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Agency

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AGENCY

ERNEST L. FOLK, III*

1. *Liability of the Unauthorized Agent*

It has long been firmly established in this State that an unauthorized agent is liable on the contract itself rather than, as in most jurisdictions, on the ground of breach of his express or implied warranty of authority¹ or, less frequently, on a theory of the agent's misrepresentation of his authority. Indeed, in this State, contract liability is said to be the "exclusive" remedy when the principal's liability fails for want of the agent's authority.²

This theory was recently invoked in *Skinner & Ruddock, Inc. v. London Guarantee & Acc. Co.*,³ to hold an insurance agent personally liable on an unauthorized insurance contract. There a Charleston insurance agent, allegedly without authority, added to a properly issued insurance policy a rider covering loss incurred in wrecking certain buildings. When the wall of an adjoining building collapsed and damaged adjacent property, the insurer denied any liability under the rider, arguing that it was unauthorized. The complaint, asserting a cause of action against the allegedly unauthorized agent was sustained against demurrer and this ruling as to the presence of a cause of action was upheld on appeal. Initially recognizing the agent's indisputable immunity on an authorized contract including an authorized insurance policy, the Court observed that:

[W]here an agent makes a contract in the name of his principal without authority and the principal is not liable, the agent may be held liable on such contract . . . Therefore, if the [agent] adjusted the loss of the [claimant] under the policy endorsement in question without authority to do so, it may be held liable on the contract.⁴

Although *Skinner & Ruddock* presents no new issue, its appearance makes timely a review of the South Carolina decisions under a rule which today seems chiefly confined to

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1. RESTATEMENT AGENCY (SECOND), § 329 (1958).
2. *Id.* § 330.
3. 239 S. C. 614, 124 S. E. 2d 178 (1962).
4. *Id.* at 619, 124 S. E. 2d at 180.

this State. The earliest decision is *Edings v. Brown*⁵ which held an unauthorized agent liable for breach of a warranty of soundness contained in a bill of sale of a slave. *Bank of Hamburg v. Wray*⁶ was the first of several decisions applying the contract liability theory to unauthorized notes or other negotiable instruments, and has been followed in the better known rulings in *Medlin v. Ebenezer Meth. Church*⁷ and *Coral Gables, Inc. v. Palmetto Brick Co.*,⁸ respectively decided in 1925 and 1937. All three of these decisions could also rest upon the universally accepted rule that, on a negotiable instrument, an agent signing without authority is personally liable, although the South Carolina Court seems not to have invoked this even as an alternative ground to support the obviously correct results in these cases.⁹ *Lagrone v. Timmerman*¹⁰ in 1896 applied the rule for the first time to insurance contracts, holding personally liable the agent of an insurer found to have no legal existence.¹¹ Although ignoring or unaware of *Lagrone*, the case most closely in point, *Skinner & Ruddock* readily fits into this line of decisions, in holding personally liable an agent of a legally existing insurer where the agent exceeded his authority in making the particular insurance contract.

In laying down the rule and its justification *Edings v. Brown*¹² relied heavily upon the authority of Chancellor Kent and Justice Story, and indeed, in the early days of the Republic, this doctrine was probably the prevailing American view. Apart from the fact — which should never be underestimated — that automatic liability of the unauthorized agent on the contract is simple and easy to apply, the *Edings* case justified the rule on two distinct grounds.

5. 1 Rich. L. 255 (1845).

6. 4 Strob. 87 (1849).

7. 132 S. C. 498, 129 S. E. 830 (1925).

8. 183 S. C. 478, 191 S. E. 337 (1937).

9. There, in *Coral Gables*, the note was a negotiable one ("I promise to pay to the order of Coral Gables Corporation," the stated sum, 183 S. C. at 480), and under Section 20 of the Negotiable Instrument Law, the decisions uniformly hold that the unauthorized agent is personally liable on the instrument he purports to sign for another. See, e.g., *New Georgia Nat'l Bank v. J. & G. Lippman*, 249 N.Y. 307, 164 N.E. 108 (1928). ("As the price, so to speak, of relief from liability when authority exists, there is to be liability on the instrument when authority fails," (emphasis supplied).)

10. 46 S. C. 372, 24 S. E. 290 (1896).

11. See, for a statement of the rule, *Ivey v. Vaughn*, 93 S. C. 203, 76 S. E. 464 (1912).

12. 1 Rich. L. 255 (1845).

The first was that "the undertaking to bind another, without authority to do so, imports fraud or culpable negligence" for which "the guilty person," the agent, should be responsible.¹³ This approach was further developed in *Bank of Hamburg v. Wray*¹⁴ where, indeed, the Court believed that the facts justified finding that "the agent [had] no authority, and [knew] it,"¹⁵ since "it cannot be credited that [the agent] was ignorant that the authority confided to him to use [his principal's] name, was given only for [the latter's] benefit in the course of his business; and not for the convenience of [the agent's] friends, or for his own."¹⁶ But even if such guilty knowledge is lacking, the agent is nonetheless liable on the same principles, for:

It is a wrong, differing only in degree, and not in its essence, to state as true, what the individual, making such statement, does not know to be true; even though he does not know it to be false; and if that wrong produces injury to a third person, who is ignorant of the grounds on which the belief of the supposed agent is founded and who has relied on the correctness of his assertions, it is equally just that he who makes such assertion should be personally liable for the consequences.¹⁷

Hence, by the time the Court decided *Lagrone v. Timmerman*,¹⁸ it could flatly declare that [f]alsehood and deceit are not necessary to charge an agent personally with a contract he had no authority to make," for, indeed, in this case "the Court takes pleasure in saying that the evidence does not justify any imputation of moral fraud or intentional wrong on the part of the" agent.¹⁹ In the later decisions, all reference to this original justification of the agent's personal liability drops out altogether. Indeed, the argument from fraud and deceit is immaterial, since the question is whether there should be some liability on the agent's part for a lack of authority, even though his action is *bona fide*. This development also parallels the warranty theory in other jurisdictions, where it has been held applicable also to agents acting reasonably and in good faith on their supposition of authority.

13. *Id.* at 258.

14. 4 Strob. 87 (1849).

15. *Id.* at 91.

16. *Id.* at 90-91.

17. *Id.* at 91.

18. 46 S. C. 372, 24 S. E. 290 (1896).

19. *Id.* at 409-10, 24 S. E. at 299.

Similarly, those few jurisdictions which expressly rely on a fraud concept to hold the agent liable have so watered down the ingredients of fraud as to make the results of cases under that theory virtually indistinguishable from those under the contract liability or breach of warranty theories.²⁰

The second ground asserted in *Edings v. Brown* is that the agent's contract liability is no more or less than a just method for making whole the third party whose reasonable expectations have been defeated because of the principal's immunity on the unauthorized contract.²¹ The agent's substituted liability is said to be "only a fair and reasonable indemnity" for the failure to bind the principal.²²

Two objections are often offered to the agent's direct contract liability. Thus, it is said that it is illogical to hold the agent liable on a promise he never intended to make,²³ an objection which was considered but rejected in *Edings*. It is true that probably the agent and the third party intended to leave the agent without liability, but this was on the assumption of the third party (and possibly of the agent) that the principal would be bound on a contract which either or both believed authorized. This does not necessarily rest on archaic ideas of subjective intent of contracting parties, but on the (probably) manifested understanding and assent to the terms of the contract. Certainly, it would make no difference on the theory of the South Carolina rule that the agent in good faith believed in his own authority; that is to say, the agent's liability would not be excused on the ground of good faith, or imposed only in the event of wilful or malicious representations of authority. Since the agent and third party presumably contract on the assumption of the principal's liability, it follows that, when that liability fails, the underlying assumption on which the contest was made is inapplicable. Because of this new situation, then, it is necessary to balance (1) the expectation, at the time of the contract, that he could contract without personal liability, and (2) the third party's expectation that he would have performance or a

20. See MECHEM, AGENCY § 324 (4th ed. 1952).

21. 1 Rich. L. 255 at 258. "It is only just that one who pretends to give a security to another, by assuming to contract in the name of a person whom he has no authority to bind, should supply, out of his own means, the security which he fails to impose on his (punative) principal." *Id.* at 257-58.

22. *Id.* at 258.

23. MECHEM, AGENCY OUTLINES § 323 (4th ed. 1952).

remedy on the contract against the principal. Since (at least in the case of the innocent agent) someone's expectations will inevitably be thwarted, the question is whether it should be the agent who presumably knew his principal's intentions and who in any event had the superior facilities and opportunity to ascertain whether it should be the third party who, absent some remedy against the agent, loses the bargained-for benefit. The only question then is the form which the remedy should take.²⁴ And this discussion so far indicates that the objection is baseless that the parties did not "intend" the agent to be liable on the contract. Indeed, at least in the case of the honest agent, it was probably intended that he should not be liable at all on any theory, although, as already noted, liability accrues in some form or other since his liability on an implied warranty of authority is absolute and not based on fault.

A second objection offered to the agent's contract liability is that it makes the third party better off than he would have been if the agent had authority and the principal were bound.²⁵ This objection only applies if there is no suitable limitation upon the third party's right of recovery. The usual example is the unfairness of holding a solvent agent fully liable on a contract purportedly binding an insolvent principal who would have been unable to perform or respond in damages had the contract been authorized and thus binding upon him. Similarly, if the agent's contract liability is not appropriately limited (as it is in the cases applying the warrant of authority theory), an agent can be held fully liable on an oral executory contract within the Statute of Frauds although the contract might not bind a principal because not in writing. A similar point could be made as to unauthorized contracts which, even if authorized, could not be performed by the principal because of supervening impossibility or illegality.²⁶ Illustrations such as these indicate that on a contract liability theory, the third party may be in a better position precisely because the agent acted with-

24. Thus, in *Medlin v. Ebenezer Meth. Church*, 132 S. C. 498, 506, 129 S. E. 830, 832 (1925), the court recognizes that in other jurisdictions unauthorized agents are normally held liable on a theory of breach of warranty of authority, but observes that "the divergence of opinion relates simply to the form of the remedy, conceding that the agent is liable." Hence, the court decides to adhere to its own line of decisions beginning with *Edings*.

25. *MECHEM, AGENCY OUTLINES* § 323 (4th ed. 1952).

26. *RESTATEMENT (SECOND), AGENCY* § 329, Comment (j) (1958).

out authority than if he had acted within the ambit of his powers.

This paradox can be resolved by confining the third party's recovery from the unauthorized agent, even though sued on the contract itself, to damages "not only for the harm caused to [the third party] by the fact that the agent was unauthorized, but also for the amount by which [the third party] would have been benefited had the authority existed."²⁷ Thus, if the principal is insolvent, it is hardly justice to allow the third party to recover in full from the unauthorized agent when, if authority had existed, there could have been no recovery against the principal; otherwise, the third party obtains a wholly unjustified windfall.²⁸ Similarly, if the principal could not be held liable on an oral contract within the Statute of Frauds, neither should the agent be held.

In short, the Court, when and if presented with this crucial issue of damages under the contract theory, should not give the third party greater damages against the unauthorized agent than could be obtained against the principal had the agent been authorized. Indeed, there are persuasive reasons for not doing so. In effect, such a rule would place a premium upon the agent's lack of authority. This in turn would be a disincentive to the third party diligently to ascertain the authority of the agent to the extent that he is able to do so. And finally, awarding damages against an unauthorized agent not obtainable against a principal if authority had existed is, in substance, a punitive measure against the agent for his lack of authority; and although all agree that he should compensate the third party, no one argues that punitive measures are in order, at least in the absence of fraud and deceit by the unauthorized agent in deliberately misstating his authority.

Thus, even though adhering to the direct contract liability of the unauthorized agent, the Court should measure the damages by the injury to the third party from the lack of authority or the benefit which the third party has lost. That is to say, the test should be the same as under the breach of warranty theory. Of course, it can be objected that if this is the measure of damages, the agent is not truly being held liable on the contract. Even if this is true, the seeming

²⁷. *Ibid.*

²⁸. In re National Coffee Palace Co., [1883] 24 Ch. D. 367 (leading case).

inconsistency of measuring damages for breach of contract by the loss to the third party from the agent's lack of authority is less objectionable than the award of full damages from the agent when no or minimal damages could be secured from the principal. For if the agent's substituted liability on the contract is in the nature of a security to the third party, as *Edings* said it was,²⁹ the security should not exceed the value of the contract to the third party if the agent had bound his principal. No South Carolina decision has had to resolve this problem, and it is uncertain how the Court would handle it. The *Edings* case observes that:

If the contract be for the payment of money, in either form of action [that is, either tort or contract] the damages must be for the sum stipulated; and if the contract be for the performance of any other act, compensation for the breach or neglect of the duty may as fairly be decided in the one form as the other.³⁰

This ambiguous language should not be taken as conclusively favoring a rule which would give third party greater damages from the unauthorized agent than he could obtain had the agent been able to bind the principal.

2. Ratification

Insurance issues gave rise to a significant decision on ratification in *Fuller v. Eastern Fire & Cas. Co.*,³¹ holding sufficient evidence of ratification to sustain a jury verdict against an insurance company. Asserting that the insurance contract was not binding on it, the insurer had refused to honor a claim arising from an automobile accident, or defend a suit against the insured, with the result that the insured personally paid a judgment against him. Thereafter, the insured sued the company for breach of contract, and his recovery was sustained, on the ground that the insurer had ratified the allegedly unauthorized policy.

Several decisions prior to *Fuller* held an insurance company liable for an agent's unauthorized oral binder.³² In *Fuller*, the

29. *Edings v. Brown*, 1 Rich. L. 255, 258 (S. C. 1845).

30. *Ibid.*

31. 240 S. C. 75, 124 S. E. 2d 602 (1962).

32. *Carolina Aviation Inc. v. Glenn Falls Ins. Co.*, 214 S. C. 222, 51 S. E. 2d 757 (1949); *Simons v. American Fire Underwriters*, 203 S. C. 471, 27 S. E. 2d 809 (1943); *Dubuque Fire & Marine Ins. Co. v. Miller*, 219 S. C. 17, 64 S. E. 2d 8 (1951). Cf. *Fulmer v. London, Liverpool & Globe Fire Ins. Co.*, 172 S. C. 525, 174 S. E. 466 (1934). See also *Aiken Pet. Co. v. National Pet. Underwriters*, 217 S. C. 236, 36 S. E. 2d 380 (1943).

agent who gave a binder was not even technically an agent of the company at the time since his license had already expired, although clearly he intended to act as an agent and not as his own principal. Ratification was given its usual relationship effect and thus validated the oral binder given by the agent. Specifically, the facts showed that on May 1, the agent gave the insured a binder and collected part of the premium. The following day, the insured had an accident and promptly notified the agent. It was not until May 4 that the agent sent to the company the premium together with the application which recited a May 1 date for the beginning of coverage. Thereafter, the insurer issued a policy, with an effective date of May 5 (the date the application was received and approved), rather than May 1. The agent did not inform the company of the accident until May 8, although, of course, he knew of it on May 4 when he submitted the application.

The Court's conclusion was that the jury had a sufficient evidentiary basis rationally to infer ratification of the insurance contract. The crucial point, of course, was the company's knowledge of the binder from the fact that the application clearly stated a May 1 date. With this knowledge, the company's actions — accepting the premium, applying to the Insurance Commissioner to reinstate the agent's expired license, etc. — was a ratification of the binder. Thus, in effect, the Court ruled that it is insufficient for an insurer to avoid ratification by merely changing the effective date of the policy, as was attempted here.

3. *Master and Servant*

The few cases in this category present no questions of general interest, as they turn on the application of established rules to their individual fact situations. Thus, *Bates v. Legette*³³ turned back an attack upon a jury's resolution, under proper instructions, of the independent contractor issue in a case involving an automobile accident between plaintiff and a cab. The cab company ("Veterans") denied liability on the ground that the particular cab was operated by an independent contractor, since it was owned by an individual and not by the corporation held liable and was licensed in the individual's name. Other evidence showed that the cab

33. 239 S. C. 25, 121 S. E. 2d 289 (1961).

carried Veterans' name, that 26 of the 34 Veterans' cabs were owned by it, that the individual operated his cab under a written arrangement with Veterans' that he was paid a monthly wage by Veterans' and was subject to Veterans' rules and discipline, including termination of the agreement at Veterans' option, that at the time of the accident he was transporting passengers picked up at a Veterans' cab stand, and that his rates were "determined" by Veterans' and "two other large taxi operators."³⁴ It is obvious, as the court found, that such evidence amply supported a fact finding of master-servant relationship. Indeed, not only did it satisfy the test that Veterans' had "the right and authority to control and direct the particular work or undertaking, as to the manner or means of its accomplishment," but seemingly there was even "actual control."³⁵ In short the typical "independent" but affiliated cab owner is a servant of the cab company.

The accepted doctrine that an employee assumes the "ordinary risks of his employment, of which he had knowledge" and that the finding of assumed risk "was fully warranted by the evidence" was the basis in *Hatchell v. Field*³⁶ for sustaining on appeal a trial court's judgment for the employer of a herdsman who had been severely kicked by one of his employer's cows, especially since the herdsman was long experienced in his trade and was familiar with the cow who administered the unfortunate kick.

34. *Id.* at 36, 121 S. E. 2d at 293-294.

35. *Id.* at 34-35, 121 S. E. 2d at 293.

36. 238 S. C. 398, 120 S. E. 2d 401 (1961).