CHAPTER 35

THE AGENCY RELATIONSHIP

Upon graduating from college, Rita Morales was hired as a software consultant by IPQ Company, a large computer manufacturing and services company. Rita negotiated a high salary and even a nice signing bonus, yet after a few years of work she found that her spending often outstripped her earnings and savings. As her credit card bills piled up, Rita started her own consulting firm. Initially, Rita provided software consulting for her clients only on nights and weekends after she had finished her IPQ work for the day. As her business grew, she began seeing clients during normal weekday working hours and calling them from her office at IPQ. To find new clients, Rita downloaded IPQ's client information from IPQ's database. She contacted more than 200 IPQ clients and asked them to switch from IPQ to Rita's business. More than two dozen IPQ clients switched to Rita.

- Do you see any potential problems with Rita's actions?
- What legally and practically can IPQ do to prevent Rita from taking its clients?
- What would an ethical employee in Rita's position do if her income did not meet her expenses?

LO LEARNING OBJECTIVES

After studying this chapter, you should be able to:

35-1 Know when an agency relationship is created.

35-2 Understand the distinction between employees and nonemployee agents.

35-3 Recognize when an agent risks breaching a fiduciary duty.

35-4 Learn the way agency relationships are terminated.

OFTEN, BUSINESSES ARE LEGALLY bound by the actions of their employees or other representatives. For example, corporations frequently are liable on contracts their employees make or for torts their employees commit. We take such liability for granted, but why should we? A corporation is an artificial legal person distinct from the officers, employees, and other representatives who contract on its behalf and who may commit torts while on the job. Similarly, a sole proprietor is distinct from the people she may employ. How can these and other business actors be bound on contracts they did not make or for torts they did not commit? The reason is the law of **agency**.

Agency is a two-party relationship in which one party (the **agent**) has the power to act on behalf of, and under the control of, the other party (the **principal**). Examples include a Toyota dealership hiring a salesman to sell cars, Google employing a software engineer to write computer code, and you engaging a real estate agent to sell your home. Agency law's most important social function has been to stimulate commercial activity. It does so by enabling businesses to increase the number of transactions they can complete within a given time. Without agency, for instance, a sole proprietor's ability to engage in trade would be limited by the need to make each of her purchase or sale contracts in person. As artificial persons, moreover, corporations can act only through their agents.

Agency law divides into two rough categories. The first involves legal relations between the principal and the agent. These include the rules governing formation of an agency, the duties the principal and the agent owe each other, and the ways an agency can be terminated. These topics are the main concern of this chapter. Chapter 36

discusses the principal's and the agent's relations with third parties. In that chapter, our main concerns are the principal's and the agent's liability on contracts the agent makes and for torts the agent commits.

Much of the law of agency, which is largely state law in the United States, has been codified or adopted by the state legislatures or their courts in the form of the *Restatement (Third) of Agency* (2006), a project of the American Law Institute (ALI). The *Restatement (Third)* was adopted by the ALI in 2006, replacing the *Restatement (Second)*, which had been the chief source of agency law since its adoption in 1958.

Creation of an Agency

LO35-1 Know when an agency relationship is created.

Formation Agency is the fiduciary relationship that arises when one person (a principal) manifests assent to another person (an agent) that the agent will act on the principal's behalf and be subject to the principal's control. The agent must also manifest assent to the relationship or otherwise consent to act for the principal and under the principal's control. Agency is a fiduciary relationship because the principal entrusts the agent with power to make contracts for the principal and to possess and use the principal's property. As a fiduciary, the agent must use the entrusted power and property in the best interest of the principal. The Supreme Court has long-stated that "[a] fiduciary cannot serve himself first and his cestuis second, and he cannot manipulate the affairs of his corporation to the detriment of stockholders and creditors and in disregard of the standards of common decency and honesty." *Pepper v. Litton*, 308 U.S. 295, 311 (1939).

As the term *manifest* suggests, the test for an agency's existence is *objective*. If the parties' written or spoken words or other conduct indicate an agreement that one person is to act on behalf of and under the control of another, the relationship exists.

If the facts establish an agency, neither party need know about the agency's existence or subjectively desire that it exist. In fact, an agency may be present even when the parties expressly say that they do not intend to create it, or intend to create some other legal relationship instead.

Often, parties create an agency by a written contract. But an agency contract may be oral unless state law provides otherwise. Some states, for example, require written evidence of contracts to pay an agent a commission for the sale of real estate. More important, the agency relation need not be contractual at all. Thus, consideration required to form a contract is not necessary to form an agency.

Capacity A person has the capacity to be a principal if that person has capacity to do the acts for which the agent has been retained. For example, a person competent to make a contract to purchase a building has the capacity to appoint an agent for that purpose.

Usually, any person may be an agent, including a person who cannot make his own contracts. An agent must merely understand that he is acting for someone else and is under her control.

Corporations have the capacity to appoint agents. In a partnership, each partner normally acts as the agent of the partnership in transacting partnership business, and a partnership can appoint nonpartner agents as well. In addition, corporations, partnerships, and other business organizations themselves can act as agents for other business organizations as well as individuals.

The *MDM* case, which follows, applies the *Restatement (Third)* definition of agency. That case shows that an agent is a fiduciary of the principal and not vice versa.

MDM Group Associates, Inc. v. CX Reinsurance Company Ltd.
165 P.3d 882 (Colo. Ct. App. 2007)

MDM Group is an insurance broker. Joseph McNasby, its president, developed an insurance program for insuring ski resorts against the risk that the number of "paid skier days" during a ski season would fall below a specified minimum. CX Reinsurance Co. and others agreed to underwrite insurance policies covering the risk for a year, starting with the 1997–1998 ski season, and issued policies to a number of ski resorts in exchange for premium payments. For the first two years, the policies generated premiums of about $550,000 and $476,000, from which MDM received a commission of 12.5 percent. No claims were submitted under the policies during the first and second seasons.

Before the 1999–2000 ski season, several underwriters declined to renew their involvement. However, CX issued policies for that year, which, because more ski resorts purchased the coverage, generated total premiums of approximately $3 million.

MDM received commissions totaling approximately $378,000. Unfortunately, the 1999–2000 ski season was not a good one for the insured resorts. There was little snowfall in the United States until well after the Christmas and New Year's ski holidays, and vacation travel was reduced because of concerns related to the millennium change. All the insured resorts, including Vail and Mammoth, submitted claims. CX negotiated, mediated, and litigated the claims, ultimately paying in excess of $23 million to settle them. As was its right, CX declined to renew the insurance policies after their one-year term expired in May 2000.

MDM initiated this action against CX asserting several grounds for liability, including a breach of fiduciary duty claim. MDM contended that CX, as the principal in an agency relationship with MDM, owed it a fiduciary duty and breached its duty by handling the ski resorts' claims improperly and in bad faith, thereby causing the resorts not to renew their policies and causing MDM to lose renewal commissions. The jury found for MDM and awarded it $6,750,783 in damages. CX appealed to a Colorado appeals court.

Casebolt, Judge

CX contends that MDM's breach of fiduciary duty claim must fail because a principal cannot owe a fiduciary duty to an agent as a matter of law.

A fiduciary duty arises among parties through a relationship of trust, confidence, and reliance. Certain types of relationships give rise to general fiduciary duties as a matter of law, such as attorney-client, principal-agent, and trustee-beneficiary. However, fiduciary duties are owed by only one of the parties in these relationships.

A fiduciary duty arises when one party has a high degree of control over the property or subject matter of another, or when the benefiting party places a high level of trust and confidence in the fiduciary to look out for the beneficiary's best interest.

In the principal-agent context, it is the *agent* who owes a fiduciary duty to the principal as a matter of law. "An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship." *Restatement (Third) of Agency,* § 8.01 (2006).

A principal does owe *some* duties to an agent. *See Restatement (Third) of Agency,* §§ 8.13–8.15. However, the "obligations that a principal owes an agent, specified in §§ 8.13–8.15, *are not fiduciary*." *Restatement (Third) of Agency,* § 1.01 comment e (emphasis supplied).

The jury was wrongly instructed that there was a fiduciary duty as a matter of law if it found that an agency relationship existed. As a matter of law, a principal is not a fiduciary of an agent. The principal is not "entrusted to act for the benefit of or in the interest of another." It is the principal who entrusts business to the agent to act for the principal's benefit. Any duties owed by a principal to an agent are not fiduciary. *Restatement (Third) of Agency,* § 1.01 comment e.

Judgment reversed in favor of CX.

Nondelegable Obligations Certain duties or acts must be performed personally and cannot be delegated to an agent. Examples include making statements under oath, voting in public elections, and signing a will. The same is true for service contracts in which the principal's personal performance is crucial, such as, certain contracts by lawyers, doctors, athletes, and entertainers. For example, the guitarist for Lady Gaga may not delegate to another guitarist his duty to perform at a Lady Gaga concert in Soldier Field.

Agency Concepts, Definitions, and Types

Agency law includes various concepts, definitions, and distinctions. These matters often determine the rights, duties, and liabilities of the principal, the agent, and third parties. In addition, they sometimes are important outside agency law. Because these basic topics are crucial in many different situations, we outline them together here.

Authority Although agency law lets people multiply their dealings by employing agents, a principal is not always liable for his agent's acts. Normally, an agent can bind his principal on a contract or other matter only when the agent has **authority** to do so. Authority is an agent's ability to affect his principal's legal relations. It comes in two main forms: **actual authority** and **apparent authority**. Each is based on the principal's manifested consent that the agent may act for and bind the principal. For actual authority, this consent must be communicated to the *agent,* while for apparent authority it must be communicated to the *third party.*

Actual authority comes in two forms: **express authority** and **implied authority**. *Express authority* is actual authority that the principal has manifested to the agent in very specific or detailed language. For example, a principal—a homeowner—may tell her agent—a tree removal

expert—that the agent is authorized to "remove the diseased ash tree in my front yard."

Agency law also gives agents *implied authority* to bind their principals. An agent generally has implied authority to act in a way the agent reasonably believes is necessary to perform his duties. For example, the tree removal expert in the example above would have authority to choose a method for removing the tree, such as topping the tree first and removing it in sections or felling the tree with one cut. Relevant factors include the principal's statements, or actions, the nature of the agency, the acts reasonably necessary to carry on the agency business, and the acts customarily done when conducting that business.

Sometimes, an agent who lacks actual authority may still *appear* to have such authority, and third parties may reasonably rely on this appearance of authority. To protect third parties in such situations, agency law lets agents bind the principal on the basis of their apparent authority. *Apparent authority* arises when the *principal's* manifestations cause a third party to believe reasonably that the agent is authorized to act in a certain way.

Apparent authority depends on what the *principal* communicates to the third party—either directly or through the agent. A principal might clothe an agent through statements to the third party, telling an agent to do so, or allowing an agent to behave in a way that creates an appearance of authority. The principal's communications to the agent are irrelevant unless they become known to the third party or affect the agent's behavior. In *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.* (1982), the Supreme Court stated that apparent authority is the power to affect the legal relations of another person through transaction with a third party, professedly as agent for that other person, arising from and in accordance with that other persons manifestation to the third party. Also, *agents cannot give themselves apparent authority*, and apparent authority does not exist where an agent creates an appearance of authority without the principal's consent (direct or tacit). Finally, the third party must *reasonably* believe in the agent's authority. Trade customs and business practices can help courts determine whether such a belief is reasonable.

Authority is important in a number of agency contexts. Chapter 36 examines its most important agency application—determining a principal's liability on contracts made by his agent.

General and Special Agents

Although it may be falling out of favor with courts, the blurred distinction between general agents and special agents still has some importance. A **general agent** is continuously employed to conduct a series of transactions, while a **special agent** is employed to conduct a single transaction or a small, simple group of transactions. Thus, a continuously employed general manager of a McDonald's restaurant, a construction project supervisor for homebuilder, Pulte, or a buyer of women's clothing for Macy's normally is a general agent. A person employed to buy or sell a few objects on a one-shot basis usually is a special agent. General agents often serve for longer periods, perform more acts, and deal with more parties than do special agents.

Gratuitous Agents

An agent who receives no compensation for his services is called a **gratuitous agent**. Gratuitous agents have the same power to bind their principals as do paid agents with the same authority. However, the fact that an agent is gratuitous sometimes lowers the duties principal and agent owe each other and also may increase the parties' ability to terminate the agency without incurring liability.

Subagents

A **subagent** basically is an agent of an agent. More precisely, a subagent is a person appointed by an agent to perform tasks that the agent has undertaken to perform for his principal. For example, if you retain accounting firm PricewaterhouseCoopers as your agent, the accountant actually handling your affairs is PWC's agent and your subagent. For a subagency to exist, an agent must have the authority to make the subagent *his agent* for conducting the principal's business. Sometimes, however, a party appointed by an agent is not a subagent because the appointing agent only had authority to appoint agents *for the principal*. For instance, sales agents appointed by a corporation's sales manager are agents of the corporation, not agents of the sales manager.

When an agent appoints a true subagent, the agent becomes a principal with respect to the subagent, his agent. Thus, the legal relations between agent and subagent closely parallel the legal relations between principal and agent. But a subagent is also the *original principal's* agent. Here, though, the normal rules governing principals and agents do not always apply. We occasionally refer to such situations in the pages ahead.

Employees and Nonemployee Agents

LO35-2 Understand the distinction between employees and nonemployee agents.

Many legal questions depend on whether an agent or some other party who contracts with the principal is classed as an **employee** (or servant) or as a **nonemployee agent** (independent contractor). [The *Restatement (Third)* does not use the term *independent contractor* because that term can designate either an agent or a nonagent, creating further ambiguity.] No

sharp line separates employees from nonemployee agents. The most important of these factors is the principal's *right to control the manner and means* of the agent's performance or work. Employees typically are subject to such control. Nonemployee agents, on the other hand, generally contract with the principal to produce a result and determine for themselves how that result will be accomplished.

Although many employees perform physical labor or are paid on an hourly basis, corporate officers who do no physical work and receive salaries usually are employees as well. Professionals such as brokers, accountants, and attorneys often are nonemployee agents of their clients, although they are employees of the brokerage, accounting, or law firms that pay their salaries. Consider the difference between a corporation represented by an attorney engaged in her own practice (a nonemployee agent) and a corporation that maintains a staff of salaried in-house counsel (employees). Finally, franchisees, like a KFC restaurant, usually are nonagents of their franchisors, like Yum! Brands.

As Chapter 36 makes clear, the employee–nonemployee agent distinction often is crucial in determining the principal's liability for an agent's torts. The distinction also helps define the coverage of some employment laws discussed in Chapter 51. Unemployment compensation, the Fair Labor Standards Act, and workers' compensation are clear examples.

In the following case, the court determined that entertainers Janet Jackson and Justin Timberlake were not employees of CBS during the Super Bowl broadcast of their infamous halftime show.

CBS Corp. v. FCC 535 F.3d 167 (3d Cir. 2008)

On February 1, 2004, CBS, the television network, presented a live broadcast of the National Football League's Super Bowl XXXVIII, which included a halftime show produced by MTV Networks. Both CBS and MTV were divisions of Viacom Inc. at the time. Nearly 90 million viewers watched the show, which featured recording artists Janet Jackson and Justin Timberlake. Jackson and Timberlake performed his popular song "Rock Your Body" as the show's finale. Their performance involved sexually suggestive choreography with Timberlake seeking to dance with Jackson and she alternating between accepting and rejecting his advances. The performance ended with Timberlake singing, "gonna have you naked by the end of this song," and simultaneously tearing away part of Jackson's bustier. CBS had implemented a five-second audio delay to guard against the possibility of indecent language being transmitted on air, but it did not employ similar precautionary technology for video images. As a result, Jackson's bare right breast was exposed on camera for nine-sixteenths of one second.

Jackson's exposed breast caused a sensation and resulted in a large number of viewer complaints to the Federal Communications Commission. In response, the FCC issued a letter of inquiry asking CBS to provide more information about the broadcast. CBS issued a public statement of apology for the incident. CBS stated that Jackson and Timberlake's wardrobe stunt was unscripted and unauthorized, claiming CBS had no advance notice of any plan by the performers to deviate from the script. After its review, the FCC determined CBS was liable for a forfeiture penalty of $550,000 on several grounds, including that under the doctrine of respondeat superior, *CBS was vicariously liable for the willful actions of its employees, Jackson and Timberlake. CBS asked the Third Circuit Court of Appeals to review the FCC decision.*

Scirica, Chief Judge

The *respondeat superior* doctrine provides that "[a]n employer is subject to liability for torts committed by employees while acting within the scope of their employment." *Restatement (Third) of Agency* § 2.04 (2006)

But even though *the respondeat superior* doctrine may apply in this context, it is limited to the conduct of employees acting within the scope of their employment. Determining whether CBS may be liable under *respondeat superior* first requires selection of the applicable legal standard for differentiating an "employee" from an "independent contractor."

In *Cmty. for Creative Non-Violence v. Reid,* 490 U.S. 730 (1989), the Court set forth a test for determining who qualifies as an "employee" under the common law:

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; and the tax treatment of the hired party.

While establishing that all of these factors are relevant and that "no one of these factors is determinative," *Reid* did not provide guidance

on the relative weight each factor should be assigned when performing a balancing analysis. Accordingly, all of the *Reid* factors are relevant, and no one factor is decisive, but the weight each factor should be accorded depends on the context of the case. Some factors will have "little or no significance in determining whether a party is an independent contractor or an employee" on the facts of a particular case. In the present case, the FCC erred by failing to consider several important *Reid* factors when determining whether Jackson and Timberlake were employees of CBS. And rather than balancing those factors it did consider, the Commission focused almost exclusively on CBS's right of control over the performers.

Only three factors weigh in favor of a determination that Jackson and Timberlake were employees of CBS. First, CBS is in business, which increases the possibility that it would employ people. Second, CBS regularly produces shows for national broadcast in the course of its business. Both factors are relatively insignificant on balance. Third, and most significant to its argument, is the factor the FCC focused on in its orders: CBS's right to control the manner and means by which Jackson and Timberlake accomplished their Halftime Show performance. As the FCC contends, CBS, through its corporate affiliates, supervised the Halftime Show and retained the right to approve all aspects of the show's performances. But it is undisputed that CBS's actual control over the Halftime Show performances did not extend to all aspects of the performers' work. The performers, not CBS, provided their own choreography and retained substantial latitude to develop the visual performances that would accompany their songs. Similarly, as the FCC notes, CBS personnel reviewed the performers' selections of set items and wardrobes, but the performers retained discretion to make those choices in the first instance and provided some of their own materials.

CBS's control was extensive but not determinative of employment. Even though a principal's right to control is an important factor weighing in favor of a determination that an employment relationship existed, it is not dispositive when considered on balance with the rest of the *Reid* factors. Of the remaining factors significant on the facts here, all are strongly indicative of Jackson and Timberlake's independent contractor status. First, it is undisputed that both Jackson and Timberlake were hired for brief, one-time performances during the Halftime Show; CBS could not assign more work to the performers.* Second, Jackson and Timberlake selected and hired their own choreographers, backup dancers, and other assistants without any involvement on the part of CBS.

Third, Jackson and Timberlake were compensated by one-time, lump-sum contractual payments and "promotional considerations" rather than by salaries or other similar forms of remittances, without the provision of employee benefits. Fourth, the skill required of a performer hired to sing and dance as the headlining act for the Halftime Show—a performance during a Super Bowl broadcast, as the FCC notes, that attracted nearly 90 million viewers and was the highest-rated show during the 2003-04 television season—is substantial even relative to the job of a general entertainer, which is itself a skilled occupation.

Also weighing heavily in favor of Jackson and Timberlake's status as independent contractors is CBS's assertion in its briefs, which the FCC does not refute, that it paid no employment tax. Had the performers been employees rather than independent contractors, federal law would have required CBS to pay such taxes.

Finally, there is no evidence that Jackson, Timberlake, or CBS considered their contractual relationships to be those of employer-employee. In *Reid,* the Court incorporated the *Restatement,* describing it as "setting forth a nonexhaustive list of factors relevant to determining whether a hired party is an employee" under the common law of agency. Among the factors not explicitly listed in *Reid,* but included in the *Restatement,* is the parties' understanding of their contractual relationship. See *Restatement (Third) of Agency § 7.07 cmt. f* (including as an explicit factor in determining employment status "whether the principal and the agent believe that they are creating an employment relationship"). Although the Commission did not inquire into this factor, it should have been a significant consideration in this case. Under the FCC's rationale, band members contracted to play a one-song set on a talk show or a "one-show-only" televised concert special presumably would be employees of the broadcaster. These performers—who frequently promote their work through brief contractual relationships with media outlets—would be "employees" of dozens of employers every year. Accordingly, it is doubtful that either the performers here or CBS believed their contracts created employment relationships.

On balance, the relevant factors here weigh heavily in favor of a determination that Jackson and Timberlake were independent contractors rather than employees of CBS. Accordingly, the doctrine of *respondeat superior* does not apply on these facts.

FCC order vacated in favor of CBS.

[Note: A subsequent Supreme Court case vacated this decision on grounds other than the issue presented in this excerpt.]

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* This factor is accorded great weight under the common law:

In general, employment contemplates a continuing relationship and a continuing set of duties that the employer and employee owe to each other. Agents who are retained as the need arises and who are not otherwise employees of their principal normally operate their own business enterprises and are not, except in limited respects, integrated into the principal's enterprise so that a task may be completed or a specified objective accomplished. Therefore, *respondeat superior* does not apply. *Restatement (Third) of Agency* § 2.04 cmt. b (2006).

Duties of Agent to Principal

LO35-3 Recognize when an agent risks breaching a fiduciary duty.

An agent has a **fiduciary duty** to act loyally for the principal's benefit in all matters connected with the agency relationship. This duty supplements the duties created by an agency contract. A fiduciary duty exists because agency is a relationship of trust and confidence. The principal's many remedies for an agent's breach of her fiduciary duty include termination of the agency and recovery of damages from the agent.

A gratuitous agent usually has the same fiduciary duty as a paid agent, but need not perform as promised. She normally can terminate the agency without incurring liability. However, a gratuitous agent *is* liable for failing to perform as promised when her promise causes the principal to rely upon her to undertake certain acts, and the principal suffers losses because he refrained from performing those acts himself.

A subagent owes the agent (his principal) all the duties agents owe their principals. A subagent who knows of the original principal's existence also owes that principal all the duties agents owe their principals, except for duties arising solely from the original principal's contract with the agent. Finally, the agent who appointed the subagent generally is liable to the original principal when the principal is harmed by the subagent's conduct.

Agent's Duty of Loyalty

Because agency is a relationship of trust and confidence, an agent has a **duty of loyalty** to his principal. Thus, an agent must subordinate his personal concerns by (1) avoiding conflicts of interest with the principal and (2) not disclosing confidential information received from the principal.

Conflicts of Interest An agent whose interests conflict with the principal's interests may be unable to represent his principal effectively. Therefore, an agent may not *acquire a material benefit* from a third party in connection with an agency transaction. When conducting the principal's business, an agent may ***not deal with himself.*** For example, an agent authorized to sell property cannot sell that property to himself. Many courts extend the rule to include transactions with the agent's relatives or business associates or with business organizations in which the agent has an interest. However, an agent may engage in self-dealing transactions if the principal consents. For this consent to be effective, the agent must disclose all relevant facts to the principal before dealing with the principal on his own behalf.

Unless the principal agrees otherwise, an agent also may *not* ***compete with the principal*** regarding the agency business and not assist the principal's competitors so long as he remains an agent. Thus, an agent employed to purchase specific property may not buy it himself if the principal desires it. Furthermore, an agent ordinarily may not solicit customers for a planned competing business while still employed by the principal.

Finally, an agent who is authorized to make a certain transaction may ***not act on behalf of the other party*** to the transaction unless the principal knowingly consents. Thus, one ordinarily may ***not act as agent for both parties*** to a transaction without first disclosing the double role to, and obtaining the consent of, both principals. Here, the agent must disclose to each principal all the factors reasonably affecting that principal's decision. Occasionally, though, an agent who acts merely as a middleman may serve both parties to a transaction without notifying either. For instance, an agent may simultaneously be employed as a "finder" by a firm seeking suitable businesses to acquire and a firm looking for prospective buyers, so long as neither principal expects the agent to advise it or negotiate for it.

An agent with a conflict of interest will not breach her duty of loyalty, however, if she acts in good faith, discloses to the principal all material facts regarding her conflict of interest, and deals fairly with the principal.

Confidentiality Unless otherwise agreed, an agent may not use or ***communicate confidential information*** of the principal for the agent's own purpose or that of a third party. Confidential information is the principal's information *entrusted* by the principal to the agent for purposes of the agent carrying out her duties. Confidential information includes facts that are valuable to the principal because they are not widely known or that would harm the principal's business if they became widely known. Examples include the principal's business plans, financial condition, contract bids, technological discoveries, manufacturing methods, customer files, and other trade secrets.

In the absence of an agreement to the contrary, after the agency ends almost all fiduciary duties terminate. For example, an agent may compete with her principal after termination of the agency. As the following *North Atlantic Instruments, Inc.* case illustrates, however, the duty not to use or disclose confidential information continues after the agency ends. The former agent may, however, utilize general knowledge and skills acquired during the agency.

North Atlantic Instruments, Inc. v. Haber 188 F.3d 38 (1999)

North Atlantic designs and manufactures electronics equipment utilized in the development and testing of systems used on ships, tanks, and commercial and military aircraft. On August 31, 1994, North Atlantic entered into an Asset Purchase Agreement with a related business, Transmagnetics Inc. (TMI).

At the time North Atlantic acquired TMI, Haber was a one-third owner of TMI, its president, and the head of sales—a position that allowed him to develop extensive client contacts. Shortly after the acquisition, on November 7, 1994, North Atlantic entered into an employment agreement (the Employment Agreement) with Haber. The Employment Agreement acknowledged that North Atlantic "is engaged in specialized businesses . . . and the information, research and marketing data developed by [North Atlantic] or any affiliate are confidential." In it, Haber expressly agreed:

> to keep secret and retain in the strictest confidence all confidential matters which relate to [North Atlantic], including, without limitation, customer lists, trade secrets, pricing policies and other confidential business affairs of [North Atlantic] . . . and any affiliate . . . and not to disclose any such confidential matter to anyone outside [North Atlantic] or any affiliate. . . .

The terms of this provision apply both "during and after his period of service with [North Atlantic]," and the agreement required that Haber turn over, upon his termination, all documents and property of North Atlantic that contained any confidential information. Haber acknowledged in the Employment Agreement that an injunction would be a permissible remedy for a material breach of the confidentiality provision because such a breach would cause "irreparable injury to [North Atlantic] and . . . money damages [would] not provide an adequate remedy to [North Atlantic]."

While Haber worked at North Atlantic, he had access to information about North Atlantic's technology and customer base, including lists of customers and contacts with their individual product needs. In July 1997, Haber left North Atlantic to join Apex Signal Corp., a company that manufactures products targeting the same niche market as North Atlantic's TMI division.

As soon as Haber left North Atlantic and began work for Apex, he began calling the client contacts he had used and developed while at North Atlantic and TMI and asking that they leave North Atlantic to do business with Apex. Indeed, Apex hired Haber specifically because his years in the business and the contacts that he had developed over those years would assist Apex in marketing its product.

North Atlantic filed its complaint on November 6, 1997, asserting, inter alia, that Haber and Apex misappropriated confidential business information and misused trade secrets. Also on November 6, 1997, North Atlantic moved for a temporary restraining order and preliminary injunction, seeking to enjoin Haber and Apex from misappropriating or disclosing any confidential proprietary information relating to North Atlantic's business and soliciting any customers of North Atlantic.

After a series of hearings in December 1997, the Magistrate Judge recommended granting the preliminary injunction in most respects and issued a Report and Recommendation to that effect on March 27, 1998. Both parties filed objections to the Report and Recommendation, and Haber and Apex filed a motion to dismiss the complaint. The District Court adopted the Report and Recommendation in all material respects and denied the motion to dismiss the complaint.

Haber and Apex appear to accept much of the preliminary injunction and now appeal only the portion of the District Court's order forbidding Haber and Apex from soliciting the contacts Haber developed while at North Atlantic and TMI. In response to Haber and Apex's appeal, the Court considered North Atlantic's likelihood of success on the merits and whether it would suffer irreparable harm in the absence of an injunction.

Straub, Circuit Judge

Both this Circuit and numerous New York courts have held "that an agent has a duty 'not to use confidential knowledge acquired in his employment in competition with his principal.'" *ABKCO Music Inc. v. Harrisongs Music, Ltd.*, 722 F.2d 988, 994 (2d Cir. 1983) (*quoting Byrne v. Barrett*, 268 N.Y. 199, 206, 197 N.E. 217, 218 (1935)). Such a duty "exists as well after the employment is terminated as during its continuance." *Id.* (internal quotation marks omitted); *accord L.M. Rabinowitz & Co. v. Dasher*, 82 N.Y.S.2d 431, 435 (Sup. Ct. 1948) ("It is implied in every contract of employment that the employee will hold sacred any trade secrets or other confidential information which he acquires in the course of his employment. This is a duty that the employee assumes not only during his employment but after its termination.") (internal citations omitted).

Haber's Employment Agreement requires that he "keep secret and retain in the strictest confidence all confidential

matters which relate to [North Atlantic], including, without limitation, customer lists, trade secrets, pricing policies and other confidential business affairs of [North Atlantic] . . . and any affiliate." The agreement also prohibits him from "disclos[ing] any such confidential matter to anyone." The Employment Agreement contains no limitation on its duration; rather it applies both "during [and] after his period of service with [North Atlantic]." In this way, it makes explicit an employee's implied duties under New York law with respect to confidential information.

Based upon the facts in the record, it is clear that Haber violated the duties imposed both by the Employment Agreement and by New York's laws. That is, the requirement that he "keep and retain [customer lists and trade secrets] in the strictest confidence" by its very terms precludes his using that confidential information for the benefit of a competitor business. Furthermore, common sense dictates the conclusion that the customer lists to which the Employment Agreement refers must encompass the list of client contacts at issue on this appeal.

Thus, the Employment Agreement reinforces Haber's duty under New York law not to use his former employer's trade secrets against the employer. Accordingly, we affirm on this point and therefore affirm the District Court's determination that North Atlantic has demonstrated a sufficient likelihood of success on the merits of its misappropriation of trade secrets claim.

Finally, we conclude that North Atlantic has shown that it will suffer irreparable harm in the absence of an injunction. We have held that "loss of trade secrets cannot be measured in money damages" because "[a] trade secret once lost is, of course, lost forever." *FMC Corp. v. Taiwan Tainan Giant Indus. Co.*, 730 F.2d 61, 63 (2d Cir. 1984) (per curiam). In addition, Haber acknowledged in his Employment Agreement that a breach of the confidentiality clause would cause "irreparable injury" to North Atlantic. *Cf. Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 69 (2d Cir. 1999) (relying on a similar clause in determining irreparable injury for purposes of upholding a grant of injunctive relief).

Because North Atlantic has demonstrated a likelihood of success on the merits and because it would suffer irreparable harm in the absence of an injunction, we conclude that the District Court did not exceed its allowable discretion in granting a preliminary injunction.

Judgment in favor of North Atlantic affirmed.

Agent's Duty to Obey Instructions Because an agent acts under the principal's control and for the principal's benefit, she has a duty to ***act within her actual authority*** and to obey the principal's reasonable instructions for carrying out the agency business.

There are exceptions to the duty to obey instructions. A gratuitous agent need not obey his principal's order to continue to act as an agent. Also, agents generally have no duty to obey orders to behave illegally or unethically. Thus, a sales agent need not follow directions to misrepresent the quality of the principal's goods, and professionals such as attorneys and accountants are not obligated to obey directions that conflict with the ethical rules of their professions.

Usually a principal's instructions are clear and can be easily followed. Sometimes, however, the instructions are ambiguous. For example, an instruction may have terms an agent does not understand. Or perhaps a cell phone conversation may be garbled due to poor signal strength. When a principal's instructions are unclear, the agent has a duty to communicate with the principal to clarify the instructions.

Agent's Duty to Act with Care and Skill A paid agent must ***act with the care, competence, and diligence*** normally exercised by agents in similar circumstances. Paid agents who represent that they possess a higher than customary level of skill may be held to a correspondingly higher standard of performance. Similarly, an agent's duty may change if the principal and the agent agree that the agent must possess and exercise greater or lesser than customary care and skill.

Agent's Duty to Provide Information An agent must use reasonable efforts to provide the principal with facts the agent knows, or has reason to know, when the agent knows or should know the principal wants the facts or the facts are material to the agency. The basis for the duty to notify is the principal's interest in being informed of matters that are important to the agency business.

However, there is no duty to notify when the agent owes a superior duty to another person. For example, a consultant may acquire confidential information from a client and thus be obligated not to disclose it to a second client. If the consultant cannot properly represent

Ethics in Action

Corporations give special attention to rooting out conflicts of interests that result from kickbacks, bribes, and gifts to the corporations' employees. To ensure independence of auditors, auditing firms commonly have rules banning their audit staff from receiving anything of value from clients. In other contexts, most corporations permit their employees to receive items or services of nominal value only. Most firms have detailed rules, such as the following from Starbucks Corporation's code of ethics:

Gifts and Entertainment

A gift or favor should not be accepted or given if it might create a sense of obligation, compromise your professional judgment, or create the appearance of doing so. In deciding whether a gift is appropriate, you should consider its value and whether public disclosure of the gift would embarrass you or Starbucks.

A gift of money should never be given or accepted. (Some retail partners, however, may accept customary tips for service well done.) As a general rule, partners should limit gifts to or from any one vendor or business associate to US $75 per year. A gift of nominal value may be given or accepted if it is a common business courtesy, such as coffee samples, a coffee cup, pens, or a similar token.

However, during traditional gift-giving seasons in areas where it is customary to exchange gifts of money, such as China, Japan, Malaysia, Singapore, and Thailand, partners should not solicit but may exchange cash with nongovernmental business associates in nominal amounts up to the equivalent of US $20.

Trading items of value with other businesses, including shops and restaurants, is strictly prohibited.

You may not encourage or solicit meals or entertainment from anyone with whom Starbucks does business or from anyone who desires to do business with Starbucks. Giving or accepting valuable gifts or entertainment might be construed as an improper attempt to influence the relationship.

the second client without revealing this information, he should refuse to represent that client.

Agent's Duties of Segregation, Record-Keeping, and Accounting An agent's duties require that she not deal with the principal's property so that it appears to be the agent's, not mingle the principal's property with the agent's property or anyone else's, and keep accounts of the principal's money and other property. Agents must keep accurate records and accounts of all transactions and disclose these to the principal once the principal makes a reasonable demand for them. Also, an agent who obtains or holds property for the principal usually may not commingle that property with her own property. For example, an agent ordinarily cannot deposit the principal's funds in her own name or in her own bank account.

Duty Not to Receive a Material Benefit Other than receiving the compensation the principal gives the agent for acting as her agent, an agent should not profit or receive any other benefit from acting on behalf of the principal. Improper material benefits include bribes, kickbacks, and gifts from parties with whom the agent deals on the principal's behalf. However, the principal and the agent may agree that the agent can retain certain benefits received during the agency. The Starbucks code of ethics in the nearby Ethics in Action box is such an example. Courts may also infer such an agreement when it is customary for agents to retain tips or accept entertainment while doing the principal's business.

Duty of Good Conduct The *Restatement (Third)* also includes a general duty that agents act reasonably and refrain from conduct that is likely to damage the principal's enterprise. While the scope of this general duty is not entirely clear, it encompasses, for example, an employee's duty not to damage the employer's computer system by exposing the system to harmful computer viruses while visiting unauthorized websites. It could also cover an agent who makes offensive statements to customers, resulting in the principal's loss of business.

Ordinarily, if a principal suffers no monetary damages from the agent's breach of duty, it is not entitled to any recovery from the agent, although termination of the agency may be justified. The following *Sanders* case shows how Madison Square Garden tried to circumvent the damage requirement by using the faithless servant doctrine. The faithless servant doctrine provides that an employee who violates his or her duty of loyalty or fidelity in the performance of his or her employment duties forfeits the right to compensation. It is based on the employee's duty of loyalty to an employer. The faithless servant doctrine is sometimes extended to agents; however, an agent is a fiduciary, not a servant, and owes the principal more duties than loyalty.

Sanders v. Madison Square Garden L.P.
2007 U.S. Dist. LEXIS 48126 (S.D.N.Y. 2007)

Anuche Browne Sanders was vice president of marketing for the New York Knickerbockers, an NBA basketball team owned by Madison Square Garden (MSG). She was responsible for all aspects of the Knicks's marketing and media efforts, and she had access to confidential MSG financial and business proprietary material. When she was hired, Browne Sanders signed a copy of MSG's Confidentiality, Code of Business Conduct, and Proprietary Property Agreement, which provided that during her employment, she may not engage in activities or have personal or financial interests that may impair, or appear to impair, her independence or judgment or otherwise conflict with her responsibilities to MSG. She also signed MSG's Employee Code of Conduct, which stated that "public trust and confidence are the greatest assets held by MSG."

In 2002, Browne Sanders was promoted to senior vice president, marketing and business operations, and her responsibilities expanded to include, among other things, oversight of the marketing and business operations budget. Browne Sanders remained in that position until she was fired in January 2006. Her total compensation for just over five years of employment with the Knicks exceeded $1,100,000. Shortly after being fired, Browne Sanders sued MSG and Knicks head coach and president, Isiah Thomas, among others, alleging that she was discriminated against on the basis of her sex and terminated in retaliation for her sexual harassment complaint against MSG and Thomas.

MSG obtained copies of Browne Sanders's federal, New York, and New Jersey tax returns for 2000–2005. The 2001–2004 returns included Schedule C deductions for the expenses of a "direct marketing" business, totaling approximately $73,000, seeming to indicate that she had conducted her own business on the side while working for the Knicks or that she had illegally deducted personal expenses as business expenses on her tax returns. Browne Sanders denied that she operated her own direct marketing business while working for the Knicks and claimed that the Schedule C deductions were due to accountant error and not a deliberate attempt to commit tax fraud. She filed amended tax returns for 2003 and 2004 that removed the Schedule C deductions. She did not amend the 2000 and 2001 tax returns on the advice of her current accountant, who informed her that there is a three-year statute of limitations for amending tax returns.

MSG counterclaimed against Browne Sanders for breach of fiduciary duty, claiming that she had breached her duty either by operating an outside business or by committing tax fraud while employed at MSG. MSG argued that under the faithless servant doctrine, it may recover all compensation paid to Browne Sanders while she was committing tax fraud or secretly operating an unauthorized direct marketing business while employed by MSG. MSG sought to amend its answer to Browne Sanders's complaint to include the faithless servant claim.

Lynch, District Judge

The faithless servant doctrine provides that an agent is obligated to be loyal to his employer and is prohibited from acting in any manner inconsistent with his agency or trust and is at all times bound to exercise the utmost good faith and loyalty in the performance of his duties. To show a violation of the faithless servant doctrine, an employer must show (1) that the employee's disloyal activity was related to the performance of his duties, and (2) that the disloyalty permeated the employee's service in its most material and substantial part.

Thus, the faithless servant doctrine, like the traditional fiduciary duty standard, is limited to matters relevant to affairs entrusted to the employee. However, unlike a traditional breach of fiduciary duty claim, which requires a showing of actual damages, to prove a violation of the faithless servant doctrine, an employer is not required to show that it suffered provable damage as a result of the breach of fidelity by the agent.

Here, MSG claims that Browne Sanders's tax returns show that she was either operating an outside business or that she committed tax fraud while employed at MSG. However, neither operating an outside business nor unethical conduct unrelated to employment violates the faithless servant doctrine unless such business or behavior adversely affects the employee's job performance. MSG neither claims nor has provided any evidence that Browne Sanders's alleged misconduct hurt her job performance.

Under MSG's interpretation of the faithless servant doctrine, an employee breaches her duty of loyalty any time she engages in conduct that is not condoned by her employer or that violates her employer's ethical standards, regardless of whether the employee's conduct was related to her job performance. However, the purpose of the doctrine is not to dissolve the well-established boundaries of an employee's fiduciary duty, but to provide a remedy for an employer if an employee breaches that duty and it is difficult to prove that harm resulted from the breach or the employee realizes no profit through the breach. *Restatement (Third) of Agency,* § 8.01 (2006). While employers may contractually obligate employees to act in an ethical manner, and condition continued employment on compliance with that requirement, an

employee's alleged violation of that requirement does not result in a violation of the faithless servant doctrine unless the employee's unethical conduct materially and substantially infringed on her job performance. A faithless servant doctrine read as broadly as urged by MSG would allow an employer to sue an employee if the employee engaged in any conduct that fell short of the employer's ethical standards, no matter how disconnected to the employer's business the employee's misconduct might have been, simply because the employee's private misbehavior might reflect poorly on her employer.

MSG conspicuously fails to identify any way in which it suffered any such damage. As noted, it does not identify any way in which her alleged derelictions affected Browne Sanders's performance of her duties. Nevertheless, having accepted the fruits of Browne Sanders's labor for five years, MSG argues that it is entitled to obtain those fruits for free by forcing the forfeiture of all of Browne Sanders's pay for her entire period of employment. The remedies of the faithless servant doctrine are drastic, and appropriately so where the doctrine applies. An employee who works to undermine or covertly compete with her employer cannot be permitted to retain the benefits of an agency relationship she has betrayed. An employee who violates an incidental work rule, however, or who cheats the government out of taxes due, may have to respond in damages for breach of contract, but need not forfeit her entire salary.

MSG's motion to amend its answer denied.

Duties of Principal to Agent

If an agency is formed by a written contract, the contract normally states the duties the principal owes the agent. In addition, the law implies certain duties from the existence of an agency relationship, however formed. The most important of these duties are the principal's obligations to ***compensate*** the agent, to ***reimburse*** the agent for money spent in the principal's service, and to ***indemnify*** the agent for losses suffered in conducting the principal's business. These duties generally can be eliminated or modified by agreement between the parties.

Duty to Compensate Agent

If the agency contract states the compensation the agent is to receive, it usually controls questions about the agent's pay. In other cases, the relationship of the parties and the surrounding circumstances determine whether and in what amount the agent is to be compensated. Where compensation is due but its amount is not expressly stated, the amount is the market price or the customary price for the agent's services or, if neither is available, their reasonable value.

Sometimes, an agent's compensation depends on the accomplishment of a specific result. For instance, an investment banker may be retained on a contingent fee basis to find a buyer for its client's product line and be compensated with a percentage of the purchase price. In such cases, the agent is not entitled to compensation unless he achieves the result within the time stated or, if no time is stated, within a reasonable time. This is true no matter how much effort or money the agent expends. However, the principal must cooperate with the agent in achieving the result and must not do anything to frustrate the agent's efforts. Otherwise, the agent is entitled to compensation despite the failure to perform as specified.

A principal generally is not required to pay for undertakings that she did not request, services to which she did not consent, and tasks that typically are undertaken without pay. Also, a principal usually need not compensate an agent who has materially breached the agency contract or has committed a serious breach of a fiduciary duty, as the *Sanders* case in the previous Duty of Good Conduct section. Of course, there is no duty to compensate a gratuitous agent.

An agent's duties to a subagent are the same as a principal's duties to an agent. If there is no agreement to the contrary, however, the original principal has no contractual liability to a subagent. For example, such a principal normally is not obligated to compensate a subagent. But a principal must reimburse and indemnify subagents as he would agents.

Duties of Reimbursement and Indemnity

If an agent makes expressly or impliedly authorized expenditures while acting on the principal's behalf, the agent normally is entitled to ***reimbursement*** for those expenditures. Unless otherwise agreed, for example, an agent requested to make overnight trips as part of his agency duties can recover reasonable transportation and hotel expenses.

A principal's duty of reimbursement overlaps with her duty of ***indemnity.*** Agency law implies a promise by the principal to indemnify an agent for losses that should fairly be borne by the principal. These include authorized

The Global Business Environment

While all modern nations regulate the relationship of agents and principals, associations of professional agents often reinforce or augment these legal duties with codes of ethics. For the real estate industry, you can find international principles of conduct for real estate agents in the 23 member countries of the International Consortium of Real Estate Associations. An excerpt from the Code of Conduct is below. Note how the listed rules relate to the agent's fiduciary duties we have studied.

1. Protect and promote your client's interests, and be honest with all parties.
2. Do not reveal facts that are confidential without permission from the rightful party.
3. Follow the applicable laws of representation, and disclose your legal and/or fiduciary relationship to all involved parties.
4. Respect your fellow professionals. Do not unfairly publicly discredit a competitor. Cooperate with other professionals when in the best interest of your client.
5. Agree to participate in known and organizationally supported dispute resolution systems in instances of conflict between members and/or the public.
6. Do not misrepresent yourself, or misrepresent or conceal pertinent facts regarding a property or transaction.
7. Disclose any personal interests in a transaction and avoid side deals without the informed consent of your client.
8. Provide professional service to all clients and customers.
9. Be knowledgeable and competent in the fields of practice in which you engage; seek expert assistance when providing services in a field in which you are unfamiliar.
10. Apply national codes of conduct to all relevant business relations and transactions, including those conducted in the international arena.

payments made on the principal's behalf and payments on contracts on which the agent was authorized to become liable. A principal may also have to indemnify an agent if the agent's authorized acts constitute a breach of contract or a tort for which the agent is required to pay damages to a third party.

So long as the principal did not benefit from such behavior, however, he is *not* required to indemnify an agent for losses resulting (1) from unauthorized acts, or (2) solely from the agent's negligence or other fault. Even where the principal directed the agent to commit a tortious act, moreover, there is no duty to indemnify if the agent knew the act was tortious. But the principal must indemnify the agent for tort damages resulting from authorized conduct that the agent did not believe was tortious. For example, if a principal directs his agent to repossess goods located on another's property and the agent, believing her acts legal, becomes liable for conversion or trespass, the principal must indemnify the agent for the damages the agent pays.

Termination of an Agency

LO35-4 Learn the way agency relationships are terminated.

An agency can terminate in many ways that fall under two general headings: (1) termination by act of the parties and (2) termination by operation of law.

Termination by Act of the Parties

Termination by act of the principal and/or agent occurs:

1. *At a time or upon the happening of an event stated in the agreement.* If no such time or event is stated, the agency terminates after a reasonable time.

2. *When a specified result has been accomplished, if the agency was created to accomplish a specified result.* For example, if an agency's only objective is to sell certain property, the agency terminates when the property is sold.

3. *By mutual agreement of the principal and the agent,* at any time.

4. *At the option of either party.* This is called **revocation** when done by the principal and **renunciation** when done by the agent. Revocation or renunciation occurs when either party manifests to the other that he does not wish the agency to continue. This includes conduct inconsistent with the agency's continuance. For example, an agent may learn that his principal has hired another agent to perform the same job.

A party can revoke or renounce even if doing so violates the agency agreement. Although either party has the *power* to terminate in such cases, there is no *right* to do so. This means that where one party terminates in violation of the agreement, she need not perform any further, but she may be liable for damages to the other party. A gratuitous agency normally is terminable by either party without liability. Also, the terminating party is not liable when the

revocation or renunciation is justified by the other party's serious breach of a fiduciary duty.

Termination by Operation of Law Termination by operation of law usually involves situations where it is reasonable to believe that the principal would not wish the agent to act further, or where accomplishment of the agency objectives has become impossible or illegal. The *Restatement (Third)* lists fewer specific instances that cause automatic termination than does the *Restatement (Second)*. Although courts may recognize exceptions in certain cases, an agency relationship usually is terminated by:

1. *The death of an individual principal.* Under the *Restatement (Third) of Agency,* this termination is effective only when the agent has notice of the principal's death.

2. *The death of an individual agent.*

3. *The principal's permanent loss of capacity.* This is a *permanent* loss of capacity occurring after creation of the agency—most often, due to the principal's insanity. The principal's permanent incapacity ends the agency even without notice to the agent.

4. *The cessation of existence or suspension of power* of an agent or principal that is not an individual, such as the dissolution of a corporation or partnership.

5. *Upon the occurrence of circumstances* from which the agent should reasonably conclude that the *principal no longer would want the agent to take action* for the principal. Changed circumstances include:

- *Changes in the value of the agency property or subject matter* (e.g., a significant decline in the value of land to be sold by an agent).
- *Changes in business conditions* (e.g., a much lower supply and a much increased price for goods to be purchased by an agent).
- *The loss or destruction of the agency property or subject matter or the termination of the principal's interest therein* (e.g., when a house to be sold by a real estate broker burns down or is taken by a mortgage holder to satisfy a debt owed by the principal).

There are other grounds for termination not listed in the *Restatement (Third):*

1. *The agent's loss of capacity to perform the agency business.* The scope of this basis for termination is unclear. As Chapter 36 states, an agent who becomes insane or otherwise incapacitated after the agency is formed still can bind his principal to contracts with third parties. Thus, it probably makes little sense to treat the agency as terminated in such cases. As a result, termination under this heading may be limited to such situations as the loss of a license needed to perform agency duties.

2. *Changes in the law that make the agency business illegal* (e.g., when drugs to be sold by an agent are banned by the government).

3. *The principal's bankruptcy*—as to transactions the agent should realize the principal no longer desires. For example, consider the likely effect of the principal's bankruptcy on an agency to purchase antiques for the principal's home versus its likely effect on an agency to purchase necessities of life for the principal.

4. *The agent's bankruptcy*—where the agent's financial condition affects his ability to serve the principal. This could occur when an agent is employed to purchase goods on his own credit for the principal.

5. *Impossibility of performance by the agent.* This covers various events, some of which fall within the categories just stated, for example, (*a*) destruction of the agency subject matter, (*b*) termination of the principal's interest in the agency subject matter (as, for example, by the principal's bankruptcy), and (*c*) changes in the law or in other circumstances that make it impossible for the agent to accomplish the agency's aims.

6. *A serious breach of the agent's duty of loyalty.*

7. *The outbreak of war*—when this leads the agent to the reasonable belief that his services are no longer desired. An example might be the outbreak of war between the principal's country and the agent's country.

Termination of Agency Powers Given as Security An agency power given as security for a duty owed by the principal is an exception to some of the termination rules just discussed. An important subset of an agency power given as a security is an agency coupled with an interest. Here, the agent has an interest in the subject matter of the agency that is distinct from the principal's interest and that is not exercised for the principal's benefit. This interest exists to benefit the agent or a third person by securing performance of an obligation owed by the principal.

A common example is a **power of sale**, a secured loan agreement authorizing a lender (the agent) to sell property used as security if the borrower (the principal) defaults. For instance, suppose that Allen lends Peters $500,000 and Peters gives Allen a lien or security interest on Peters's

land to secure the loan. The agreement might authorize Allen to act as Peters's "agent" to sell the land if Peters fails to repay the loan.

Because the power given the "agent" in such cases is not for the principal's benefit, it sometimes is said that a power given as a security or an agency coupled with an interest is not truly an agency. In any event, courts distinguish it from genuine agency relations in which the agent is compensated from the profits or proceeds of property held for the principal's benefit. For example, if an agent is promised a commission for selling the principal's property, the relationship is not a power given as a security or an agency coupled with an interest. Here, the power exercised by the agent (selling the principal's property) benefits the principal.

Why is a power given as a security or agency coupled with an interest important? The main reason is that it is not terminated by (1) the principal's revocation, (2) the principal's or the agent's loss of capacity, (3) the agent's death, and (4) the principal's death. However, unless it is held for the benefit of a third party, the agent can voluntarily surrender it. Of course, it terminates when the principal performs her obligation.

Effect of Termination on Agent's Authority

Sometimes, former agents continue to act on their ex-principals' behalf even though the agency has ended. Once an agency terminates by any of the means just described, the agent's *actual authority* (expressed and implied) ends as well. Nonetheless, such "ex-agents" may retain *apparent authority* to bind their former principals.

Third parties who are unaware of the termination may reasonably believe that an ex-agent still has authority. To protect third parties who rely on such a reasonable appearance of authority, an agent's *apparent authority* often persists after termination. Thus, a former agent may be able to bind the principal under his apparent authority even though the agency has ended.

Notice to Third Parties Apparent authority ends only when the third party receives appropriate notice of the termination, that is, when it is no longer reasonable for a third party to believe that the agent has actual authority. Some bases for termination by operation of law (such as changed circumstances) may provide such notice.

Under the *Restatement (Third) of Agency*, an agent's apparent authority may continue even after the principal's death or loss of capacity. An agent may act with apparent authority following the principal's death or loss of capacity because the basis of apparent authority is a principal's manifestation to third parties, coupled with a third party's reasonable belief that the agent acts with actual authority. When third parties do not have notice that the principal has died or lost capacity, they may reasonably believe the agent to be authorized. The rule that the principal's death does not automatically terminate apparent authority is consistent with the interest of protecting third parties who act without knowledge of the principal's death or loss of capacity.

To protect themselves against unwanted liability, however, prudent principals will want to notify third parties themselves. The required type of notification varies with the third party in question.

1. *For third parties who have previously dealt with the agent or who have begun to deal with the agent,* **actual notification** is necessary. This can be accomplished by (1) a direct personal statement to the third party or (2) a writing delivered to the third party personally, to his place of business, or to some other place reasonably believed to be appropriate.

2. *For all other parties,* **constructive notification** suffices. Usually, these other parties are aware of the agency but did no business with the agent. Constructive notification normally can be accomplished by advertising the agency's termination in a newspaper of general circulation in the place where the agency business regularly was carried on. If no suitable publication exists, notification by other means reasonably likely to inform third parties—for example, posting a notice in public places or at a website—may be enough.

In the next case, a summer camp counselor's actual authority terminated when the summer season ended. His apparent authority ceased when a camper learned that he had finished his stint at the camp. For that and other reasons, the camp that previously employed him was not liable for his assault of the camper.

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Gniadek v. Camp Sunshine at Sebago Lake, Inc.
11 A.3d 308 (Me. Sup. Jud. Ct. 2011)

Camp Sunshine at Sebago Lake Inc. is a nonprofit corporation providing a traditional summer camp experience in Maine for children with chronic or life-threatening illnesses. To attend a session, children must be accompanied by a parent or guardian who lodges with them. Katie Gniadek, who was 17 years old at the time, attended the camp with her mother, Kimberly Cooper-Morin. Gniadek had been attending Camp Sunshine annually for four years. During their week at the camp in 2005, Gniadek and Cooper-Morin met Michael Newton, a first-year volunteer counselor. Newton was 58 years old. On Gniadek's last day of camp, Newton gave her a card and gift and asked if they could stay in touch. Gniadek agreed, and Newton gave her his contact information. Gniadek, Cooper-Morin, and Newton also obtained copies of the contact lists for that week compiled by the camp, which recorded the name, address, and phone number of the counselors and parents in attendance. The camp had begun assembling these lists at the request of campers' families. Inclusion on the list was voluntary for parents. Cooper-Morin's contact information was on the parent-camper list.

After leaving Camp Sunshine on September 9, Gniadek had no contact with Newton until November 23, when he called to invite her to go with him to New York to visit a family who had attended camp. During their call, Gniadek learned that Newton had finished volunteering at Camp Sunshine for 2005. Gniadek obtained her mother's permission and agreed to go on the trip. Camp Sunshine had no knowledge of these plans. On November 25 around 6:00 P.M., Newton picked up Gniadek, and they left for New York. Gniadek and Cooper-Morin believed that there were two possible places where Gniadek and Newton would be staying that night, and both were the homes of former Camp Sunshine volunteers in New York. However, neither Gniadek nor Cooper-Morin had contacted these volunteers about this trip. Instead of staying with other volunteers, Gniadek and Newton stopped at a Connecticut motel. During the night, Newton assaulted Gniadek.

Newton was charged with assault and consented to a charge of assault in the third degree in the Connecticut Superior Court. He was sentenced to five years in jail.

Camp Sunshine was not operating or sponsoring any sessions in Maine on November 25–26, 2005, and at that point, Gniadek had not yet applied to attend Camp Sunshine in 2006. The camp had received Newton's 2006 volunteer application but had not acted on it. After learning about the assault, the camp sent Newton a letter informing him that his volunteer services were no longer needed at Camp Sunshine. The letter also instructed him not to "solicit, recruit, speak on behalf of, or represent Camp Sunshine."

In 2008, Gniadek sued Camp Sunshine alleging, among other grounds, vicarious liability of Camp Sunshine for the acts of Newton. At the close of discovery, the trial court granted the camp's motion for summary judgment, finding that Newton was not Camp Sunshine's agent at the time of the assault. Gniadek appealed to the Supreme Judicial Court of Connecticut.

Jabar, Judge

Gniadek contends that Newton committed his tort under the apparent authority of the Camp.

Apparent authority is authority which, though not actually granted, the principal knowingly permits the agent to exercise or which he holds him out as possessing. Apparent authority exists only when the conduct of the principal leads a third party to believe that a given party is its agent. Termination of actual authority will not alone end the apparent authority held by an agent. *Restatement (Third) of Agency* § 3.11(1) (2006). Instead, apparent authority ceases when it becomes unreasonable for the third party to believe that the agent continues to act with actual authority. Id. § 3.11(2)

The *Restatement (Third) of Agency* § 7.08 specifically addresses tortious liability for acts of agents cloaked with apparent authority. That section states:

> A principal is subject to vicarious liability for a tort committed by an agent in dealing or communicating with a third party on or purportedly on behalf of the principal when actions taken by the agent with apparent authority constitute the tort or enable the agent to conceal its commission.

The commentary explains that section 7.08 applies to torts such as "fraudulent and negligent misrepresentation, defamation, tortious institution of legal proceedings, and conversion of property obtained by an agent purportedly at the principal's direction." § 7.08 comment a. In the commission of these torts, there must be a "close link between an agent's tortious conduct and the agent's apparent authority" in order for the principal to be liable. § 7.08 comment b. "Thus, a principal is not subject to liability when actions that an agent takes with apparent authority, although connected in some way to the agent's tortious conduct, do not themselves constitute the tort or enable the agent to mask its commission."

Our interpretation of a predecessor to section 7.08 recognized similar limitations. In *Mahar v. StoneWood Transport*, we interpreted the *Restatement (Second) of Agency* § 219(2)(d) (1958) as

"limited in its application to cases within the apparent authority of the employee, or when the employee's conduct involves misrepresentation or deceit." 823 A.2d 540, 546 (Me. 2003). Although we had not "expressly adopted" that section, we nonetheless explained that it would not encompass assaultive and threatening conduct by an employee who did not purport to act on his employer's behalf.

Here, when Newton invited Gniadek to accompany him on a trip to New York, he told her that he had finished with Camp. By this statement, he conveyed that he was no longer acting with the actual authority of Camp Sunshine. Even assuming that after learning this, it would still be reasonable for Gniadek to believe that Newton acted on behalf of Camp Sunshine, the assault was not committed with apparent authority. Newton's conduct does not fall within the scope of section 7.08.

Judgment for Camp Sunshine affirmed.

Problems and Problem Cases

1. When Del-Mar Development Corp. failed to pay real estate taxes on an office building it owned, the building was seized by tax authorities and sold to pay the taxes. The purchaser was Euclid Plaza Associates. The sale was not valid, however, until approved by a court. After the sale and before the court's approval of the sale, Del-Mar agreed to a three-year lease of the building with African American Law Firm (AALF), which immediately began paying rent of $1,500 per month to Del-Mar. After the court approved the sale, Euclid claimed it was not bound by the lease made by Del-Mar with AALF. Euclid wanted to evict AALF unless it paid $2,033 in monthly rent. Was Del-Mar acting as Euclid's agent within Del-Mar's actual and apparent authority when Del-Mar leased the building to AALF?
2. Albert Arillotta, acting for Interstate Demolition and Environmental Corp. (IDEC), sent an e-mail to CSX Transportation, a railroad company, stating an interest in buying rail cars as scrap. Arillotta represented himself to be "from interstate demolition and recovery express." The e-mail address from which Arillotta sent this inquiry was "albert@recoveryexpress.com." The domain name of the e-mail address was assigned to Recovery Express. Arillotta did not work for Recovery Express, but he was allowed to use its offices and e-mail because he had been involved in another venture with it. CSX agreed to sell rail cars to IDEC, and they were delivered to the location specified by Arillotta. Neither Arillotta nor IDEC paid for the rail cars. CSX sued Recovery Express to recover the price of the rail cars. Did the court hold Recovery Express liable to CSX on the grounds that Arillotta had apparent authority to transact for Recovery Express?
3. Julianne Eisenberg was hired by Advance Relocation & Storage, a Danbury, Connecticut, warehouse. When she was hired, Advance did not inquire into any special skills that Eisenberg may have had, and it did not ask about her prior work experiences. Eisenberg and her coworkers were responsible for loading and unloading furniture from trucks at the Advance warehouse and customers' residences. They were paid on an hourly basis and were required to punch in and out. Eisenberg and her coworkers were occasionally sent home early if there was little to do, and they were sometimes asked to work on the weekend. At the warehouse, Advance gave Eisenberg orders, telling her where to go and what to do. At job sites, an Advance representative told the crew what objects each crew member, including Eisenberg, was to move. Eisenberg claimed that when she worked at Advance, she was sexually harassed and subjected to a hostile work environment, in violation of the Civil Rights Act of 1964. Advance argued that she was not an employee under the act, and therefore, she could not invoke its protections. Was Eisenberg an Advance employee?
4. Merrill Lynch, the investment firm, hired Elliot Jarvin as director of wealth management services. His duties included managing a team of 10 wealth managers who advised Merrill Lynch clients regarding their investment portfolios. When Jarvin joined Merrill Lynch, he brought with him 15 very wealthy clients to whom he provided investment services on behalf of Merrill Lynch. Unknown to Merrill Lynch, Jarvin had five additional clients, the five wealthiest of his clients. Jarvin continued to advise these clients on his own, retaining for himself all fees he charged for services provided to the five clients. In addition, to help him service the five personal clients, two members of his Merrill Lynch wealth management team frequently met with Jarvin's five personal clients to

create investments plans for them. Has Jarvin breached a fiduciary duty owed to Merrill Lynch?

5. Catherine Creteau and her husband contracted with a travel agency, Liberty Travel, to arrange a trip to Jamaica. While staying in Jamaica in accommodations arranged by Liberty Travel, they were robbed at gunpoint. The Creteaus alleged that Liberty Travel either knew of safety issues with the accommodations or such information was available to Liberty Travel. What duty did the Creteaus allege their agent had breached?

6. When Perry Olsen died, his children placed his ranch in Vail, Colorado, up for sale. Perry's children retained Vail Associates Real Estate, a real estate broker, to sell the land for them. Vail Associates introduced the children to Magnus Lindholm, who wanted to buy Perry's ranch along with adjacent land owned by Perry's children. The children eventually decided to sell only Perry's ranch and not the children's land. Their asking price for Perry's ranch was $400 per acre. Before committing to buying Perry's ranch (because he needed more land), Lindholm asked Vail Associates to introduce him to Del Rickstrew, whose land also abutted Perry's ranch. Rickstrew refused to negotiate the sale through a real estate agent, so Lindholm negotiated directly with Rickstrew. Vail Associates did, however, introduce Rickstrew to Lindholm and provide a model contract to Lindholm. A month later, Lindholm agreed to buy Rickstrew's land for $6,000 per acre, subject to his buying Perry's ranch also. Vail Associates was not aware that Lindholm and Rickstrew had a contract or that the price was $6,000 per acre. Two months later, with Vail Associates's assistance, the children sold Perry's ranch to Lindholm for $400 per acre. Vail Associates received a commission from the sale. When the children discovered later that Rickstrew received 15 times as much for his acreage as did they for Perry's ranch, they sued Vail Associates for failing to disclose material information—that is, that Lindholm was negotiating with Rickstrew. Did Vail Associates breach a fiduciary duty?

7. When Nitrogen Media was acquired by General Electric's NBC Universal unit, Nitrogen's vice president of finance, Babs Grogan, was terminated as a Nitrogen employee but hired by NBCU as an outside consultant. The term of Grogan's contract was three months, and her engagement with NBCU required her to assess business opportunities presented to NBCU, such as the financial value of newly created television shows. Grogan represented to NBCU that she had an MBA degree in finance and six years of experience in financial analysis. In fact, Grogan had falsified her academic record and possessed only an undergraduate degree in political science. In addition, she had no experience as a financial analyst, having delegated such work to coworkers for the past six years, although she took credit for their work. When NBCU asked Grogan to value the new TV show *Car Shop*, she delegated the task in part to a new MBA graduate, Roger Harvey, who was recently hired by NBCU and had virtually no on-the-job experience. As a result, Grogan and Harvey failed to perform a reasonable investigation into the facts regarding the TV show's value and to use appropriate valuations tools. Did Grogan and Harvey breach their fiduciary duty?

8. Mui Luu and Cu Tu Nguyen sold their Vietnamese calendar business to Con Tu. Luu and Nguyen agreed to continue to work for Con Tu for four years as managing agents of the business. During the time they were managing agents, Luu sent an e-mail to a competing calendar company that included 1,000 names and addresses, approximately 90 percent being names and addresses of Con Tu's customers. The competing business was controlled by Luu and Nguyen. Have Luu and Nguyen breached a fiduciary duty?

9. The song "He's So Fine" is a huge hit in the United States and Great Britain. Bright Tunes Music Corporation is the copyright holder of "He's So fine" and sues ex-Beatle George Harrison and Harrisongs Music in federal court, alleging that the Harrison composition "My Sweet Lord" infringed its copyright to "He's So Fine." Harrison's business affairs are handled by ABKCO Music and Allen Klein, ABKCO's president. Shortly after suit begins, Klein unsuccessfully tries to settle by having Harrison purchase Bright Tunes. Shortly thereafter, Bright Tunes goes into receivership, and the suit does not resume until years later. At this time, coincidentally, ABKCO's management contract with Harrison has expired; however, Klein continues his efforts to have ABKCO purchase Big Tunes. As part of these efforts, Klein gives Bright Tunes three schedules summarizing Harrison's royalty income from "My Sweet Lord," information he possessed because of his previous service to Harrison. Meanwhile Harrison's attorneys are eagerly trying to settle the copyright infringement suit with Bright Tunes, and Klein's activities of giving Bright Tunes information about the economic potential of its suit may have impeded Harrison's efforts to settle. Ultimately, Bright Tunes chooses not to settle with Harrison and at trial

the court finds that Harrison has infringed on Bright Tunes's copyright. A damages hearing is set for a later date. By the time of the damages hearing, ABKCO had purchased the "He's So Fine" copyright and all rights to the infringement suit from Bright Tunes, making ABKCO the new plaintiff in the trial for damages on the suit. At trial, Harrison files a counterclaim for damages resulting from Klein and ABKCO's alleged breaches of the duty of loyalty to him. Will the Court find that Klein and ABKCO breached its duty of loyalty to Harrison?

10. On March 2, Bankers Life & Casualty Co. proposed in a letter addressed to Gaston Trepanier that he accept a lump-sum settlement of $20,000 in exchange for Bankers Life's release from a disability income policy that paid Trepanier a $400-a-month benefit as long as he lived. The letter stated that should Mr. Trepanier decide "to accept our offer," he could "jot a note at the bottom of this letter and return it." Mrs. Trepanier discussed the idea with her husband, who decided to accept the offer and directed her to write a note on the bottom of the March letter as directed. She did so on April 6 and placed the letter in an envelope, intending to send it the following day. On April 7, Mr. Trepanier was hospitalized and the letter was not mailed. Mr. Trepanier fell into a coma on April 8. On April 12, Mrs. Trepanier tried to accept the offer by mailing the letter to Bankers Life. On April 14, Mr. Trepanier died. Bankers Life subsequently revoked its offer and issued a final disability payment. Was a contract formed when Mrs. Trepanier accepted the $20,000 offer on her husband's behalf?