acts to

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\(^{17}\) "In general, control will be implied by law if the activity of the employee at the time bears such a connection to the business of the employer as will permit the conclusion that responsibility for the employee's conduct in such a situation is fairly included within the risk of doing business assumed by the employer." Cobb v. United States, 247 F. Supp. 505, 506 (N.D. Ill. 1965). See Leidy, Salesmen As Independent Contractors, 28 Mich. L. Rev. 365, 377-78 (1930).


\(^{19}\) See Lindemuth v. Steffy, 173 Pa. Super. 509, 511, 98 A.2d 242, 244 (1953), for an example of a servant who has been delegated discretion to choose his physical method. As to acts forbidden by the master, see United States v. Taylor, 236 F. 2d 649, 654 (6th Cir. 1956); Montgomery
further the execution of his assigned tasks, he will be held to be in the controlled course of his employment, with the rare exceptions of his choice of patently unreasonable modes or instrumentalities.

The principal-agent relationship is a much more particular employment concept than the master-servant for anyone using common legal parlance, as opposed to the language of the Restatement. Agency may be defined as the consensual relationship in which one party, the principal, appoints a second party, the agent, to act in his behalf in a representative capacity, primarily to make contracts between the principal and third party. Thus the key feature of the agency relationship is that it is at least trilateral. The principal employs an agent to go into the marketplace and deal for him with third parties. The primary purpose is to make contracts between the principal and third parties through the negotiations of the agent. Some particular classes of agents, however, such as real estate brokers, merely execute preliminary negotiations and do not enter contracts for their principals. In any case, the distinguishing characteristic of the agent's tasks is communication with third parties in an effort to make contracts and not the physical activity characteristic of most servants.

Although a principal may retain the right to control the details of the agent's conduct with respect to matters entrusted to him, there is no presumption he will do so. In fact, most agents are delegated discretion to devise the best method of effecting contracts for their principals within the scope of their delegated authority. In many cases, agents are hired because they have skills in negotiating purchases or sales which their principals do not have. Furthermore, the agent's power to make contracts for his principal in excess of his delegated authority, the apparent authority problem,


clearly illustrates the degree to which the agent has independence of action. The early explanation of agency as the fictional identification of action by the agent as that of the principal gives no recognition to the fact that the key issues of agency law center on the discretion vested in agents and their misuse of it.\textsuperscript{23}

In addition to the differing tort liabilities of masters and principals, which will be examined in the final sections of this paper, the key reason for determining if an employee is basically a servant or an agent is concerned with what presumptions third parties may legally make about the employee’s power to contract for his employer, the apparent authority problem. If the employee is an agent, his primary function is to make contracts for his principal. Third parties, having been informed by the principal that the employee is his agent, may presume the employee has the same authority as other agents in that line of business. But third parties should never presume that an employee who is basically a servant has general agency authority.\textsuperscript{24} When a clerk or other servant is given possession of goods or documents of title, his wrongful “sale” or “pledge” of the goods or documents will not transfer title from his master to innocent third parties.\textsuperscript{25} In contrast, a mercantile agent in possession of a principal’s goods can, in violation of the principal’s direction, transfer title to innocent third parties.\textsuperscript{26}

The distinction between the principal-agent relationship and the master-servant relationship has also been held decisive in a few other situations. In certain instances, statutes are applicable either to servants or to agents, and a court cannot determine liability in those cases without first determining which type of employee is concerned.\textsuperscript{27} Under many employment contracts, a principal is free to discharge his agent with little or no notice, while a master is usually bound to give due notice to his servants.\textsuperscript{28}


\textsuperscript{24} East Coast Freight Lines v. Baltimore, 190 Md. 256, 58 A.2d 290, (1948); Moore v. Tickle, 14 N.C. 266 (1831).


Although the basic character of an employee as servant, agent, or independent contractor must be determined before one can assess the legal effects of the employee's attempts to contract for the employer, this does not mean a servant or independent contractor can never be given any agency authority. Many employees who are basically servants are delegated special limited agency authority. A retail shop assistant (sales clerk), for example, is basically a servant empowered to show his master's goods to prospective customers. Yet, this servant, who does not have general agency power to negotiate price or terms of trade, does have limited agency power to finalize a contract by handing the customer his purchase and taking his money. An independent contractor can also be given limited or special agency power. Brokers and factors combine the characteristics of agents and independent contractors. A building contractor usually receives the full price for delivering a completed building, but the purchaser could in unusual circumstances appoint the contractor a special agent to make the purchaser liable to material suppliers. This might happen if the contractor's credit standing was impaired and he was unable to buy the materials to complete the building. Another example is the independent contractor who is in two businesses at once, warehousing and brokerage. As to goods entrusted to him for sale he has agency power, but as to goods entrusted to him solely for warehousing he does not have agency power.  

II. PRINCIPAL'S VICARIOUS LIABILITY FOR AGENT'S TORTS

The liability of a principal for the torts of his agent is not as broad as the liability of a master for the torts of his servants. If the agent has also the characteristics of an independent contractor in that he holds himself out as an independent enterpriser who represents more than one principal, the principal is not liable even if a physical tort arises directly out of the agent's transaction of the business of the agency. Thus one who employs a broker, factor, attorney, or collection agency is not responsible for physical torts committed by these agents in the execution of the agency. This rule is stated in Section 250 of the Restatement (second) of Agency as follows:

A principal is not liable for physical harm caused by the negligent physical conduct of a non-servant agent during the performance of the principal's business, if he neither intended nor authorized the result nor the manner of performance, unless he was under a duty to have the act performed with due care.\textsuperscript{33}

Where the agents are full-time or regular employees, such as sales or purchasing agents, the rules for the principals' liabilities in tort are more complex. The basic presumption of most courts is the same as stated above for agents who are also independent contractors. But the principal incurs vicarious liability for the physical torts of his full-time agent if:

(1) The principal has actually controlled the physical method of the agent, expressly or impliedly, in which case the master-servant course-of-employment rule applies, OR

(2) Even though the principal has not controlled the agent's physical method, the tort is committed in the transaction of the business of the agency with the third party.

These two possible grounds of liability must be considered separately.

A. \textbf{Actual Control of Physical Method}

The first possible ground of principal's liability, actual control of the agent's physical method, results in the application of the broad course-of-employment rule. This general rule for the master's liability for servant's torts is applied to principals only when they actually control their agent's physical methods. The principal, in contrast to the master, is not presumed always to control the mode, manner and details of his agent's physical activity because the agent is not employed primarily to do physical tasks. If physical activity, such as getting to the third party's place of business, is necessary, it is merely incidental to an agent's primary function of negotiating contracts. The principal may leave this choice of physical method entirely to the discretion of the agent. So long as the principal does not exercise actual control, expressly or impliedly, of the agent's incidental physical activities, he is not liable for torts arising therefrom, even though they obviously occur in the course of the agent's employment. As to this incidental physical activity, the agent is comparable to an independent contractor.\textsuperscript{34}

If the principal does actually control the agent's choice or means of locomotion, then he assumes the risks arising therefrom; he is

\textsuperscript{33} 1 \textit{Restatement (Second) of Agency} § 250 (1957).

\textsuperscript{34} McCrady \textit{v.} National Starch Products, 41 Del. 392, 23 A.2d 108 (1941).
liable for the agent's negligence because, by controlling the means, he is presumed also to control the details of the employee's method of executing his tasks, as in the case of master and servant. If the principal supplies the vehicle, it is reasonably inferred that he has chosen the means of transport. In *Singer Manufacturing Co. v. Rahn*, the principal supplied the sales agent with a wagon and the agent furnished the horse and harness. The contract of employment gave the principal general power to prescribe and regulate the details of the agent's activities, including routing and driving. The principal was held liable for negligent driving by the agent within the course of his employment.

When the agent uses his own car, determination that the principal has actually controlled the agent's choice of transport and therefore his physical method is more difficult. If it is a condition of employment that the agent supply and use his own automobile to reach third parties, the principal has clearly directed the choice of physical method. In other cases, actual control of means or method by the principal is inferred from the fact that the agent is reimbursed by the principal for his automobile expenses or from the fact that it is customary in that trade and expected by principals that agents will use automobiles. But in a greater number of cases imposing liability on the principal, the courts revert to the classical language, describing an agent as a type of or equivalent to a servant. In these cases, if the agent is not proved to be a distinct independent contractor, then he is held an employee or servant. Treating him this way, the courts apply the usual rule for servants that the mere right to control physical method, and not actual

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36 132 U.S. 518 (1889).
control, is sufficient for liability of the master. In these cases, whether the agent is a servant or an independent contractor is a jury question and is based on weighing certain key criteria. In many of these courts, however, the paramount issue of the degree of control reserved by the principal is side-stepped by merely labeling the agent a servant and then adopting the presumption of control which is found in most master-servant tort cases.

In England and in a large group of American states, the distinction between agent and servant is maintained. Absent proof of actual control of method, the principal is not liable for the agent's physical torts. In these jurisdictions, if the traveling sales agent uses his own car, chooses his own route and is paid by commission, the usual inference is that the principal has exercised no control over the agent's means of locomotion. The principal is therefore not liable to an injured party for the agent's negligent driving enroute to call on a customer even though the agent is clearly in the course of his employment. In the leading English case of this type, Egginton v. Reader, a principal was held not liable to a plaintiff injured by his agent, and was held not to have controlled the agent's means of transport even though he knew the agent would use his own car and the principal paid the agent £1 per week in addition to his commissions for upkeep of the car. The American decisions were reviewed in the leading cases of Stockwell v. Morris and American Nat. Ins. Co. v. Denke, and the majority adopt the same rule as the Egginton case.

In some of the cases, absence of control by the principal is demonstrated by the agent's freedom to choose any means of transport, such as bus, train or taxi. But in most of the cases the evidence is clear that the automobile is the only efficient means of

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40 "... (1) the degree of control exercised by the employer, or the independence enjoyed by the contractor or agent; (2) whether the party is to be paid by the job or is to receive a certain salary by the day, week or month; (3) whether his employment consists solely in working for his employer; (4) the control that is exercised over him in method and manner of performing work; (5) whether the agent uses his own equipment, or whether the equipment, if any, so used, is owned and controlled by the owner; and (6) the nature of the contract, whether written or oral." Commonwealth Life Ins. Co. v. Gay, 365 P.2d 149, 151 (Okla. 1961).

42 46 Wyo. 1, 22 P.2d 189 (1933).
travel, so that the agent can maximize the time spent in his primary function of negotiating contracts with third parties. In this majority of cases, the courts emphasize that though the principal has knowledge and consents to the agent using his own car, the principal reserves no right to control the physical method of the agent in handling the car. As noted in a leading case under Massachusetts law:

It is the normal presumption that the right to control as to the detailed operation of the car is an incident of proprietorship; and to render the general employer liable on the doctrine of respondeat superior there must be some evidence warranting that the owner, while permissively using his own car on company business, has yielded up to his employer this right to control speed, route and the other details of operation.

In elucidating the agent's freedom from control, some of the courts emphasize the agent's authority to choose his own hours of work, his travel route and his methods of selling. But these factors are not really significant to the issue of liability for physical torts. The crucial presumption is that the agent is not subject to the principal's supervision over the state of repair of the agent's car and over what is a safe manner of operating the car. The agent is even free to borrow his wife's car or a friend's car rather than use his own on any particular business day. So long as the principal leaves the agent completely free to make these choices, the principal is not liable for physical torts. In fact, some courts confuse the issue by labeling such a full-time agent an independent contractor even though he clearly does not meet the criteria for the generally accepted definition of a contractor.

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46 Conversions and Surveys, Inc. v. Roach, 204 F.2d 499, 501 (1st Cir. 1953).


48 Fuller v. Lindenbaum, 29 Cal. App. 2d 227, 84 P.2d 155 (1938); McDonald v. Dodge, 231 Iowa 325, 1 N.W.2d 280 (1941); Atlas Life Ins. Co. of Tulsa v. Foraker, 196 Okl. 389, 165 P.2d 323 (1946); Dunne
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B. COMMITTED IN THE TRANSACTION OF THE BUSINESS OF THE AGENCY

Even though the principal has neither reserved the right to control nor exercised any actual control of the agent's physical method, so that the course-of-employment rule would not apply, the principal is still liable for torts of the agent committed in the transaction of the business of the agency.\(^9\) Transaction of business in this context can only mean the dealing of the agent with third parties in order to enter or to execute contracts within the scope of the agent's authority. If a physical tort by the agent arises out of these negotiations, the principal will be held liable and control of method is not an issue. Judge Lumbard suggests this liability is a basic principle of agency which applies even though the doctrine of respondeat superior is excluded because it is held applicable only to the master-servant relationship.\(^5\) A common example is the intentional tort of battery. An agent negotiates to buy or sell for his principal and the negotiations lead to an argument about the product or service in question. When the controversy ends in assault by the agent on the third party, the principal is held liable.\(^5\) But he will not be liable if the assault takes place because, after the transaction is completed, the third party tells the agent he will report him to his employer.\(^5\) In those cases where sale of the principal's product requires physical demonstration of it, torts resulting from the demonstration clearly arise from the transaction of the business of the agency. A car salesman who negligently failed to make certain the transmission was not in gear before pushing the linkage of an idling car which lurched forward injuring the customer for whom it was being demonstrated commits a tort for which his principal is liable.\(^5\) And if a car salesman negligently permits a prospective customer who is an inexperienced driver to

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\(^9\) This language is found in CAL. CIV. CODE § 2338 (1872), as borrowed from the CIVIL CODE OF NEW YORK § 1253 (1865). In spite of the clear difference in English usage, the California Courts have held "transaction of the business of the agency" to be equivalent to "course of employment". In this way, they have extended a statute particularly designed to deal only with the tort liabilities of principals to codify also the tort liabilities of masters. See Tighe v. Ad Chong, 44 Cal. App. 2d 164, 166, 112 P.2d 20, 22 (1941).

\(^5\) De Ronde v. Gaytime Shops, 239 F.2d 735, 738 (2d Cir. 1957).


drive the car, the principal will be liable for injuries to property and persons resulting from the driving. In these cases, the agent is not using the car as a mere incident to the business, but rather he is using it for the very transaction of the business of the agency.

This second basis of principal's liability applies to many torts in addition to the physical ones already discussed. Conversion is a prime example. When a ship's master makes an unnecessary sale of damaged cargo, the owners of the ship will be liable to the consignee for the value of the goods. Likewise, when goods are in the possession of a bailee under an option to purchase and the bailee notifies the bailor it does not intend to exercise the option and has no further use for the chattels, it is conversion for the managing agent of the bailee to refuse to deliver them up, for which his principal is liable. A principal will also be liable for false imprisonment if his agent has authority to cause the arrest of persons in the protection of the principal's property. If an employee is suspected of misappropriating funds or a customer of shoplifting, the managing agent of the business may detain the suspect for questioning and commit the tort of false imprisonment. Since the detention is committed as part of the management of the business, it can be said to occur in the transaction of the business of the agency. A similar rule applies to an action for malicious prosecution and for defamation against principals whose agents committed these wrongs while doing acts within the scope of their authorities.

The general rule has been applied to tortious acts of many types arising out of agents' transactions. A real estate broker, for example, was held liable for the negligence of his agent in overvaluing a price of property which was taken in trade by a customer of the broker. And a labor union was held liable for the torts of

54 Kelly v. Lowney & Williams, 113 Mont. 385, 126 P.2d 486 (1942).
58 Peak v. Grant, 386 S.W.2d 685 (Mo. 1964); Dillon v. Sears-Roebuck Co., 126 Neb. 357, 253 N.W. 331 (1934).
60 De Ronde v. Gaytime Shops, 239 F.2d 735 (2d Cir. 1957). See Restatement (Second) of Agency § 254 (1957).
61 Fredrick v. Squillante, 144 So. 2d 848 (Fla. 1962).
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its business agent in inducing breach of contract. Another recent example concerns the rental agent who, in violation of a rent control law, demands an illegal premium from prospective tenants before renting them a flat. In *Navarro v. Moregrand Ltd.*, the premium was held recoverable by the tenant from the landlord even though agent’s taking of the premium was a crime. So long as the tenants did not know the agent intended to pocket the premium as his own, the illegal act clearly in excess of the agent’s authority arose out of the transaction of the business of the agency.

III. PRINCIPAL’S VICARIOUS LIABILITY FOR AGENT’S MISREPRESENTATIONS

The principal’s vicarious liability for fraudulent misrepresentations of his agents is reviewed separately not only because of the close relation to innocent misrepresentation, which is not a tort, but also because of the special determining effect of this tort on contract. Furthermore, the principal’s liability when the agent acts from private motives differs in fraud cases as compared to physical torts.

The general rule for vicarious liability of principals for agent’s fraudulent misrepresentations is the second one stated in the previous section. The principal is liable if the fraud is committed by the agent in the transaction of the business of the agency. If the principal has conferred actual or apparent authority upon agent to make representations of fact to third parties concerning the subject matter of the agency, the principal will be liable for fraudulent misrepresentations committed in negotiating such a transaction. But the rule is even broader. The Restatement asserts that even if principal has done no act to confer actual or apparent authority upon the agent to make representations of fact, he will be liable for fraudulent misrepresentations committed in that trade to make representations. Thus it is argued that even the undisclosed principal will be held liable for the fraud of his agent who has been told to make no representations if it is reason-

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65 *Restatement (Second) of Agency* § 258 (1957), comment a. at 560. See Horack, Vicarious Liability For Fraud And Deceit In Iowa, 16 Iowa L. Rev. 281, 371 (1931).
able in that trade for the third person to rely on the representation. The argument is strongest when the agent has received money or other assets from the third party in reliance upon the fraud and has paid over or transmitted these assets to the undisclosed principal.

The general rule was confirmed in English law in *Barwick v. English Joint Stock Bank.* The managing agent of defendant bank, in an effort to collect a debt for his principal, fraudulently induced the plaintiff to extend further credit to the debtor. In holding the bank liable for its agent's fraud, the court rejected the earlier view of some English courts that a principal was liable only if he authorized or ratified such fraud. It held the principal liable for such wrong "as is committed in the course of the service and for the master's benefit, though no express command or privity of the master be proved." The condition that the agent act for his principal's benefit if the principal is to be held for fraud is no longer law. It had developed most clearly in cases concerning bills of lading. In *Grant v. Norway,* for example, the master of a ship as part of a conspiracy to borrow money for his own benefit, fraudulently issued a bill of lading though no goods had been delivered to him. His principal was held not liable for this fraud even though the agent had actual authority to issue bills of lading, because it was outside the scope of the agent's authority to issue a bill of lading for his private benefit when no goods were received. Thus, in this action upon the case, the court emphasized the contract concept of authority and used it to limit the principal's liability in tort.

Although *Grant v. Norway* has not been specifically overruled in England, the courts have rejected the limitation that the principal has vicarious liability for fraud only when the agent acts for principal's benefit. The leading case is *Lloyd v. Grace, Smith & Co.* The conveyancing manager of defendant, a firm of solicitors, fraudulently induced the plaintiff, a widow who came to the firm for advice, to convey two cottages and a mortgage to him personally. The manager then mortgaged the two cottages and called in the other mortgage, both for his own benefit. The House of Lords held defendant vicariously liable on the general ground that the agent committed fraud while purporting to transact the type of business in which he was authorized. The rule relating to physical torts

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68 L.R. 2 Ex. 259, 265.
that the agent must be actuated at least in part by a purpose to serve the principal was rejected here. An attempt to limit this rule to cases in which the plaintiff was defendant's client was rejected in *Uxbridge Permanent Benefit Building Society v. Pickard.* The managing clerk of defendant solicitors forged a deed and obtained a loan of £500 upon a mortgage of the property to plaintiff. Since the ostensible authority of such clerks included obtaining loans, the principal was held liable for fraud committed while the agent was transacting business within such authority. The court specifically rejected any analogy to a servant who was off on a frolic of his own and also rejected the contention that fraud by forgery was different from other fraud committed while transacting business within an agent's ostensible authority. This broad rule of vicarious liability can now be said to have general application whether the principal is a person or corporation.

Those American courts which in the last century had concurred with *Grant v. Norway* in exempting the principal from liability when the agent committed fraud for his own benefit have also rejected this limitation. The leading modern case is *Gleason v. Seaboard Air Line Ry.* The freight agent of defendant railroad in charge of bills of lading falsely informed plaintiff cotton factor that certain goods had arrived; he then forged a draft and a bill of lading and presented it to plaintiff, who paid the $10,000 demand. The agent executed the whole scheme for his own secret purpose and benefit, and he absconded with the money. In reversing the court below, which had held for the defendant because the agent had acted solely for his own benefit, the Supreme Court said:

> And we think that the restriction of the vicarious liability of the principal adopted by the court below is supported no more by reason than by authority. Undoubtedly formal logic may find something to criticize in a rule which fastens on the principal liability for the acts of his agent, done without the principal's knowledge or consent and to which his own negligence has not contributed. But few doctrines of the law are more firmly established or more in harmony with accepted notions of social policy than that of the liability of the principal without fault of his own.

The breadth of the rule in American courts is summarized in Section 261 of the Restatement: “A principal who puts a servant or

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71 [1939] 2 K.B. 248.
75 278 U.S. at 356.
other agent in a position which enables the agent, while apparently acting within his authority, to commit a fraud upon third persons is subject to liability to such third persons for the fraud." Kean v. National City Bank is typical of a large group of cases where bank officers use their business affiliation to induce the reliance of third parties in a fraudulent scheme solely for their own personal gain. In this case, the vice-president of a bank, knowing negotiable bonds to be stolen, as part of a fraudulent scheme sold them in the bank's name. Although the bank had no material connection with the transaction other than the wrongful use of its name, it was held liable for the fraud of its agent because his position enabled him to execute the scheme. Similarly, in Rutherford v. Rideout Bank where successive bank managers had undertaken to give financial advice to an inexperienced woman depositor and mortgagor, a confidential relation existed between her and the bank. When the manager of the bank fraudulently advised her to sell a ranch at a low price to a secret friend of the manager with whom he was sharing the proceeds of the scheme, the bank was liable for fraud even though it was not generally in the business of giving investment advice and received no gain from the transaction. The cases rest on the reasonable inference of third parties that the agent is acting for his principal in the transaction. If a reasonable man should not make the inference in the particular circumstances, then the principal will not be liable for the fraud.

The equitable remedies of a third party who is induced to enter a contract by fraud of an agent are even greater than those at common law. This is illustrated by that small class of agents who have neither actual nor apparent authority to make representations concerning the subject matter of the agency. In the United States, this is particularly true of most real estate agents, who merely bring buyers and sellers together but do not enter contracts or even negotiate price or terms of trade. If such an agent has no authority to make any representations, his principal will not be vicariously

76 Restatement (Second) of Agency § 261 (1957).
liable in tort for the agent's fraudulent misrepresentations. Nevertheless, though the third party will not have an affirmative action in fraud in such a situation, if he relied on the misrepresentations in good faith, he will still be allowed to rescind the contract. The principal will not be allowed to benefit from his agent's fraud concerning a material aspect of the transaction even though representations are outside the scope of the agent's authority. Third parties who do not often buy real estate and who are unfamiliar with the unusually narrow apparent authority of real estate agents are allowed rescission, since it would be unreasonable to expect them to investigate the extent of such authority.

A. Exculpatory Clauses

Clauses in written contracts expressly limiting the representations to the document and disclaiming other representations of negotiating agents or clauses exempting principals from liability for fraud of agents are common in the United States. In the English reports, however, there appears to be only one case, on appeal from Ireland, *S. Pearson & Son, Ltd. v. Dublin Corp.* The exculpatory clause did not purport to exempt the principal from fraud, but merely stipulated that the third party must satisfy himself concerning all facts of existing structures and the principal did not hold itself responsible for the accuracy of information supplied by it. The House of Lords held that this clause contemplated honesty on both sides and did not purport to exempt defendant from liability for the deliberate fraud of its agents. In dictum, Lord Loreburn indicated it might be possible for a principal to exempt himself from liability for fraud of his agents by an express contractual clause to that effect.

In the United States, even though it is against public policy for a principal to contract out of liability for his own fraud, as to liability for fraud of his agent, most courts follow Section 260 of the Restatement. As summarized there, a principal may validly

82 [1907] A.C. 351.
83 *Id.* at 354.
84 *Restatement (Second) of Agency* § 260 (1957).
contract to relieve himself of vicarious liability in tort for fraud of his agent, but when such a contract is induced by fraudulent misrepresentations of the agent, it is still subject to rescission by the third party. The rule is applied whether the exculpatory clause merely states that all representations are limited to those in the written contract or the clause specifically attempts to exempt the principal both from actions of deceit and rescission.

The rationale of the American view, which allows rescission in spite of the exculpatory clause, is the paramount rule that even an innocent principal will not be allowed to benefit from his agent's fraud concerning a material aspect of the transaction. As in the case of the agent without any authority to make representations, the contract is voidable though the statements are clearly outside the scope of the agent's actual authority. The clauses are thus not taken at face value. The third party, however, must prove that he has overlooked the exculpatory clause, which is usually in a printed form contract supplied by the principal, in order to demonstrate that he has relied on a material misrepresentation of the agent. If he carries this burden of proof, the third party is not estopped from claiming he was misled. Estoppel is fundamentally an equitable doctrine founded on good conscience and fair dealing, usually for the purpose of preventing fraud and injustice. Consequently, a principal will not be allowed to interpose estoppel on the third party in order to take advantage of his agent's fraud.

In a few cases, the exculpatory clause is given full effect and the defrauded party will not even be allowed to rescind the con-


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tract. But in these cases the courts have found that either the third party had read the exculpatory clause and therefore could not reasonably rely on the agent's oral misrepresentations, or he had failed to exercise care in not reading the form contract he signed. In the latter group of cases, the courts have had to weigh the claims of an innocent principal against those of a negligent third party, and they have given decision for the principal.

B. NEGLIGENT MISREPRESENTATIONS OF AGENT

A principal's liability for misrepresentations of his agent which are negligent but not fraudulent and which result only in pecuniary loss but not physical injury to the third party raises many complex issues. Until 1963, the English courts did not recognize an action for such a negligent misrepresentation at all, so that the issue of a principal's possible vicarious liability did not arise. The decision of the House of Lords in Hedley Byrne & Co. v. Heller & Partners Ltd. appears to go a long way toward overruling the earlier English view. The plaintiff, an advertising agency, before extending substantial credit to a customer, asked its bank to inquire of defendant merchant bankers concerning the financial status of the customer. One of the partners of defendant, knowing that the statements would be relied on by firms dealing with the customer, negligently reported the customer to be in good financial standing. The response carried the disclaimer, "For your private use and without responsibility on the part of the bank or its officials." When the customer failed and plaintiff brought this action for damages, the trial court held that there were negligent misstatements, but on the authorities defendant was not liable. On appeal, the dismissal of the action was affirmed on the basis of the disclaimer of responsibility in the defendant's response to the credit inquiry. Nevertheless, the opinions of the Law Lords centered on the issue that a duty of care could exist in the making of representations resulting in pecuniary loss, a cause of action separate and distinct from fraud or from any equitable rights of rescission. In their opinions, they expressly disapproved the earlier authorities which had denied such a cause of action. Although vicarious liability was not put in issue.

in the case, since a bank was being sued for the misstatements of a partner, possible liability of a principal was clearly presumed in the appeals opinions. The decision would seem to open the way for later English courts to impose a new and larger vicarious liability on principals for representations of agents.

In the United States, there is general liability for negligent misrepresentations to a person who is in privity of contract with the defendant, but most courts refuse to extend this liability to other third parties. However, if the negligent statement is made by one purporting to have special knowledge of or competence in the subject matter and if it is made directly to the plaintiff or to someone who can reasonably be expected to transmit it to the plaintiff, defendant will be liable though there is no privity of contract. Thus a public weigher or public accountant will be liable for their negligent reports or financial statements to third parties who are not in privity but who can be expected to rely on the representations. Prosser suggests that even though the liability is not as wide as that for fraud, that there is a rational basis for an extensive liability for negligent misrepresentations. This is surely true when a bank or accountant is reporting on the financial status of a client to those who will extend credit. It would be an onerous burden to expect such a third person who relied on the misstatement to prove either fraud or gross negligence which is equivalent to fraud.

Given these general principles of liability, it can be assumed they would also be applied in holding a principal liable for his agent's negligent misrepresentations. Eamoe v. Big Bear Land & Water Co. is an example of such liability where there was privity of contract between plaintiff and defendant. The agent of the land company negligently showed plaintiff building lots other than described in the contract of sale to him and told him he could proceed with building if he desired. Upon discovery of the error, the plaintiff chose to affirm the purchase of the described lots and sue for the damages he incurred by having built on land he did not own. In spite of both the absence of fraud and a broad exculpa-

91 The leading authority is Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931).
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A principal who with fraudulent intent transmits his misrepresentations to third parties through an innocent agent is of course liable for fraud.\textsuperscript{97} This liability of the principal in tort is not varia
cious, but direct. The agent is a mere channel, comparable to a telephone or the mails. If the principal not only knows that apparent facts of the subject matter are untrue, but has a fraudulent intent to withhold or conceal this information from his agent, he will be liable for fraud though the agent's misrepresentation is innocent. Hence, a principal who consciously permitted his agent to remain ignorant of material facts in order to prevent disclosure should the third party inquire about them was liable for fraud.\textsuperscript{98}

An innocent principal was held vicariously liable when an innocent agent transmitted information to a third party which he obtained from a second agent of the principal who had the fraudulent intent and knew the information was to be forwarded to third parties.\textsuperscript{99} Here all the elements of fraud were in the second agent. In a similar situation, a corporate principal was held liable for fraud when its agents fraudulently assembled plans, drawings and speci
cfications which the principal, innocent of the details, forwarded to third parties.\textsuperscript{100}

It is essential, however, for an action in tort for fraud that all the elements of fraud be found in one person. In the agency situation, this means that the misrepresentation of material fact and the knowledge of falsity be found either in the principal or the agent but not divided between them. In Armstrong v. Strain,\textsuperscript{101} the owner of a bungalow employed a real estate agent to sell it. The agent made certain innocent misrepresentations concerning the property; the owner, who did not know such representations were

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\textsuperscript{98} Bumpas v. Stein, 18 Idaho 578, 111 P. 127 (1910); Dargue v. Chaput, 166 Neb. 69, 88 N.W.2d 148, 156 (1958); Ludgater v. Love, 44 L.T. 694 (1881). See Restatement (Second) of Agency § 256(1) (1957).
\textsuperscript{100} Pearson & Son, Ltd. v. Dublin Corp., [1907] A.C. 351.
\textsuperscript{101} [1952] 1 K.B. 232. See Gibson v. Cottingham, 32 D.L.R. 213 (1916); Restatement (Second) of Agency § 256(2) (1957).
to be made by the agent, did know facts which rendered them untrue but had no fraudulent intent to conceal these facts. Since there was a division of the elements of fraud between the principal and agent, the Court of Appeal affirmed the trial court judgment for defendants. "[Y]ou cannot add an innocent state of mind to an innocent state of mind and get as a result a dishonest state of mind." This case follows the doctrine of Cornfoot v. Fowke, in which a third party's defense of fraud to a breach of contract action was denied where an agent to lease a house innocently said there was nothing objectionable about it, while his principal knew there was nothing objectionable about it, while his principal knew that there was a brothel next door.

Even though there can be no affirmative action for fraud when the ingredients of deceit are innocently divided, may the third party rescind the contract by refusing to perform because it was induced by the agent's innocent misrepresentation? The early English decision of Cornfoot v. Fowke said no, if the principal sued at common law for money damages. The subsequent decision of Mullens v. Miller makes it clear that innocent misrepresentation by an agent is a good defense for the third party against a principal's action in equity for specific performance. Since the Judicature Act of 1873, a defendant in England may set up an equitable defense in any court, common law or equity. The House of Lords has affirmed the general application of this rule, so that the decision denying the defense of innocent misrepresentation in Cornfoot v. Fowke is not valid law today. In the United States, innocent misrepresentation of material facts is generally a good defense to an action for breach of contract at common law or in equity, and this defense is available to a third party induced to enter contracts by the innocent misrepresentations of an agent.

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104 Id.

105 22 Ch.D. 194 (1882).


109 Adams-Mitchell Co. v. Cambridge Distributing Co., 189 F.2d 913, 917 (2d Cir. 1951); Bloomquist v. Farson, 222 N.Y. 375, 118 N.E. 855 (1918); RESTATEMENT (SECOND) OF AGENCY § 259(1) (1957); Annot., 95 A.L.R. 763 (1935).
CONCLUSION

The Restatement (second) of Agency attempts to merge the rules for vicarious liability of principals and masters for physical torts of employees into a single body of law. It is submitted that the effect is to confuse many lawyers and judges and create the misapprehension that there are no rational and reasonable distinctions between agents and servants in the legal impact of their physical torts. In fact, the contrary conclusion is apparent from the Restatement's definition of servant and the usual presumptions of the English and American courts which have met the issues. In the master-servant relationship, the master is presumed to control the details of the servant's physical method of executing his assigned tasks and is therefore held liable for torts committed in the course of the servant's employment. In the principal-agent relationship, there is no such presumption of control by the principal. If there is actual control of the agent's physical method by the principal, then the course-of-employment rule can be applied. But this key issue of the existence or amount of control by the principal is many times slighted or overlooked by courts following the Restatement's view that an agent is a type of servant. Furthermore, there is another group of situations in which a principal may be liable for his agent's physical torts even though he has exercised no control of physical method. This is when the tort is committed in the transaction of the business of the agency of the third party and is at least in part motivated to serve the principal.

As to the principal's liability for his agent's misrepresentations, the course-of-employment rule from the law of servants' physical torts has no application, since fraud is not physical. Here again, many courts become confused and try to apply master-servant law. It is clear, however, that liability of a principal for fraud of his agent is peculiar to the law of agency. A principal is liable for his agent's fraud if it is committed in the transaction of the business of the agency so that it is reasonable for the third party to believe that agent is transacting his principal's business. It is now established law in both England and the United States that the principal can be liable for fraud even though the agent commits the tort solely for his private motive and profit. Here again the rule for fraud differs from that for physical torts.

In the areas of both physical and verbal torts, the law in England and in the United States is very similar, though the confusion of servants and agents occurs in both countries. Even in the area of liability for negligent misrepresentations, the House of Lords has recently imposed liability on a basis comparable to that in American courts. It is submitted that a codification of the basic
rules of agency would obviate many of the problems created by the failure of courts to understand the unique and special characteristics of agents as compared to other employees. Just as the Uniform Commercial Code has resolved many controversies in the law of sales, negotiable instruments and security devices, so codification could clear up many of the confusing issues of the law of agency.